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**Section I**  
**International Affairs and European Integration**

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**Subsection 1**  
**International Affairs**

## 30 Years since the Convention on Sea Law

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### Abstract

*This year we celebrate 30 years since the CONVENTION ON THE LAW OF THE SEA was adopted and signed in Montego Bay – Jamaica, at 10th December 1982. As at 03 June 2012, the number of parties to UNCLOS stood at 162, including the Cook Islands and Niue including the European Community. United Nations Secretary - General Ban Ki-moon will launch the Oceans Compact—an initiative to strengthen United Nations system-wide coherence to deliver on its oceans-related mandates--on Sunday, 12 August, in Yeosu, Republic of Korea. “The world’s oceans are key to sustaining life on the planet,” the Secretary-General says in the Compact, “constituting a conduit for ninety per cent of the world trade, and for connecting people, markets and livelihoods.” But he adds that humans have put the oceans under risk of irreversible damage by overfishing, climate change and ocean acidification, increasing pollution, unsustainable coastal area development, and unwanted impacts from resource extraction, resulting in loss of biodiversity, decreased abundance of species, damage to habitats and loss of ecological functions.[1]*

**Key words:** UNCLOS; Romania; Black Sea  
**J.E.L. classification:** K33 - International Law

### 1. Introduction

On 12 August 2012, at the Yeosu (Republic of Korea) International Conference to commemorate the thirtieth anniversary of the opening for signature of the United Nations Convention on the Law of the Sea the United Nations Secretary-General, Mr. Ban Ki-moon, launched the Oceans Compact - an initiative to strengthen United Nations

system-wide coherence to deliver on its oceans-related mandates.

“The world's oceans are key to sustaining life on the planet. The ocean constitutes a conduit for ninety per cent of the world trade, and for connecting people, markets and livelihoods. In light of the ocean's interconnectedness, all nations of the world should strive to make the oceans places of safety and sustainability of maritime activities for all humankind.

Humans, however, have put the oceans under risk of irreversible damage by over-fishing, climate change and ocean acidification (from absorbed carbon emissions), increasing pollution, unsustainable coastal area development, and unwanted impacts from resource extraction, resulting in loss of biodiversity, decreased abundance of species, damage to habitats and loss of ecological functions”[2].

### 2. Legal frame

All countries of the world are continuously striving to decide on proper legal norms for the international co-operation process, in order to piece up differences in an amicable way through negotiations based on legal equality according to art. 2 paragraph 3 of the United Nations Charter.

During different stages and phases of its development the social and economic life depends upon the maritime field where through common efforts of the entire humanity we are called upon to obey fundamental requirements regarding: a) the rights and duties of each state for the use of seas and oceans of the world b) the definition of practical forms and means to improve their riches. [3]

#### 2.1. International legal frame

The most important international forum the United Nations' Organization has had preoccupations regarding the coding of legal regulations and norms in the maritime field.

In 1958 during the first UNO Conference on the Law of the Sea concrete norms were drawn up for the first time in all fields of maritime law, i.e. the territorial sea, continental shelf, high seas and fishing, and thus all maritime spaces have been included in a general concept envisaging both the issue of national area, with the rights and obligations of the neighboring states and the other states in the region and the issues of the free sea where the rights to sail, to fish, to lay cables and pipelines and to fly over were recognized.

After these regulations have been adopted some important issues such as those concerning the limit of the territorial sea [4] and the regime of submarine land [5] have been reconsidered in order to draw up new legal solutions. Thus, following debates during 1967 - 1970 regarding the legal regime of the submarine land which are beyond the limits of national jurisdiction, The General Assembly of the UNO adopted in 1970, the *Declaration of Principles*, through which the international area was established as „common patrimony of mankind”. Gradually, the issue of this patrimony has stirred more and more interest; ways and practical means to draw up and exploit the resources in these territories have been approached and the conclusion was that mineral resources should be capitalized on equal terms and under no circumstances should the resources „be acquired by certain states or individuals”[6].

Under the influence of sweeping changes in the world economy, as a consequence of the contemporary scientific and technical revolution when new resources have been discovered and due to the exacerbation brought about by the noxious effects of pollution on the marine benthos, further developments of maritime reports have determined the summon of the 3rd UNO Conference on the Law of the Sea in 1970 [7].

The Conference adopted in a constructive manner all maritime issues in order to obtain „real progress in setting an exploration and exploitation system of the resources of the oceans in *the interest of all nations*.

### **3. 30 years since the CONVENTION ON THE LAW OF THE SEA**

This year we celebrate 30 years since the CONVENTION ON THE LAW OF THE SEA was adopted and signed in Montego Bay – Jamaica, at 10th December 1982.

When the CONVENTION ON THE LAW OF THE SEA was adopted everybody expected that an order will be established concerning the issues related to the sea and at the same time concerning a uniform exploitation of the riches of the Planetary Ocean in the benefit of all nations.

The reference period was scattered with many misunderstandings and disputes regarding the settlement of issues according to the provisions of this Convention.

During this period all institutions mentioned in the Convention have been designed to deal with the solving of this problem and have made efforts in this respect.

Although the issue of limiting some maritime areas between riverside states to the seas and oceans of the world have not yet been finished and, as a consequence we appreciate that these may cause a potential conflict.

We can also mention as novelty a new area which may bring about a potential conflict. This is determined by the climatic changes which call forth the thawing of the ice cap, and thus disclose new possibilities to explore and exploit resources with restricted access in respect with the economic potential of certain states.

This is also a present reality since the objectives of the convention in what concerns the exploring and exploitation of seas and oceans of the world unconventionally dissociate between the economic advanced countries in respect with the expectancies of the countries under development which have not practically capitalized on the advantages of these international provisions.

Illegal fishing and other maritime offences are activities which violate the provisions of the CONVENTION ON THE LAW OF THE SEA and which are still going on in certain maritime areas without the real possibility to prevent or sanction them by applying corrective forces of maritime world.

Some clarifications regarding military and security activities are expected that should clearly state rules concerning foreign military operations and intelligence activities in the Economic Exclusive Zone.

Also, measures envisaged for the maintaining of security at sea are still not clearly defined, thus enabling threats of international terrorism on land extend to sea as well.

Many states have no logistics to perform control to impose measures and to maintain a state of safety regarding the navigation of tankers in adjacent areas of the Contiguous Zone and Territorial Sea, respectively.

In areas restricted to certain rules under the control of riverside states through their political and economic pressures a threat regarding the freedom of safe navigation can be foreseen in the interest of the countries which owe tankers with drafts over the maximum admitted limits.

The problem of „innocent passing” and the situation of mines on the seabed which have not yet been detected and destroyed must be also considered in what regards maritime safety and the international authorities should revise their approach in this respect.

If till the adoption of the CONVENTION ON THE LAW OF THE SEA the academic teams of experts have played an important part in promoting negotiation regarding maritime issues among states, after 30 years there is a decrease of their role. This role has been taken over by the 162 states (including the Cook Islands and Niue and the European Union Cook Islands and Niu) and the European Union [8] which have adhered or ratified this Convention so far.

The process to include the provisions of the CONVENTION ON THE LAW OF THE SEA in the national maritime law is closely linked to the act of its ratification. In this respect, we consider that most provisions of this Convention contain legal norms which in a certain degree support the initiatives of the under developed countries but they still remain ineffective because of their reduced economic potential.

The legal norms edited by the Convention have imposed all states to accept obligations on equal terms in order to perform maritime activities but they disregard economic and political realities of the industrialized countries. In this respect we can singularize

the United States of America, a country which has not ratified the CONVENTION ON THE LAW OF THE SEA up to the present, although in the issues of international law and external policy they observe and promote its principles.

### 3.1. Chronological lists of ratifications of, accessions and successions to the Convention and the related Agreements as at 03 June 2012 [9]

No	The United Nations Convention on the Law of the Sea of 10 December 1982
162.	Thaïlande (15 mai 2011 )
161.	Malawi (28 septembre 2010 )
160.	Tchad (14 août 2009)
159.	République dominicaine (10 juillet 2009)
158.	Suisse (1 mai 2009)
157.	Liberia (25 septembre 2008)
156.	Congo (9 juillet 2008)
155.	Lesotho (31 mai 2007)
154.	Maroc (31 mai 2007)
153.	République de Moldova (6 février 2007)
152.	Monténégro (23 octobre 2006)
151.	Nioué (11 octobre 2006)
150.	Bélarus (30 août 2006)
149.	Estonie (26 août 2005)
148.	Burkina Faso (25 janvier 2005)
147.	Lettonie (23 décembre 2004)
146.	Danemark (16 novembre 2004)
145.	Lituanie (12 novembre 2003)
144.	Canada (7 novembre 2003)
143.	Albanie (23 juin 2003)
142.	Kiribati (24 février 2003)
141.	Tuvalu (9 décembre 2002)
140.	Qatar (9 décembre 2002)
139.	Arménie (9 décembre 2002)
138.	Hongrie (5 février 2002)
137.	Madagascar (22 août 2001)
136.	Bangladesh (27 juillet 2001)
135.	Serbie (12 mars 2001)
134.	Luxembourg (5 octobre 2000)
133.	Maldives (7 septembre 2000)
132.	Nicaragua (3 mai 2000)
131.	Vanuatu (10 août 1999)
130.	Ukraine (26 juillet 1999)
129.	Pologne (13 novembre 1998)
128.	Belgique (13 novembre 1998)
127.	Népal (2 novembre 1998)
126.	Suriname (9 juillet 1998)
125.	République démocratique populaire lao (5 juin 1998)
124.	Union européenne (1 avril 1998)
123.	Gabon (11 mars 1998)
122.	Afrique du Sud (23 décembre 1997)
121.	Portugal (3 novembre 1997)
120.	Bénin (16 octobre 1997)
119.	Chile (25 août 1997)
118.	Royaume-Uni (25 juillet 1997)
117.	Guinée équatoriale (21 juillet 1997)
116.	Iles Salomon (23 juin 1997)
115.	Mozambique (13 mars 1997)

114.	Fédération de Russie (12 mars 1997)
113.	Pakistan (26 février 1997)
112.	Guatemala (11 février 1997)
111.	Espagne (15 janvier 1997)
110.	Papouasie-Nouvelle-Guinée (14 janvier 1997)
109.	Roumanie (17 décembre 1996)
108.	Brunéi Darussalam (5 novembre 1996)
107.	Malaisie (14 octobre 1996)
106.	Palaos (30 septembre 1996)
105.	Mongolie (13 août 1996)
104.	Haïti (31 juillet 1996)
103.	Nouvelle-Zélande (19 juillet 1996)
102.	Mauritanie (17 juillet 1996)
101.	Panama (1 juillet 1996)
100.	Pays-Bas (28 juin 1996)
99.	Suède (25 juin 1996)
98.	Norvège (24 juin 1996)
97.	Irlande (21 juin 1996)
96.	Finlande (21 juin 1996)
95.	République tchèque (21 juin 1996)
94.	Japon (20 juin 1996)
93.	Algérie (11 juin 1996)
92.	Chine (7 juin 1996)
91.	Myanmar (21 mai 1996)
90.	Bulgarie (15 mai 1996)
89.	Slovaquie (8 mai 1996)
88.	Arabie saoudite (24 avril 1996)
87.	France (11 avril 1996)
86.	Géorgie (21 mars 1996)
85.	Monaco (20 mars 1996)
84.	République de Corée (29 janvier 1996)
83.	Nauru (23 janvier 1996)
82.	Argentine (1 décembre 1995)
81.	Jordan (27 November 1995)
80.	Samoa (14 August 1995)
79.	Tonga (2 August 1995)
78.	Grece (21 July 1995)
77.	Austria (14 July 1995)
76.	India (29 June 1995)
75.	Slovenia (16 June 1995)
74.	Bolivia (Plurinational State of) (28 April 1995)
73.	Croatia (5 April 1995)
72.	Cook Islands (15 February 1995)
71.	Italy (13 January 1995)
70.	Lebanon (5 January 1995)
69.	Sierra Leone (12 December 1994)
68.	Singapore (17 November 1994)
67.	Mauritius (4 November 1994)
66.	Germany (14 October 1994)
65.	Australia (5 October 1994)
64.	The former Yugoslav Republic of Macedonia (19 August 1994)
63.	Viet Nam (25 July 1994)
62.	Sri Lanka (19 July 1994)
61.	Comoros (21 June 1994)
60.	Bosnia and Herzegovina (12 January 1994)
59.	Guyana (16 November 1993)
58.	Barbados (12 October 1993)
57.	Honduras (5 October 1993)
56.	Saint Vincent and the Grenadines (1 October 1993)
55.	Malta (20 May 1993)
54.	Zimbabwe (24 February 1993)
53.	Saint Kitts and Nevis (7 January 1993)
52.	Uruguay (10 December 1992)

51.	Costa Rica (21 September 1992)
50.	Dominica (24 October 1991)
49.	Djibouti ( 8 October 1991)
48.	Seychelles (16 September 1991)
47.	Marshall Islands (9 August 1991)
46.	Micronesia (Federated States of) (29 April 1991)
45.	Grenada (25 April 1991)
44.	Angola ( 5 December 1990)
43.	Uganda (9 November 1990)
42.	Botswana (2 May 1990)
41.	Oman (17 August 1989)
40.	Somalia (24 July 1989)
39.	Kenya (2 March 1989)
38.	Democratic Republic of the Congo (17 February 1989)
37.	Antigua and Barbuda ( 2 February 1989)
36.	Brazil (22 December 1988)
35.	Cyprus (12 December 1988)
34.	Sao Tome and Principe (3 November 1987)
33.	Cape Verde (10 August 1987)
32.	Yemen (21 July 1987)
31.	Paraguay (26 September 1986)
30.	Guinea-Bissau (25 August 1986)
29.	Nigeria (14 August 1986)
28.	Kuwait (2 May 1986)
27.	Trinidad and Tobago (25 April 1986)
26.	Indonesia (3 February 1986)
25.	Cameroon (19 November 1985)
24.	United Republic of Tanzania (30 September 1985)
23.	Guinea (6 September 1985)
22.	Iraq (30 July 1985)
21.	Mali (16 July 1985)
20.	Iceland (21 June 1985)
19.	Bahrain (30 May 1985)
18.	Tunisia (24 April 1985)
17.	Togo (16 April 1985)
16.	Saint Lucia (27 March 1985)
15.	Sudan (23 January 1985)
14.	Senegal (25 October 1984)
13.	Cuba (15 August 1984)
12.	Gambia (22 May 1984)
11.	Philippines (8 May 1984)
10.	Côte d'Ivoire (26 March 1984)
9.	Egypt (26 August 1983)
8.	Belize (13 August 1983)
7.	Bahamas (29 July 1983)
6.	Ghana (7 June 1983)
5.	Namibia (18 April 1983)
4.	Jamaica (21 March 1983)
3.	Mexico (18 March 1983)
2.	Zambia (7 March 1983)
1.	Fiji (10 December 1982)

#### 4. Conclusions

Twenty-seven years have passed since the conclusion of the United Nations Convention on the Law of the Sea, by means of which we reached a delicate balance among countries, in order to strengthen maritime security, to protect the oceans of the planet and to generate international cooperation on maritime issues.

The threats to maritime security and safety can only be addressed through the concerted efforts of all States. It is also important that those measures taken in order to meet such challenges have to be consistent with the international law.

The report concludes that sustainable fisheries development remains a significant challenge for the international community. Most of the world's main capture fisheries have reached maximum potential. Unsustainable fishing practices persist in most areas of the world, and vulnerable marine ecosystems are being adversely impacted by non-selective fishing gear and techniques. The demand for fish products is expected to increase, and more efforts are needed in order to set out the commitments in the Johannesburg Plan of Implementation, which have to be met by 2015. As such, it is imperative to address unsustainable fishing practices and promote universal participation in international instruments that provide for the long-term conservation of fishery resources.

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## The Protection of New Plant Breeds

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### Abstract

*New plant breeds created or discovered or developed by a person, may be protected in terms of industrial property law, only by requesting / granting a plant breed patent. In these circumstances, the owner of the plant breed patent - breeder acquires an exclusive right of exploitation, throughout the entire period of the breed protection, and he also has the right to prohibit to any other person to perform without his authorization acts on breeding, production, sale or resale or any other form of marketing, importation or exportation or storage for one of these purposes. The protection under the plant breed patent of a protected breed, whose plant breed patent holder may be any legal entity or natural person, has direct effects on a financial plan, by reducing the innovation costs and by boosting the research and innovation activities for research institutions, companies and inventors in this field.*

**Key words:** breeder, plant breed patent, industrial property, plant breeds

**J.E.L. classification:** K11

### 1. Introduction

The patentability of new plant breeds is related to the authenticity and purity of the breeds discovered or altered, obtained through lengthy testing and assessments related to the professional capacity of researchers in this field [1]. The process of approval and certification of plant breeds requires several scientific stages which are universally available in the world of plants destined to agriculture and finalized with legal instruments for the protection in the field of industrial property law. Each year there are tested and retested thousands of breeds from the species for large scale culture, i.e. cereals, legumes, sunflower,

rapeseed, potato, sugar beet, fodder plants, medicinal and aromatic plants, vegetable species, fruit trees and shrubs, grape vine and ornamental species. The main creator of new plant breeds are research institutes, which, by their intellectual creation in conjunction with the application of legal concepts, are called primarily to ensure the health of new breeds and hybrids.

### 2. New plant varieties protection regulation

The protection of plant breeds was brought into discussion for the first time at international level by means of granting several exclusive rights to plant growers, by researchers in the United States of America [2]. Thus, since 1930, the growers' rights have been protected by a plant patent, which was representing a special form of exclusive law, available only to those plant breeds reproduced asexually, within a handful of European countries [3]. This group drafted on 02.12.1961 the International Convention for the Protection of New Plant Breeds, and it was revised in Geneva on 10.11.1972, 10.23.1978 and 19.03.1991; Romania adhered to it by Law no. 186/2000 [4]. Under the Act of 1978, the rights of plant growers are granted in each Member State for its own territory, and there was also established the International Union for the Protection of New Plant Breeds (UPOV). At the level of the European Community, there were found specific regulations which are not harmonized at Community level, regarding the industrial property regime applicable in each country, which led to the adoption of Regulation (EC) no. 2100/94 of the Council for the Establishment of a system for the protection of plant breeds through the Community Plant Breeds Office. Subsequently, several modifications were made by Regulation (EC) no. 1768/95 and Regulation (EC) no. 2605/1998 the

Commission of 3/12/1998. However, the Regulation (EC) no. 2100/94 has brought several clarifications for the sake of the consistency between the Community regime regarding the protection of plant breeds, the provisions of the European Patent Convention, and the Agreement on issues related to intellectual property rights regarding trade, including trade in counterfeit goods [5]. Nationally, plant breeds enjoy a special protection system governed by Law no. 255 of 30 December 1998 on new plant breeds (r1), as amended by Law no. 119 of 04 May 2006 and the Regulation for applying the Law no. 255/1998 on the protection of new plant breeds approved by G.D. 984 of 22 August 2007. The protection of plant breeds will be taken over by the State Institute for Breeds Testing and Registration, starting from 1<sup>st</sup> July 2011, according to Article 38 of Law no. 266/2002 (r1).

### **3. The protection of the new breeds on the romanian territory**

Foreign natural or legal persons registered with the office or domicile outside the Romanian territory shall enjoy the Protection of new breeds in Romania, under the International Conventions to which Romania is party. The plant patent holder is entitled to royalties or to equitable remuneration for the exploitation of the protected breed in case of licensing on a contractual basis and the licensee is obliged to pay the agreed sums of money. The disputes shall be settled by common law Courts.

### **4. Conclusions**

The protection of new plant breeds is achieved through a plant breed patent application to the State Office for Inventions and Trademarks or to the Community Plant Breeds Office. The main conditions to be met are: novelty, distinctiveness, uniformity and stability and it has to be designated by the generic name proposed by the manufacturer, under the examination which certifies that the respective name is eligible.

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## The Downside of "Think Global, Act Local" in Multinational Environments

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### Abstract

*The purpose of the present paper is to investigate some of the issues raised by a number of analysts who either consider globalization as beneficial (opening numerous cultural possibilities, multiple identities and choices) or as a threat (the loss of individual thought and local culture caused by the growing bias in favor of the visible and vociferous elements of civil society).*

**Key words:** globalization, culture, economics, international environments, critics of globalization

**J.E.L. Code:** Z19

Globalization most often refers to the growth of transnational politics, the integration of the world economy, and a subsequent blending of cultures around the world. remote areas still untouched by free trade, television, or migration, might still exist, however, the scope of globalization's impact is by definition global. Commentators have asserted that globalization, above all, creates cultural possibilities that might have been impossible in the modern era when state, economy, culture and people were more tightly aligned. The effect of globalization is to increase the number of choices for actors to the extent that '[m]ultiple identities and the decentering of the social subject are grounded in the ability of individuals to avail themselves of several organizational options at the same time' [1].

Since have concluded that global culture is additive to local culture, a logical consequence would be that actors throughout the world effectively become bi- or poly-cultural. The idea of globalization has long been debated and issued a large number of

theories: Thomas Friedman (1999) sees globalization as the dreamed-of opportunity for economic development and political liberalization for 'backward' peoples around the world. Postcolonial scholars see crypto-imperialist motives in the exploitation of subaltern labour markets and natural resources (Antonio and Bonanno 2000). Arjun Appadurai (1996) sees globalization as the unravelling of the quintessential modern project of nation-building, undermined by a myriad hybrid identities and cultures. [2] The question becomes 'which globalization?' The answer, according to Roland Robertson (1992), is that globalization deserves to be considered in terms of the intellectual and practical terrain on which actors draw their conclusions about globalization, thereby leaving open the possibility of multiple images of globalization. From our perspective, Robertson is right to acknowledge the variety of images of world order with resonance in contemporary society. Yet, despite the wide variety of theory on globalization, it is possible to distill a few key propositions concerning contemporary global culture:

-the world is more pluralistic than the hegemonic world-views of modern social theory had previously allowed. Globalization theory is exceptionally sensitive to differences within and between its analytic categories.

-individuals have more power to adapt, innovate and manoeuvre within a globalized world than the top-down perspectives of modern social theory had previously allowed. Globalization theory takes individuals into account as self-creating agents.

-social processes are relational and contingent. Cultural globalization provokes a variety of reactions—ranging from nationalist entrenchment to cosmopolitan

embrace—that feed back on and transform globalization.

-the key cultural changes of the late twentieth century are the increasing commodification of social life and the increasing velocity and centrality of media. Commodities and media became the material of self-creation as well as legitimate objects of social scientific inquiry .[3]

Economist David Henderson of the Melbourne Business School expands the definition into five related but distinct parts:

- \* the increasing tendency for firms to think, plan, operate, and invest for the future with reference to markets and opportunities across the world as a whole;

- \* the growing ease and cheapness of international communications, with the Internet the leading aspect;

- \* the trend toward closer international economic integration, resulting in the diminished importance of political boundaries. This trend is fueled partly by the first two trends, but even more powerfully by official policies aimed at trade and investment liberalization;

- \* the apparently growing significance of issues and problems extending beyond national boundaries and the resulting impetus to deal with them through some form of internationally concerted action; and

- \* the tendency toward uniformity (or "harmonization"), by which norms, standards, rules, and practices are defined and enforced with respect to regions, or the world as a whole, rather than within the bounds of nation-states.[4]

Obviously, the main beneficiaries of the trend are the long-suffering consumers in those nations that had been "protected" from global competition. Purely theoretically speaking ( and considering only the point of view of those in favour), it expands the range of choice, improves product quality, and exerts downward pressure on prices. Other foreseen advantages would be that it delivers an immediate gain to workers by raising the real value of their wages. Or that it transfers wealth from formerly protected producers to newly liberated consumers, with the gains to consumers exceeding the loss to producers because the deadweight losses to the economy are recaptured through efficiency gains.

Least developed countries, we are often told, have the most to gain from engaging in the global economy. Their first and most important gain would be: access to much larger markets, both for imports and exports. On the import side, consumers gain access to a dramatically larger range of goods and services, raising their real standard of living. As a result, domestic producers gain access to a wider range and better quality of intermediate inputs at lower prices. On the export side, domestic industries can enjoy a quantum leap in economies of scale by serving global markets rather than only a confined and underdeveloped domestic market.

Second, least developed countries that open themselves up to international trade and investment gain access to a much higher level of technology. This confers on least developed countries a "latecomer's advantage": rather than bearing the cost of expensive, up-front research and development, poor countries can import the technology off the shelf. They can incorporate new technology by importing capital equipment that embodies the latest advances and computers with the latest software. Subsidiaries of multinational companies also bring with them new production techniques and employee training that bolster the host nation's stock of human capital.

Third, engagement in the global economy provides capital to fuel future growth. Most least developed countries are people-rich and capital-poor. In a few countries in Asia, the level of domestic savings has been high enough to finance domestic investment, but typically the domestic pool of savings in an least developed countries is inadequate. Global capital markets can fill the gap, allowing poor nations to accelerate their pace of growth. In 1998, \$166 billion in foreign direct investment flowed from the advanced economies to the less developed. A poor country that closes its door or fails to maintain sound domestic policies will forfeit the immense benefits this capital can bring.

Fourth, openness to the global economy can provide the infrastructure a developing economy needs for growth. Foreign capital can finance more traditional types of infrastructure, such as port facilities, power generation, and an internal transportation

network, just as British capital helped to finance America's network of canals and railroads in the nineteenth century. But just as importantly, multinational companies can provide an infrastructure of what could be called "enabling services," such as telecommunications, insurance, accounting, and banking. As China and India have realized, a protected and inefficient service sector weighs down an entire economy, retarding the development of manufacturing and other industries. Least developed countries need to shed the mistaken idea that opening their economies up to international service competition is a "concession" to be made to gain access to farm and manufacturing markets in the advanced economies. In reality, liberalizing their service sectors by opening them to foreign competition is a favor least developed countries can do for themselves.

Fifth, engagement in the global economy encourages governments to follow more sensible economic policies. Sovereign nations remain free to follow whatever economic policies their governments choose, but globalisation has raised the cost that must be paid for bad policies. With capital more mobile than ever, countries that insist on following antimarket policies will find themselves being dealt out of the global competition for investment. As a consequence, nations have a greater incentive to choose policies that encourage foreign investment and domestic, market-led growth. New York Times columnist Thomas Friedman, in *The Lexus and the Olive*, his 1999 book on globalization describes these progrowth policies as "the Golden Straitjacket." The increasingly manifest rewards of engagement encourage nations to unilaterally restrict the scope of government action. As Friedman explains:

To fit into the Golden Straitjacket a country must either adopt, or be seen as moving toward, the following golden rules: making the private sector the primary engine of its economic growth, maintaining a low rate of inflation and price stability, shrinking the size of its state bureaucracy, maintaining as close to a balanced budget as possible, if not a surplus; eliminating and lowering tariffs on imported goods, removing restrictions on foreign investment, getting rid of quotas and domestic monopolies, increasing exports,

privatizing state-owned industries and utilities, deregulating capital markets, making its currency convertible, opening its industries, stock, and bond markets to direct foreign ownership and investment, deregulating its economy to promote as much domestic competition as possible, eliminating government corruption, subsidies and kickbacks as much as possible, opening its banking and telecommunications systems to private ownership and competition, and allowing its citizens to choose from an array of competing pension options and foreign-run pension and mutual funds.[5]

The advance of the globalization trend has not been a smooth or a pain-free process. The changes it has caused, or is perceived to have caused, have spurred a number of political backlashes. Two of the most common complaints against it are that it has undermined labor and environmental standards, and that it has exacerbated the gap between rich and poor, both among and within countries.

Critics of globalization quite often warn of a destructive "race to the bottom," as advanced nations are forced to weaken labor and environmental standards to compete with less-regulated producers in developing nations. This theory rests on the assumption that lower standards give least developed countries a significant advantage in attracting global capital and gaining export markets at the expense of more developed countries. The OECD has found that, in practice, a lack of core labor standards plays no significant role in attracting foreign investment or in enhancing export performance. The OECD did find strong evidence "that there is a positive association over time between sustained trade reforms and improvements in core standards." [6]

In other words, trade liberalization encourages higher standards, not lower standards. If anything, the real race may be toward the top. For reasons of internal efficiency as well as public perceptions, multinational companies tend to impose higher standards on their overseas production plants than those prevailing in local markets, thus raising average standards in the host country. Free trade and domestic liberalization--and the faster growth they create--are the best ways to encourage higher standards. As per capita incomes rise in less

developed countries, so does the domestic political demand for higher standards, and the ability of the productive sector to pay for them. Punishing least developed countries with trade sanctions would only cripple their long-term ability to raise domestic labor and environmental standards.

Some environmental activists complain that the global trading system, as embodied in the WTO, favors free trade at the expense of environmental protection. But WTO rules place no restraints on the ability of a member government to impose any environmental regulations determined to be necessary to protect its own environment from domestically produced or imported products. Article XX of the General Agreement on Tariffs and Trade 1994, the basic charter of the WTO, plainly states that members may impose trade restrictions "necessary to protect human, animal, or plant health." The Sanitary and Phytosanitary Agreement of the Uruguay Round does require that such restrictions be based on sound scientific evidence--a commonsense requirement necessary to discourage the use of health and safety issues as a cover for protectionism. If WTO members are found to be in violation of their commitments, they remain free as sovereign nations to simply ignore any adverse WTO rulings against domestic regulations that impact trade. A prominent example is the European Union's ban on the sale of beef from cattle treated with growth hormones. The EU has repeatedly lost in the WTO, but it has no plans to lift its ban, even though it has produced no scientifically sound evidence that the banned beef poses any hazard to public health. The United States retaliated against the EU in May 1999 by imposing sanctions on \$117 million worth of imports from Europe, but retaliation as a weapon of trade disputes existed long before the WTO. [7]

Antitrade environmental activists complain that several decisions by the WTO have undercut U.S. environmental regulations. In the so-called Shrimp-Turtle case, the WTO ruled against a U.S. ban on shrimp from countries the United States judged were not adequately protecting sea turtles from being caught and killed in shrimp nets. In an earlier, similar case, the WTO had ruled against a U.S. ban on tuna from Mexico that the United States claims

was caught through a process that endangers dolphins. Environmental critics of the WTO point to these two cases as proof of their claim. [8]

As we have seen, economic globalization proves to be a long contested and powerful trend. It is driven by a combination of technological developments, profit-seeking businesses, and generally supportive public policy. Despite these facts, it is also less pervasive and more fragile than is widely believed by both its supporters and its opponents. There are at least two counter arguments which can be brought into discussion: on the one hand it is not an irreversible trend (contesters fully prove that), on the other hand, national borders and policies continue to play a role in limiting and directing international transactions. The most extreme and active of globalization's opponents caricature it as the source of all that is wrong in the modern world, including poverty, injustice, inequality, violence, and war.

Therefore, a possible common sense conclusion about the trend, meant to calm down the spirits would be that it : „is not a magic cure-all for what ails a nation's economy, nor is it a plot by profit-hungry megacorporations to exploit workers and despoil the environment. Globalization is not the return of colonialism, nor is it the arrival of world government. At the most fundamental level, globalization simply means an expansion of the range of possible commercial activities. Acts of buying, selling, producing, borrowing, and lending that used to be ruled out by geographic, technological, or legal barriers have now become practical".[9]

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## Considerations on the Future of Globalization

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### Abstract

*Globalization is generic concept for a variety of social processes, including internationalization of businesses, the raise of multinational companies, the convergence of business practices. The global interdependences are more tighten, fast-making and more complex ones. The global configuration comprises various local arrangements, either through standardization or adaptation. Globalization is not only an economic issue, is a complex one, multifunctional. It spreads across the entire socio-humane activities: the market and business dimension, the political and social dimension, the religious and spiritual dimension, the domestic and international law, the nation-state and the global society. But the future of globalization is generating a series of problems that we are addressing in this paper. Globalization effects' should be reevaluated.*

**Keywords:** globalization, economic development, international trade.

**J.E.L. classification:** F43, F50.

### 1. Introduction

The movement of the space abolishes the time flow. According to Zygmunt Bauman, for some, globalization is something that we must necessarily accomplish if we want to be happy, according to others, the source of our unhappiness lies precisely in globalization. It is safe for everyone that globalization represents the implacable fate that awaits the world, an irreversible process which affects us all equally the same. The globalization divides and unites in equal measure. In

parallel with the rise of business, trade and information at world level, a process of „location" of fixing in space was started. Modern life floats according to global / local hierarchy: globality and locality became contrary and fundamental values, coveted or rejected, but in the center of dreams, nightmares and conflicts of life [1].

It is estimated that the globalization of economic activity and raised governance issues have started after the Second World War during the 1960s. Globalization represents a term often said, be they managers, journalists and, above all, politicians [2].

Other authors claim that globalization process has its origins in a long period preceding the First World War, characterized by a faster development of trade and financial flows, as well as the increasing of international migration. This trend manifested itself acutely in the period 1870-1914, when a strong expansion of European colonialism in Africa and Asia occurs, when the United Kingdom was the first economy in the world and many countries were under the domination of a single currency (gold standard) [3].

### 2. Meanings of globalization

The real challenge of the XXI century is the democratization of commerce. The clash between the forces of globalization and trade protectionism is a topical issue. One of the great paradoxes of international trade is that, although it brings great benefits to the society in general and to consumers in particular, the liberalization is still threatened by protectionism, which is even more subtle constituted. Despite the creation of WTO in 1995 and other reforms, the aspects of international trade system are far from being

solved, and the dispute between supporters of the liberalization of international trade and those of protectionism continues.

All economists agree that free trade is superior to any form of trade protectionism, i.e., it is the best policy of a country, even if all the others practice protectionism, arguing that the economy which remains open will earn more from cheaper imports, unless will lose from declined exports. The big fluctuations of the values of currencies have affected the finances lately, and the integration of world financial markets had a negative impact on the functioning of the international monetary regime. However, protectionism has never completely disappeared, but in the last two centuries trade restrictions have been a permanent feature of the global economy. They were especially acute in times of economic failure. This is because, with few notable exceptions, most of WTO members are part of regional trade agreements. Thus, the WTO should inexhaustible and objectively judge the compatibility of regional and continued multilateral trade agreements. The "full" structure of WTO has allowed all economic powers to often resort to ad hoc extralegal procedures outside the WTO. What will happen when Russia will be admitted as a member?

Until now, the free trade has worked only asymmetric, allowing the penetration on the markets in the developing countries of the products in the advanced industrialized countries without absolute reciprocal. We appreciate the fact that in the following period, the trade negotiations will focus on the issues of official barriers and especially of the hidden ones and what is called, the "new trade agenda".

The term "globalization" has become customary in the second half of the 1980s, correlative with the huge increase of FDI of NMC's. As an argument, we can show that FDI has grown significantly in the late 1980s, growing into a higher rate than world trade and global economic output. In this framework we should illustrate the fact that FDI is highly concentrated and very unequally distributed around the globe, the majority in the U.S.A., Western Europe, China, and modest, in some Latin American countries (the car sector in Brazil and

Mexico). Consequently, corporate globalization refers to only a few countries.

Globalization is perceived only as an economic phenomenon, although its major implications also focus the socio-psychological: as a proof, anti-globalization demonstrations in Seattle (December 1999), Washington (2000 and 2001), Quebec (2001), Prague (September 2000) and Genoa (2001). Among the latest are: over 15,000 people protested against globalization in London, the city which hosts the G20 summit of industrialized countries (March 29, 2009), anti-globalization protests took place in London and in Germany (March 29, 2009); protests with the heads in the sand to G20 meeting in Scotland (11/08/2009) 14 anti-G20 militants, arrested in Pittsburgh (24.09.2009); 8 June 2007, G8 summit gathered thousands of anti-globalization protesters in northern Germany, anti-globalization protests at Olympic Games in Vancouver (February 15, 2010), where hundreds of anti-globalization protesters clashed with the Canadian police in the Winter Olympics; chaos in the streets of Geneva due to anti-globalization activists (February 21, 2011); protests at the climate summit in Copenhagen : 400 young people required to stop the global warming (December 2009). It can also be mentioned the anti-Mc'Donalds protests: France (José Bové), bomb attempts at McDonald's in Indonesia that resulted in three deaths, attacks against restaurants in Pakistan.

AdBusters organization, organizes Buy Nothing Day "- The day in which I buy nothing", on the 26th of November each year, a time when people stop for a day at the so coveted status of a consumer: "Life is more than an accumulation of goods!" In this context we remember the names of some organizations opposing to the globalization: Greenpeace, Amnesty International, World Wildlife Federation, Clean Clothes Campaign, the World Social Forum, etc.

As a consequence of globalization, international trade increased at a rate almost double of the growth rate of world GDP. In order to prevent the strong balance of payments imbalances, the states are forced to increase the proportion of the prudential reserves for imports. For example, the minimum reserves must be equal to the value of imports for three months.

It is argued that the first proponent of globalization was the Venetian Marco Polo, who with his brother accomplished world trade from the east. As he returned home, he published the famous book of impressions of journeys, "Travels of Marco Polo". In general, there is a convergence of opinions in defining globalization. *The essence of globalization* is the free movement of people, goods, services and capital across the national borders [4].

### 3. Directions of globalization

From the economic point of view, there are three main trends which can be identified as causes of the increasing of international trade and globalization process. First of all, the one which has the deepest implications, is represented by the technological change. Second of all, more and more governments have promoted liberal policies, in order to open the markets and eliminate the administrative obstacles impeding the development of economic activities. Third, the joint action of new technologies and the existence of freer markets has allowed companies in more countries to internationalize their activity, creating the global economy level as a set of interrelated activities. These trends led to the emphasis of the interdependences which brought together the national economies, creating unprecedented opportunities but also new economic, political and social challenges (Table 1).

Table 1. New indicators of globalization

Economic integration - International trade, FDI, port capital flows and investments
Political commitment - subscription in international organizations, ratification of international treaties and government transfers
Technology connectivity - Internet users, access to wireless telephony and servers security
Personal contacts - international travel and tourism, international telecommunications traffic
Quality of life - access to increasingly broader health education systems. A longer life expectancy

Source: adapted from James Canton, „Provocările viitorului. Principalele tendințe care vor reconfigura lumea în următorii 5, 10, 20 de ani”, *Polirom, Iasi, 2010, page 206.*

The globalization of the world economy affects, without doubt, almost every aspect of domestic and international business. *Its supporters* converge on the assumption that no obstacle should block the free movement of goods, services and capital. Many agree that the globalization releases latent economic energies and leads to an efficient use of decreasing world resources, to maximize global wealth, to promote world peace and to economic benefits for all nations.

*The critics of globalization* see it as a triumph of the ruthless capitalist system marked by exploitation, domination and inequalities. Free market ideology has proved to be an excuse for new forms of exploitation. „Privatization”, a feature of the foreigners in buying fertile land, mines and oil fields in the developing countries, at moderate prices. Trade liberalization also meant that foreign companies could wipe out the embryonic industries from the Earth, stifling the entrepreneurship development. In fact, capital moves freely but not the same thing happens with manpower, except for the very gifted. Banks are often less interested in lending new industries, but to finance speculative investments, for example, real estate field or to credit governments [5].

The world is engaged in a contest between economic growth and population growth, and population growth seems to prevail until now. As the percentage of poor population decreases, the absolute number of poors increases. 40% of the world population lives with less than two dollars a day and a billion people with less than a dollar a day. From a historical perspective, Africa is the region most exploited by globalization [6].

The poors in less developed countries "subsidize" the rich in the developed countries. It is argued that the most important result of market globalization is the triumph of the market on the nation-state and, consequently, the end of national economic sovereignty. Economic policies and the welfare state are slaughtered in the name of corporate profits and international competitiveness. We bring as an example General Motors, which has been radically restructured and eventually nationalized as a result of economic recession in 2009.

A series of alarmist works present an obscure world of the cultural homogenization

and unleashed commercialism, pollution, if not even the destruction of Western civilization but also undesirable phenomena: the increase of economic inequality and unemployment, the collapse of social programs and welfare state, the destruction of national cultures, illegal migration, increased crime, etc. According to UNICEF estimates, it is estimated a number of 246 million working children. Almost three quarters of them work in dangerous situations - in mines, with chemicals and pesticides, in agriculture, or handle dangerous machinery.

Millions of girls work as maids and are particularly vulnerable to exploitation and abuse - can be trafficked (1.2 million), become slaves to debt or other forms of slavery (5.7 million), forced to prostitution and work in the pornography industry (1.8 million), to participate in armed conflicts (0.3 million) or other illicit activities (0.6 million). Most children (at least 70%) work in agriculture. Asia-Pacific has the largest number of working children in the age group five to 14 years: 127 300 000 (19% of children working in the region). Sub-Saharan Africa had 48 million working children", meaning one child of three, under 15 years (29%). Latin America and the Caribbean, with children as workers, approximately 17.4 million (16% of children who work in the region). Fifteen percent of the children in the Middle East and North Africa. About 2.5 million children in industrialized countries and countries in transition.

Populists wonder how Americans or Europeans workers are living, who earn at least \$ 20 per hour, to compete with the billions of workers from China, India, Indonesia, Bangladesh and others, whose income per hour does not achieve 20 cents. Countries like Mexico, China do not have standards imposed on the labor process or environment protection, factors that increase the production costs in developed countries. In Europe, socialists and neo-fascists often expressed their antipathy on opening economy and the fear for losing the national self-determination. Pope John Paul II believed that NMC activities and international trade lead to the emphasis of the international inequality; during his visit to Cuba (January 1998) he stated that the rich people from everywhere are getting rich and the poor ones become more poor. He even

speculated the concern about the fact that globalization might lead to rich countries with poor people.

One of the (political) economic approaches, the *Theory of the world system*, gives us a vision of the capitalist world divided into "central nations" and "peripheral nations", each topping, semiperiferia". This theory represents a neo-Marxist approach in which the accent moves from the study of the exploitation of the proletariat by the capitalists in a capitalist society, to exploitation between capitalist societies belonging to the capitalist world system. The supporters and detractors of the globalization have different expectations on the distribution of wealth and power within and between national economies. The prosperity of the developing countries which are rich in resources depends on how much they get in exchange of their resources. The prosperity of corporations in advanced industrialized countries depends on how less they pay for these resources. This represents a conflict in the center of the welfare paradox.

It is stated that many of the claims of supporters and critics of globalization, are either exaggerated or untrue, but many of them reflect some truth. For example, indeed, the great concentration of economic power is born from the merger of large corporations, the takeovers and alliances, this rationalization of corporate activities substantially transforms the global economy. The impact which globalization has on the distribution of power between nations (or dominant economies and subordinate economies) should also be correctly interpreted. In fact, a democratic and egalitarian international system has never been recorded in history, and is unlikely to occur, with or without the support of globalization. In an open global economy, there is a risk for a country to lose control over important aspects of its own economy. Norway, Australia and the Netherlands lead the world in the "*Human Development Index (HDI) 2011*", while the Democratic Republic of Congo, Niger and Burundi, are at the bottom of the league's annual Human Development Report, realised by the United Nations Development Programme (UNDP). United States of America, New Zealand, Canada, Ireland, Liechtenstein, Germany and Sweden, complete the top 10 countries. Try

to tell an inhabitant of Africa or in the Caribbean area about globalization...

The reason why international trade agreements have been unsuccessful is their imbalance: advanced industrialized countries were allowed to impose tariffs on goods produced by developing countries or which were four times higher than the tariffs applied on goods produced by other advanced industrialized countries. Although the developing countries were forced to abandon their subsidies designed to help the emerging industries, the advanced industrialized countries have continued to benefit from their large subsidies in agriculture, which led to the decrease of food prices and disruption of the living standards in developing countries. Prices are an important source of government revenues in less developed countries. Their cut brings negative effects in the amount of education funding, infrastructure and social benefits.

Table 2. The future of globalization

Economy based on innovation
Poverty
Higher life standards
International commerce
Changes in the population - global manpower
Cultural diversity
Terrorism
Global security

Source: adapted from James Canton, „Provocările viitorului. Principalele tendințe care vor reconfigura lumea în următorii 5, 10, 20 de ani”, Polirom Publishing House, Iasi, 2010, page 191

The globalization limits the capacity of the nation- states to respond in many ways. Governments which try to control the flow of capital realize they are powerless, unlike individuals who seek ways to avoid rules. A country could want to increase the minimum wage, but discovers that this is not desirable, because foreign companies operating in its territory will decide to move to a country with lower wages. The inability of a government to control the actions of people or companies is limited by international agreements affecting the right of the sovereign states to make decisions. Signing international trade agreements may prevent governments to regulate the entry and exit of hedge, dynamic funds, even if capital market liberalization can lead to economic crises.

The globalization process requires the countries to create a strong image, a brand, in order to be better position for global competition. In some cases these images are stereotypes, extreme simplifications of reality that are not necessarily correct [8].

We have a chaotic, uncoordinated global governance system, without a global government, from a variety of institutions and agreements covering a range of issues, from global warming to international trade and capital inflows. The problem is, therefore, the deficit of democracy. Europeans learned with difficulty, how to regard themselves as Italian, French, German, Romanian but also European.

Although there is development, most people are on the breadline. *Gradual economic theory*, which supposes that with the development of society as a whole, everyone has benefits, proved to be erroneous repeatedly. According to some, globalization is inevitable and should be accepted with all its shortcomings. Taking into account that most of the planet lives in democratic regimes, whether globalization will have positive consequences for most of us, we will respond eventually. For a day or two, we can be fooled, with stories according to which, although we suffer today, benefits will soon appear. Globalization will never produce the convergence of economic institutions and practices in the world. Also, globalization can't lead to the "trade" of all aspects of existence, but can lead to some homogenization of values and human behavior.

#### 4. Conclusions

The recent integration of some aspects of the international economy was extremely uneven, limited to certain sectors and not as comprehensive as some think. The only global economic field is the financial one, highly mobile, and the last crisis made credible the accusation that globalization has greatly increased economic international instability. The experience shows that when financial institutions and players move billions of dollars from an economy (or sector) to another one by a simple click, international financial markets can cause disaster in national economies and could destabilize the international economy. We

live in a world where the IMF, World Bank and other institutions could become an anathema of the global democratic civilization.

If we want globalization to work, an international economic regime is desirable in which the welfare of developed countries and of the developing countries to be easier ensured, i.e., a new global social contract between developed and less developed countries. Achieving this new vision will require a new economic model where sustainability will require a diminished emphasis on material goods for those who consume too much and a shift towards the innovative activities. Globalization should be restructured so that the individuals in developed countries and those in developing countries, both generations and the future together can benefit from it, although there are some special interests which will lose and their representatives will oppose these changes. It is time to have strong economies and societies which appreciate more values like culture, environment and life itself.

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## Romania in a More Globalized World

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### Abstract

*Considered by some as a factor of progress and by others as the origin of many insufficiencies, globalization is an unstoppable phenomenon of the current times.*

*It would be counteractive from the part of many countries, not to try, under these circumstances, to use the opportunities brought by the process of globalization to their own advantage.*

*Through the economic openness which was assumed by Romania, the country has integrated itself more and more in the world economy. The indexes upon which this openness was based have been emphasized both in their dynamic but also in comparison with other countries in this study, without excluding the vulnerabilities which threaten our countries in a more and more globalized world.*

**Key words:** globalization, economic openness, commercial, international commercial trade, foreign direct investments

**J.E.L. classification:** F01

### 1. Introduction

The acceptance by the majority of the world's countries of an open system regarding international trades, international financial flows, international technological transfers etc., represent irrefutable realities. The collapse of the socialist production block, starting with 1989, and the remarkable progresses in the area of communication and transportation are other factors which have allowed the amplification of economic interdependences between different countries.

International companies are regarded as being the vectors of the globalization process. The businesses of multinational

companies overcome borders, and their investments can be found everywhere in the world and they determine the geographic spread of the new technologies.

The amplification of the phenomenon of globalization must be linked to the activity, sometimes questionable activity, undertaken by global financial institutions.

The World Bank, but most of all the IMF, through imposing the Washington Consensus (deregulation, privatization, the diminishing of the government's role in the economy etc) on the countries with financial difficulties has determined on a medium and long term an economic and social worsening in most cases.

The World Trade Organization through its negotiation rounds in the course of time has managed to impose a liberalization of the goods and services trade on a global level. The economic opening of the world's countries has proved to have advantaged especially the competitive economies. In the same time the developed countries have been the ones to initiate the majority of tariff and non-tariff protection procedures, which in most cases have been ungrounded. It is obvious that from the liberalization of international trades, the ones with the least advantages have been the poor countries, thus opening the question regarding the fairness of this procedure.

Before 1990, the economic development of Romania was autarchic. The development of many sectors in which the competitive advantages of Romania were inexistent was pursued. The foreign direct investments attracted by our country were limited due to the restrictive national legislation. However, the necessity for imported raw materials supplies for industrial sites and the forced increase in exports in order to pay external debts determined the participation of Romania to the commercial international trades, participation which we can consider as being active.

The transition of Romania from a planned economy to a market one took place under the conditions of assuming the rules of the World Trade Economy and of entering the European Union. These factors have generated an increase in the interdependences of the Romanian economy with the exterior, fact which has imposed a significant economic opening of our country.

In order to make the analysis of the Romanian economic openness as suggestive as possible, apart from considering the

phenomenon in its dynamic, a comparison of the data with the ones recorded by the BRIC countries was also recorded.

## 2. The openness of Romania under the context of world economy participation

In the specialized literature a series of indexes are used in order to appreciate the level in which a national economy is involved in international economic trades.

Table no. 1. The international commercial openness of Romania and BRIC countries

	Romania		Brazil		Russia		India		China	
	'89	2010	'89	2010	'89	2010	'89	2010	'89	2010
Exports mill.	11,3	57,9	37,58	233,7	-	444,7	20,0	345,1	57,1	1749,4
Imports mill.	10,0	66,3	24,2	238,7	-	325,2	24,7	418,9	58,3	1477,8
Population mill.	23,1	21,4	147,0	194,9	-	142,9	855,7	1224,6	1108,2	1318,1
Exports/capita	489,1	2705,6	255,1	1199,0	-	3111,9	23,3	281,8	51,5	1327,2
Imports/capita	432,9	3098,1	164,6	1224,7	-	2275,7	28,8	342,0	52,6	1121,1
Weight of exports in GDP	19,9	35,8	9,9	11,1	-	30,0	6,6	20,0	12,4	30,4
Weight of imports in GDP	15,5	41,0	6,4	11,4	-	21,9	8,2	24,3	12,6	25,7
International opening of the economy	35,4	76,8	16,3	22,5	-	51,9	14,8	44,3	25	56,1
GDP	56,8	161,6	375,4	2088,9	-	147,8	300,7	1722,3	459,7	5739,3

Among the most used indexes we can state:

- The weight of goods and services exports in the GDP reveals the level of dependence of the analysed country on external markets. From this point of view we can see an accentuate evolution of Romania during the interval 1989-2010, given our analysis, in the last year, we can say that our country is situated over the world average and over the numbers which are representative for BRIC countries.
- The weight of goods and services imports in the GDP, represent the dependence on external markets, both regarding assuring population consumption but also assuring the national economy with production factors. Under this aspect, in 2008 Romania overcomes the world average, but most of all overcomes the BRIC countries.

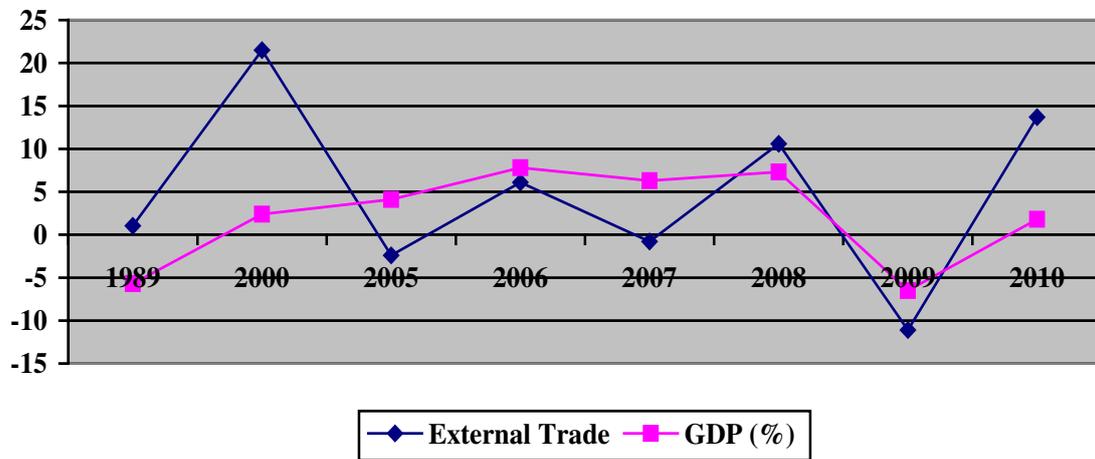
- The international opening of the economy is calculated as a weight in the GDP of the sum between imports and exports and it basically represents the dependence of a national economy on external markets. If in 1989, Romania recorded a number of 35,4% for this index, which was close to the world average, in 2010 it reached a level of 76,8%, level which is significantly higher than the levels of China (56,1%), Russia (51,9%), India (44,3%) and Brazil (22,5%). These numbers prove the major dependency of the Romanian economy on external markets and therefore the vulnerability of our country to the changes in the global economy. It is observed that Romania has been deeply anchored in the process of globalization and has recorded levels of growth inferior to those of China, Brazil and India, countries with a more reduced level of international opening of the

economy, but that are acknowledged as being the main beneficiaries of globalization.

- When reporting the growth rhythm of the external trade recorded by a country to the growth rhythm of the GDP, under the aspect of real values, emphasis the level of integration of a national economy in the global economy. This index is dependent on the liberalization of the external trade of the country in discussion, phenomenon realized through the reduction of tariff and non-tariff barriers. In the case of Romania, the evolution of external trade and of the GDP (in prices for 2005) indicate an

annual evolution with a bigger amplitude of the external commerce than the GDP. Overall, in the period 2005-2010 the average growth rate of the Romanian external trade was 2,68%, inferior to the GDP annual growth rate of 2,87%. At first sight this evolution could indicate a reduction of Romania’s participation in the world economic circuit, but we should not forget the global financial crisis which determined on a part the reduction of the Romanian GDP in 2009 with 6,5% and on the other a much more diminished 11,1% external trade of our country.

Fig no. 1 The evolution of the Romanian external trade and GDP (%)



### 3. The financial dimension of the Romanian economic openness

The level of involvement of an economy in the global economy, from the point of view of capital flows, is based mainly on foreign direct investment flows. We have to

take into account that the values regarding foreign direct investments do not make any distinctions between the capital and/or brut assets which are transferred from an investor to another and that the capital has a novelty character.

Table.no 2. Economic openness under the aspect of FDI

Indexes	World level		Romania		Brazil		Russia		India		China	
	'89	2010	'89	2010	'89	2010	'89	2010	'89	2010	'89	2010
FDI Inflows	1838,4	17950,4	-	70,0	34,2	472,5	-	423,1	1,4	197,9	17,2	578,8
FDI Outflows	1934,0	20408,2	-	1,4	40,4	180,9	-	433,6	0,1	92,4	3,6	297,6
FDI Inflows/ Capita	355	2785	-	3258	233	2424	-	2960	2	162	16	439
FDI Outflows /Capita	403	2970	-	69	275	928	-	3033	0	75	3	226
Weight of FDI Inflows in GDP	9,22	29,7	-	43,9	9,13	22,9	-	28,7	0,4	12,9	3,7	9,8

Weight of FDI Outflows in GDP	10,1	31,8	-	0,9	10,7	8,78	-	29,4	0,04	5,6	0,7	5,0
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In order to appreciate the role of direct foreign investments in the openness of the economy of a country we are taking into account the following indexes:

- The inflows of foreign direct investments per capita represent the quality of national policies promoted in the direction of attracting foreign investors and the potential of the national economy to generate profit. Regarding this index, in comparison to both the world situation and the BRIC countries, Romania is recording superior values, fact determined by the lack of national powerful investors and the massive participation of foreign capital in the process of privatization.
- The outflows of foreign direct investments per capita represent the capacity of the national economy to generate investment flows abroad. Under this aspect, Romania is recording much lower values in comparison with the analysed entities, two of which occupying the first two positions in the world (China and India).
- The net position under the aspect of foreign direct investment results from the difference between the inflows and outflows of foreign direct investments. In 2010 Romania recorded FDI inflows of 70,0 billion dollars, a huge value when compared to the FDI outflows of 1,4 billion dollars. This difference is much more neglectable in the case of BRIC countries, where we can also find an exception, Russia, where the value of foreign direct investment outflows are bigger than the value of foreign direct investment inflows.
- The weight of FDI inflows in the GDP reflects the contribution that foreign capital has in the economic development of a country. This way the national economic dependence on foreign investors is emphasized. With a weight of 43,9% in 2010, Romania is way above the world average (31,8%) and over the values of Russia (28,7%), Brazil (22,9%), India (12,9%), China (9,8%).

- The weight of FDI outflows in the GDP express the economic power of a country's multinational companies and their capacity to launch business abroad. With a value of 1% Romania is basically inexistent.

In order to appreciate the level of economic openness of a country we can also take into consideration other parameters.

The workforce migration, but most of all the inflows of remittances, represent elements which must be taken into account. It is estimated that over three million Romanians have the status of immigrant in other countries, the inflow of remittances being ranked in the top 30 annually. Moreover, the weight of remittances in the GDP is relatively important, having a value of 2,4% of the GDP in 2010.

Regarding the number of households with internet access, an increase of about 5% since 2010 was recorded in comparison to the previous year, emphasizing the increase of communication possibilities with the rest of the world. On the other hand, we must mention that Romania is ranked on the 26<sup>th</sup> position among EU countries under the aspect, Bulgaria occupying the last position.

#### 4. Conclusions:

It is obvious that in comparison with the 90's Romania is currently much more integrated in the world economy. Quantifying the phenomenon of globalization, taking into account its multidimensional character, is difficult to be done. In such a ranking, made on the basis of KOF Index of Globalization, Romania occupies the 35<sup>th</sup> position, overcoming the USA in a ranking comprising 208 states.

In the specialized literature, Romania is included in the category of ex-socialist countries which have entered the EU, being characterized as a country which has moderately taken advantage of the phenomenon of globalization.

The economic openness of Romania must be analysed from all the points of view, including the loss of sovereignty and the

negative effect generated by the contagious phenomenon of crises.

It is essential that Romania maximize the advantages offered by the globalization and reduce as much as possible the negative phenomena induced by it.

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## Authorizing the Activities With Significant Environmental Impact

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### Abstract

*Strategic environmental assessment has emerged as a precautionary measure, at the highest decision making level, because the assessment of impact at project level proved so far a quite exhaustive and weak measure and consequently, a failure. This is because of the late moment in the decision making process, when the EIA procedure is applied to projects. Thus, responses to questions raised at the highest level, such as "what kind of development should take place, where and when it should really take place" were often unsubstantiated in terms of protection environment*

**Key words:** Environment, Sustainable development, Environmental protection, Environmental permit

**J.E.L. Classification:** K 32

### 1. Introduction

What is strategic environmental assessment? It is a tool used systematically at the highest level, which facilitates very early integration of environmental considerations in decision-making process leading to the identification of specific measures to mitigate the effects and establishes a framework for further evaluation of projects in terms of environmental protection.

Strategic evaluation is applied by some countries in policies and even legislation as a method of ensuring sustainable development. In this respect, an international instrument has developed that Romania signed in Kiev in 2003, The Protocol on strategic environmental assessment - it refers to plans, programs, policies and legislation that may be subject to environmental assessment.

The National Environmental Protection Agency, a public institution with legal personality, financed entirely by the state budget, is the specialized body for the

implementation of policies and environmental legislation, under the central authority for environmental protection

### 2. Content

Environmental Assessment or "strategic environmental assessment" applies to the highest level and planning, for example in developing policies, strategies and obviously, plans and programs. In this way you can focus on the "source" of environmental impact and not "solve" the symptoms appeared after production. One of modern techniques currently used to prevent or limit harm to the environment is the obligation to obtain a special permit prior to conducting certain activities or use of products and services with ecological risk.

Public authorities, that carry the interest of protecting the environment, check the fulfillment of certain requirements, establish a series of technical and technological parameters of operation, establish a control of activities in order to protect the environment. In terms of objectives subject to authorization, the trend is that they be broad, going to the requirement of prior authorization of all facilities constructed and operated so as to avoid serious environmental harm or risk, inconvenience or disturbance to the neighborhood or community. The goal is to protect human beings, goods, fauna and flora against any environmental damage, to the extent that they may be harmed because of the activities subject to authorization, and protect against any risk, inconvenience or major disruption. At the same time concern goes to prevent any possible environmental damage. All activities hazardous to the environment, regardless of their owner (individual, corporate or non-profit) shall undergo the procedure of prior authorisation

One problem that arose was that the ratio of the new licensing system established and existing polluting activities, national laws have opted for a special exception to the rule

of retroactivity, meaning that the new mandatory authorization requirements apply to all cases prior to the new rules, so as is the case with OU no. 195/2005 modified and completed environmental protection. The specific areas considered for assessment of certain plans and programs are: spatial planning and urbanism, land use, agriculture, forestry, fisheries, transport, energy industry including quarrying minerals, waste management, water telecommunications, tourism. Environmental authorities provide information and public participation in environmental assessment procedure.

It is possible that environmental authority have other environmental information relevant to the plan or program in question, than those provided by the plan or program owner. As such, the authority is obliged to provide, where required, information and present information that is disseminated by default. The legislature considered it necessary that during the public debate of the plan / program and environmental report to participate, in addition to the environmental authorities and health authorities, also those involved in the screening stage, to allow these authorities to "take the pulse" of the public. In this way it enables those authorities to consider public comments and opinions, especially when they relate to their area of responsibility. As such, it made it compulsory to the owner to invite at public debate the aforementioned authorities. To enable effective public participation and if the plan / program may have transboundary effects, the holder is required to invite public debate competent authorities for environmental protection and health of potentially affected States, and to inform the public (in those states) affected, likely to be affected, or having an interest in decision-making about public debate. The notice shall be made through state environmental authorities likely affected, if anyone is interested in public debate, participation is permitted.

### 3. Conclusions

Most authorization systems are not designed to eliminate any pollution or risk, but rather to act against serious pollution and minimize their levels. They are considered an intermediate path between unregulated

industrial practices and absolute prohibitions.

Informing the public of regulatory procedures for plans, programs, projects and activities are carried out under specific legislation in force.

Public consultation is mandatory during procedures for issuing regulatory acts. Procedure for public participation in decision making is established by specific legislation.

Administrative authorizations are based on preliminary assessment of the environmental impact of proposed projects or activities concerned. Application of a formal authorization requirements is based on environmental impact assessment of the activities concerned, for which impact assessment is an integrated part of the licensing process and its conclusions are part of the decision granting or refusing authorization.

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## **Actions and Ideas: Building a Global Quality Culture in Education Following New Institutional Prescriptions**

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### **Abstract**

*Quality culture encompasses a more implicit consensus on what quality is and how it should be maintained and promoted. Nonetheless, this paper is based on the conviction that quality culture can be consciously promoted. The procedure of promotion described here after is based on the agreement of common goals from which indicators of success and quality measures are derived. By a conscious promotion of a common quality culture in international cooperation, potential failure of the partnership can be diminished because contradictions with existing quality cultures at partner institutions are avoided and the partnership is firmly based on common goals as the focus of cooperation.*

*Therefore a common quality culture or, more broadly, a global quality culture may emerge if the mentality of confrontation is abandoned. The single suitable rule is the cooperation. Applying this rule each step towards a global quality culture should be taken cautiously. There is need of an entire process based on intercultural dialogue. The agents of each culture should interact until the harmonization of their values, believes, standards etc. As a result, a new culture will take form which is not a mere sum of the former ones.*

**Key words:** quality culture, global intelligence, formal education

**J.E.L. Classification:** B15, B52, I25.

### **1. Introduction**

At national and regional levels the education is important for its promises for future economic growth and development.

Even the neo-institutional theories depart from the human intrinsic cognitive systems and follow all the way to the same end point: economic performance.

This is not the only way, but it is one of the most sophisticated economic demonstrations for the role played by education in the contemporary world.

### **2. The call for mentality and paradigmatic shifts**

Yet there is a growing awareness that we all are lost if continue to follow the economic way. Some global approaches to world education change the direction toward a global intelligence. That is: “the ability to understand, respond to, and work toward what is in the best interest of and will benefit all human beings and all other life on our planet. This kind of responsive understanding and action can only emerge from continuing intercultural research, dialogue, negotiation, and mutual cooperation; in other words, it is interactive, and no single national or supranational instance or authority can predetermine its outcome. Thus, global intelligence, or intercultural responsive understanding and action, is what contemporary nonlinear science calls an emergent phenomenon, involving lifelong learning processes”. [7: 3]

*How can global intelligence be acquired?*

It involves remapping traditional knowledge, accumulated and transmitted by various educational disciplines, and finally dropping out the disciplinary mentality. The global intelligence presupposes a holistic mode of thinking, a trans-disciplinary or integrative one, and also new kinds of knowledge from an intercultural perspective.

Yet, a global mode of thinking will emerge from “local” knowledge with its own historicity. Knowledge is always bound to a

specific time and place, to a specific culture or system of values and beliefs or, indeed, to a specific lifestyle. A global approach attempts to identify the cultural specificities of knowledge, explore commonalities and differences among them, and negotiate, if need be, among such specificities. It also presupposes that, in the process of exploration of cultural commonalities and differences in the way in which we acquire and utilize knowledge, new kinds of cross-cultural knowledge emerge through intercultural research, dialogue, and cooperation, and new kinds of integrative cognitive and learning processes become possible. [7: 8]

Then there is a need for designing educational models to foster the kind of local-global learning environments and intercultural, intellectual climate that are needed for sustainable human development in the next few decades.

The current educational system privileges imitation students, not creative, critical, and analytic professionals with a broad and disciplinary free understanding of society at large. The core challenge for educational institutions is to turn away from conventional lecturing to learning situations based on the search for solutions to real-life, open-ended problems. [4: 134]

Innovative education practices for sustainable human development covering all three types of education (formal, informal, and non-formal) must be encouraged. These practices will be configured to provide a good spread of activities focussing on all three pillars of sustainable development: environmental, economic and social. Their innovative character should come from mission and objectives assumed, the delivery method of educational services and the institutional frameworks.

There is a large scope for systematic and trans-national educational reform to change the current situation of powerful constellation of forces through cooperative and innovative practices.

Paradoxically, the ongoing economic determinism of development process can be counterproductive. All the demonstrations of the economic development theories formalized or not, are very interesting intellectual exercises that unfortunately bring just little long termed benefices for human

beings. Even more these benefices are not shared equally and equitable to all the people of the world. It is high time for return to natural and simple things. People always had the inclinations to struggle for survive or to cooperate for surviving. The economic institution – market is probably the most populated field of battle throughout history. Are we prepared to imagine a world in which competition is totally replaced by cooperation? And yet we wonder the project of global economy undertake only the disappearance of many types of frontiers? In market terms this means that finally we'll have a larger battle field.

This is the call for mentality and paradigmatic shifts. It should be abandoned the mentality of confrontation and look for other ways of organizing human relations, as well as our cognitive and learning processes. The shift will take place gradually, much impeded by the tendency of path dependence. This shift enhances a learning process that changes the national cultural filter and prepares the emergence of a global culture. Once such conditions installed, it will enable proliferate of global intelligence. From the paradigmatic perspective, in our opinion the neo-institutional approaches still find a place in this landscape of scientific inquire based on mutually, intercultural cooperation. A new set of economic, social and politic institutions should be crafted to guide all of our future interactions on this planet. This new rules of game borne from cooperative actions, but not confrontational selection process will naturally lead ourselves to the achievement of the final goal – that of the sustainability of human development.

### **3. Toward a quality culture in formal education**

Within the economic, social and ecological axes of human sustainable development, quality has a significant importance and represents a challenge since quality assurance in formal education has more and more come to the fore in recent years.

Quality is a multi-faceted concept, difficult to render operational in educational terms. In general, there are a number of quality concepts as regards formal education programmes. All of these are seen as relevant

and competing. In fact, there is a strong belief that a ‘one-fits-all’ concept of quality is not desirable. Instead, differentiation is much welcome in view of differences of needs and in order to match a broad spectrum of individual and economic demands.

Among the quality concepts of formal education are – just to mention only the most common ones here –, according to broadly accepted typology: quality as (a) perfection or consistency, which is linked to notion of reliability and to conformity through compliance with set standards; (b) the exceptional or excellence, which bears an element of elitism; (c) fitness for purpose, often linked to the need to address to a required reference point; (d) value for money, which is sometimes linked to the notion of value for time invested, both of which relate more closely than other definitions of quality to the quality concept of – partly rational and partly emotional – customer satisfaction; (e) transformation, considering the individual gain accrued in the course of a learning experience.

Positive definition of quality approaches are necessarily paralleled by negating or abandoning others. Here the slogans ‘from input factors to learning outcomes defined in terms of competences’ and, which is partly related when seen from the viewpoint of process and approach, ‘from teaching to learning’ and ‘student-centred learning’ come to mind. Despite profound and serious difficulties in defining the content of learning outcomes and relevant competences, in validating them, in making them operational, in installing fit-for-purpose learning devices and environments, and in measuring their accomplishment, the shift to learning outcomes and to student-centred learning rather than focussing on input and teacher perspectives has been one of the key mantras in the quality debate. However, there is still no denying of the relevance of input factors, such as qualification and numbers of staff, of equipment, or of student intake. So in practice, from case to case, there seems to be considerable ambivalence between rhetoric and traditional reality in defining and measuring quality features.

The likely key to consolidating all these approaches is that all factors need to be linked in a methodically correct manner. This is done by not taking input factors as isolated

starting points for developing and judging quality. Instead, input factors should rather be seen as elements to be considered incidentally when addressing the question as to whether or not the envisaged educational purposes could, in terms of underpinning both at the level of concept and of its subsequent implementation, feasibly be accomplished.

It clearly results that quality cannot be solely evaluated by calculating quantitative indicators, such as: the number of students per member in the teaching staff, educational spaces etc. Other specific indicators are even more important: the professional and methodological competence of the teaching staff, the cultural, ethical and social accountability of education, student satisfaction. Consequently, a quality education depends, to a large extent, by the synergic harmonization of three elements: institutional capacity, educational efficiency and quality management.

To this end, a functional emerging educational system should capitalize on the following aspects:

- educational goals, curricula, teacher competence and the efficiency of educational practices;
- educational spaces, equipment, libraries and reading rooms;
- performance criteria, standards and indicators, internal and external evaluation pertaining to such standards and causes of dysfunction;
- the amount of financial resources.

The success in setting up a “quality culture” is influenced by objective and subjective factors, by national and global trends. Some countries have set the trend and the others need to follow in their footsteps. This is about the assertion that the majority of countries have understood the expectations of the minority of leading countries in the world economic hierarchy. Each of them is just a piece in a puzzle called the Global Economy, which needs to adjust to fit in. Very much like a diligent student who learnt his/her lesson well, the governments set priority action plans which will directly impact upon the future development of the national education system.

How can such plans be accomplished? How can we achieve a global quality culture? The necessary steps are easy to set, hard to

achieve and impossible to quantify, as tangible results become visible in many years. Firstly, one should improve the quality assurance system at pre-school, primary, secondary and tertiary levels, by assisting schools to improve their management and supply relevant jobs for the labour market. Secondly, improving teaching competences and the competences of the people involved in the educational system by supporting them in their life-long learning process. Thirdly, one needs to extend the life-long learning framework by assisting the agents/suppliers of life learning education to reach the standards of quality management assurance. Fourthly, young researchers should be encouraged to develop their competence by increasing their doctoral and post-doctoral educational opportunities. This enumeration can continue indefinitely. It will be interesting to note, however, whether such desires, expectations and actions pertaining to a “quality culture” will ever take effect in a national culture. In retrospect, forthcoming generations will easily solve this problem.

For the time being, the majority of countries are currently importing patterns and solutions created by developed countries. Although quality assurance activities have not had a long tradition worldwide, some countries or groups of countries have obtained worthwhile results. Therefore, the mission lies in promoting “compatible quality assurance systems” meant to render national education internationally recognized. In more concrete terms, we need to set in motion a mechanism meant to ensure that educational establishments observe national and international quality assurance standards. To this end, quality assurance strategies mirror the ability of an educational supplier to be accountable to internal clients (pupils, students, teaching staff) and external agents (employers, society) and ensure that standards are met. This quality assurance becomes an important factor in the invisible competition between nations in terms of culture and education.

Consequently, judging by the promise of progress it delivers, we consider that the implementation of a quality assurance system is necessary, yet far from being accessible, due to certain specificities: the school is not a factory, students are not goods/commodities, there are multiple clients (students, parents,

employers, the society) and so one cannot identify precisely all the elements of a manufacturing process. Despite such specificities, quality management can be functional in education as well. The educational process can be improved, teaching efficiency can enhance and teacher/student satisfaction can increase. Quality management stands for a different way to organize and harmonize efforts so as to ensure that people fulfill their tasks enthusiastically and actively contribute to improving their techniques. It might look rather impossible, yet practice provides us with plenty success stories for this type of management. To increase the chances of success, one needs to observe a simple principle - the process should prevail over the product. Such management will capitalize on the learning process as such, rather than on the results evinced by tests and examinations. From this perspective, the human factor is in the foreground again, and we consider that the weak spot which management should address is individual attitude towards the educational process. We need to consider that both the student and the teacher act and interact under complex incentive structures. We need to identify those mechanisms to induce perceptions and values meant to ensure the quality of the teaching activity. Quality culture derives from this; it stands for cooperation and responsibility.

#### **4. Conclusions**

Educational discourse is replete with references to the process of building a quality culture inside the educational system. In particular, the issue of educational quality has become an area of great interest and concern due to the conviction that education plays a pivotal role in global economy sustainable development. In choosing to investigate continuity and change surrounding learning process, the questions rely on the contextual and evolving character of the process. The ideas elaborated in this chapter point to the fact that education is a “path dependence” phenomenon. Knowledge acquisition is underlain by perceptions derived from the process of collective learning across generations. The act of learning is a cumulative process subject to social and cultural filtration. The overall

social approach to the benefits of expanding knowledge (in various stages of historical development) is the major source of long term change. Likewise, educational improvements are dependent on the features of social institutions and the institutions are variables strictly influenced by the level of education. Hence social institutions are likely to become inertial to change. How can one overcome this obstacle? Economics can provide at least one solution: joining the efforts of researchers coming from different economic areas can lead to worthwhile progress with respect to unveiling the causes and mechanisms of change. Thus, progressing onto a continual ladder of discovery and learning, horizons will broaden, and the prevailing patterns of thinking and perception will become more flexible.

The distinctiveness between formal, non-formal and informal education determines a shift in focus. Learning is a culturally – filtered and cumulative process. Most reforms should be targeted at informal education. The pre-school, primary, secondary and tertiary levels of education form a complex edifice which needs to be built in gradual stages.

Meeting international quality assurance standards is not against this principle; on the contrary, it is quite compatible. It will make us aware that we are in competition with other participants/players worldwide and only quality players win. According to the guidelines developed by this paper, the authentic and enduring progress in the quality formal education is only triggered by reforms targeted at informal aspects pertaining to the national institutional paradigm. This is the unique way to create a real global quality culture: the continuity of national specific reforms and the gradual change towards “universal” values imposed by the winners of global competition.

The global quality culture is fully compatible with the global intelligence. One emerges as a result of the other. This is the supreme stage, but we haven’t reached that point yet. For the moment we could speak mainly about different national quality cultures and common quality cultures of joint educational programmes. Some steps are made toward the global quality culture, but in the light of neo-institutionalism, they are

illusory because even the international standardization of education is just a formal initiative. Merging standards and processes doubled by the promotion of intercultural enquiry especially through non-formal/informal education will conduct us to a global culture, in general, and a global educational culture, in particular.

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## Structural Implications of Economic Crisis on Container Throughput. Evidences from Port of Constanta

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### Abstract

*Ports have become a key element of modern supply chains through the important role they play in coordinating material and informational flows. However, because of the fixed nature of port assets, they can rarely control the supply chains dynamics, which are most often affected by the strategies of other players in the network. In this context, we try to explain the adverse effects of the economic crisis on the container traffic volume in the Port of Constanta, one of the hardest hit European port, on this segment of traffic.*

**Key words:** Seaport, Economic Crisis, Supply Chain, Port of Constanta, Container.

**JEL Classification:** R41, L91, L14, O14.

### 1. Introduction

In late 2003, the most advanced container terminal in the Black Sea basin and Eastern Mediterranean region came into operation in Port of Constanta. The results did not wait to appear, the throughput of containers in Port of Constanta (summation of all containers handled by a port either as imports, exports or transshipment) increasing in 2004 with 104.17%, compared to 2003. Increases continued until 2007, when the peak of the throughput for containerized shipping was obtained. During this period, the proportion that this type of throughput recorded of all operating activities increased from 3% in 2003, up to 22% in 2007. Between 2007 and 2008, for this type of cargo, Port of Constanta managed to be on an unexpected 16th place in the top of the European ports, surpassing many with a background in handling containers and which were enjoying a much more developed hinterland in terms

of infrastructure and were positioned near major shipping routes. With the onset of the economic crisis in 2008, Port of Constanta was a direct hit, with an overall traffic drop of 32% in 2009, but managing to return on a 13.2% increase in 2010 compared to 2009.

On the container segment in 2009 the decline was much steeper, registering a deficit of approximately 55% of the volume of 2008, and continuing in 2010 with another 0.17% deficit relatively to 2009.

This decrease is unusual if we relate it to generic performance indicators of the Port of Constanta (total transfers and total cargo ships operated) and of the Romanian economy - Constanta Port's main hinterland. The new circumstance takes a dramatic dimension when analyzing the throughput of containers from the Romanian port in the context of European ports. Thus, on this transfer segment, Port of Constanta dropped in 2009 from number 16 to number 23, followed in 2010 by losing of another position up to 24th (according to [1]). However, even more surprising is that the rate of traffic loss of 55%, ranks Port of Constanta first in this respect from the 39 analyzed European ports. Also, in 2010, only 7 of the 39 analyzed ports failed to increase the volume of container handled, Port of Constanta being among them.

To find an answer to the problem of decreasing container throughput in the Port of Constanta, once the effects of the economic crisis of 2008 triggered, we will have to go beyond port boundaries and analyze changes in the port industry before the economic crisis, stressing the importance that container traffic has in modern supply chains.

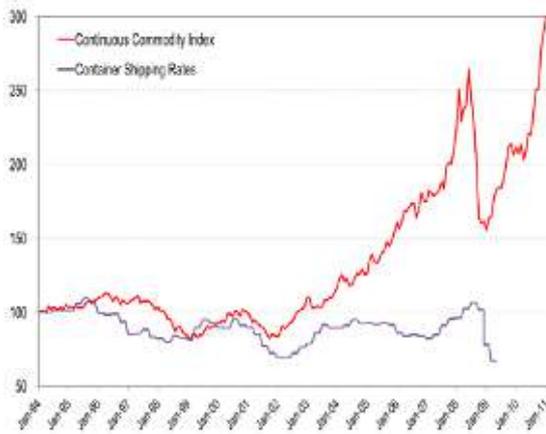
Thus, in this paper we examine the role played by containerization in supply chains and the tendency of integration in these networks, first of the shipping lines and

second of the port terminal operators. Secondly, we analyze the effects of the economic crisis on the two major players (shipping lines and terminal operators) in the supply chains and how they responded. Part 3 will be devoted to analyzing the effects on the containers throughput in Port of Constanta in the context of global industrial change mentioned in previous sections. In the final section we draw the conclusions of this research on new problems that the financial crisis has revealed.

## 2. Containerization and supply chains

Containerized cargo movement is a result of manufactured goods and subassemblies transported from supply to retail markets. Between these locations there is a whole range of distribution activities managed in, terminals and distribution centers. Spatial distribution flexibility and efficiency were the two attributes that have supplied mobility to containerized goods, driving the development of global production and distribution networks ([2], [3]). With increasing proportion of containerized cargo, this transport type has become cheaper, as Figure 1 shows.

Figure 1: Continuous Commodity Index and



Average Container Shipp. Rates, 1994-2011  
Source: [4]

Container shipping rates were obtained by calculating the un-weighted average rates for the shipping of one containerized freight unit (one TEU) on four major sea transport routes (Asia-USA, USA-Asia, Asia-Europe, Europe-Asia). CRB Index or Continuous Commodity Index (CCI) is a composite index of futures prices of 19 basic commodities, with different shares in the index. It was developed by the Commodity Research

Bureau in 1957 and is one of the most cited indicators of overall commodity prices. The decline of container shipping rates between 1995 and 2002 is due to the effects of economies of scale that have reached maturity in container shipping.

Even if, in the same period Continuous Commodity Index also shows a similar trend, starting with 2002, this index is at a rising trend, while the rates for containers shipping are continuing the downward trend. Thus, if we compare the evolution of the value of goods to the cost of transport per TEU, we note that container transport has become more convenient, even after severe corrections occurred in 2008-2009.

With the increase of containerized transport, the container has become a distribution unit, which has led to radical changes in the distribution of goods, focusing on time-based management strategies, the most stricken example being given by the implementation of *Just in Time* models of production and distribution ([5], [6]). The concept behind this strategy is simple - the shorter the transit time, the lower the inventory level, hence, significant cost reductions.

Although this concept has proved his utility in a boom period, his usage on a large scale reducing inventory costs and increasing the speed of deliveries, we will show on what follows that, faced with a crisis of overcapacity, result of the recession started in 2008, shorter transit time was not the rule who guided the actors in the supply chain.

## 3. New roles for freight shipping lines in distribution systems

The intermodalism resulted from the high grade of mobility of containerized cargo, but also the elements which have led to the success of container transport (including relocation of global output amid globalization of economic activity), have changed the perception on maritime shipping.

Therefore, this service is no longer viewed in terms of its attributes on a specific commercial route (trust, capacity, speed), but rather by the coverage of increasingly diverse logistics services, integrated in a distribution network. According to [7], shipping companies' response to the new challenges induced by the dynamics of the international

economic environment that evolved after the year 2000 was made on three main issues.

First, the growing needs of shippers to access supply and retail markets using an increasingly lower number of carriers in the distribution system were confronted by the maritime carriers' offer of transportation services provided on a wider geographical area.

Second, as shippers have sought to integrate and improve supply chain performance, maritime carriers had to widen the range of services offered, this generating in turn, a number of issues relating to the organizational integration that had to be established between various services provided.

Third, maritime shipping lines had to find new ways to reduce costs, this actually meant effort to achieve economies of scale and scope, key dimensions of business in any industrial network. Systematic confrontation with these three problems turned the industry of maritime shipping lines from one that addressed the costs from a ship-based perspective into one where the cost approach is made through a network perspective.

In a transport industry already dominated by high capacity ships, mergers, acquisitions and strategic alliances, cost reduction potential at sea becomes increasingly small, pressure to detect new sources of reduction - in the field of landside logistics, was increased. In addition to considerations of costs and revenues, the pull force of the market demand is the main force that drives the carriers to integrate services across commodity chains ([2]).

#### **4. Ports integration in global supply chains**

Ports are complex organizations made up of several parts in which various institutions and functions are intersecting at different levels. As integrated supply chain management is at the epicenter of the business transformations from the last decade ([8]), more companies surpass the boundaries established between internal company functions and even the company itself and key partners in the supply chain (customers, distributors, suppliers, carriers etc.). One of the main purposes of such an approach is the agglomeration of all the actors in the supply chain in a common platform characterized by

logistical transactions and information systems.

Viewed in this sense, competition is no longer held between individual firms as autonomous entities, but rather as supply chains. According to [9], supply chain is a network of organizations that, through connections upstream and downstream, produce value in providing products or services to the final consumer. According to [10] supply chain can be defined as a set of companies that facilitate the advance of goods.

As transportation is an integral part of the supply chain, ports have become a key element, through the important role they play in coordinating material and informational flows in the supply chain ([8], [11], [12], [13], [14]). Therefore, they have evolved from the traditional function of facilitating the loading /unloading of ships, turning into a connection interface of wider logistics chains due to the fact that through their location, they are ideal points for positioning logistics services that add value to goods in transit, thus facilitating the meeting and interaction of members coming from different transport channels.

Although operating terminals are key elements of supply chains, rarely they can hold the control in this network of organizations. This is primarily due to the fixed nature of port property assets compared with the dynamic environment in which they operate. According to the study of [12], in terms of issues of cooperation and networking channels, port terminal operators are seen only in the 5th place as importance among supply chain actors, first topping shipping lines ([12] - p.59). The results of this study underlines the fragility of the place occupied by terminals operating in the supply chain, explaining to some extent why a large number of operating terminals have been more seriously hit by economic crisis installed in 2008, than their counterparts in the supply chain.

#### **5. Structural implications of the economic crisis on the supply chain actors**

With the falling of the world trade, seaborne cargo volumes have experienced a serious decline, the overall decrease in shipping activity in 2009 being 20% lower

than in 2008. As an immediate consequence, ships began to sail with unusually low load factors, shipping rates recording unexpected decreases.

The financial crisis caused by the credit crunch of 2008 determined a crisis of overcapacity in the shipping industry. If before 2008, the main problem facing the maritime industry was finding funding for development of infrastructure necessary for the increasing flow of container traffic and eliminating the congestion effects, after 2008 the situation reversed, all shipping lines and terminal operating companies facing an acute underutilization of existing capacities.

According to [15], against the crisis of overcapacity faced by shipping lines in 2008-2009, the measures taken were aimed mainly at increasing cost savings. They consisted of: closing secondary routes in order to concentrate freight volumes on main routes, increasing transportation strategic partnerships, giving up the chartered ships, reducing logistics and port costs and optimization of capacities in line with transport demands.

On the other hand, [16] argues that the first step of shipping lines to reduce costs, was the delaying of construction of ships already ordered, action combined with the removal from service of obsolete ships. In 2009, the world fleet that was idle reached the figure of 1.3 million TEUs, or 10.4% of the total fleet of container vessels ([17]). The most affected shipping route was Far East-Europe. On this route, the maritime shipping lines have drastically reduced their transport services due to the downturn in demand, the total capacity decrease occurred between October 2008 and March 2009, being of 21% (Table 1).

Table 1: Far East-Europe capacity Situation

	October 2008	March 2009	% Change
Total no. of weekly services (North Europe/Mediterranean)	64 (36/28)	45 (26/19)	-30%
Total ships deployed	549	406	-26%
Total capacity (TEU)	3.58 million	2.97 million	-17%
Average weekly capacity (TEU)	405,90	319,30	-21%

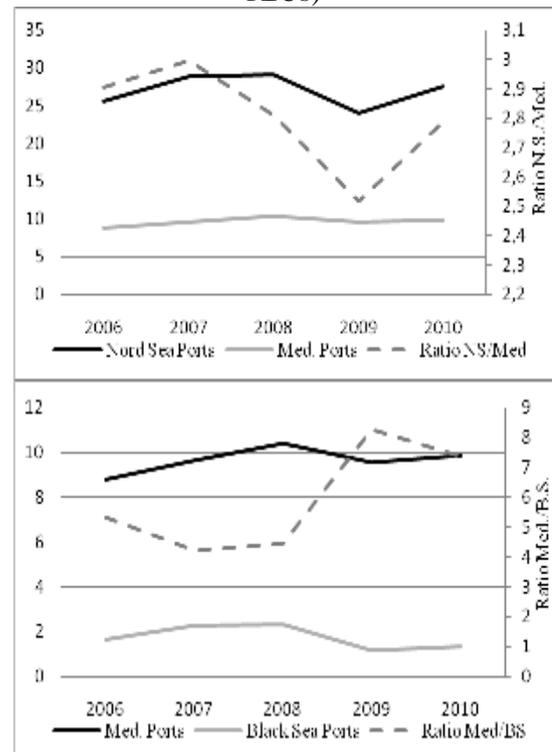
Source: Author, based on [16]

Following the substantial decrease in demand for transport registered on Far East-Europe trade route, maritime shipping lines have tried to absorb some of the existing transport overcapacity by lowering the transport speed of ships, coupled with changing the pattern of routes. Thus, in early 2009, a significant part of shipping lines covering this route, have opted to avoid transiting the Suez Canal on their way to European ports, altering their route around the Cape of Good Hope, South Africa.

The change was made only for the eastbound leg of the route, due to considerations related to lower tariffs for this purpose, the low price of bunker fuel in early 2009, but also in the context of the purpose to absorb excess capacity by increasing travel time.

Changing strategies of shipping lines had a domino effect on the throughput registered by the sea ports, the next link in the supply chain (Fig.4).

Figure 2: Comparative traffic of the first three Nord Sea, Mediterranean and Black Sea Ports 2006-2010 (left axis – in million TEUs)



Source: Author, based on data from [1]

For the realization of the chart, the annual container traffic (expressed in TEUs) was summarized for the first three ports (chosen according to the throughput level), in each of the specified areas. Thus, for the North Sea

were considered the ports of Rotterdam, Antwerp and Hamburg, for the Mediterranean Sea, the ports of Valencia, Algeciras and Gioia Tauro and for the Black Sea, the ports of Constanta, Odessa and Novorossiysk.

Analyzing the evolution of the two ratios - Nord Sea/Mediterranean throughput and Mediterranean/Black Sea throughput, we note that the changing strategies of shipping lines led to a redistribution of container traffic in the three studied areas. Thus, in the first quadrant we see that since mid 2009, the equalization trend of trade between the two regions started in 2007 is discontinued abruptly, because some of the lost traffic in 2008 was recovered by the ports of North Sea, on account of the Mediterranean ones.

In the second quadrant, we note that traffic is evolving simultaneously in both areas, at a change in activity in the Mediterranean ports, Black Sea ports responding in the same direction and in a larger proportion. This is a normal phenomenon, given that most shipping lines entering in the Black Sea, have crossed the Mediterranean coming from Far East, and have made at least a call at a port from this region. After the evolution of the two ratios, the first with an ascending trend for the North Sea ports, the second for the Mediterranean ports, we observe a tendency towards concentration of traffic in major ports - traditional hubs, highly integrated in supply chains, as opposed to smaller ports.

This trend manifests itself amid the maritime shipping lines transport strategy to abandon the secondary routes and to avoid additional expenses of port fees.

## **6. The case of Port of Constanta**

Port of Constanta is the largest port at the Black Sea and one of the largest ports in Eastern Mediterranean basin. If until the year 2004, container throughput in Port of Constanta reached modest proportions, with the development of a new container terminal and the long-term lease of this facility by an international terminal operator company, the container throughput has seen spectacular growth rates, reaching as far as 104.17%/year (source: [18]).

Shortly after the opening of the new terminal, Constanta Port has become a regional distribution center of containers in

the Black Sea basin, reaching in 2007 an throughput of containers with approx. 40% higher than the throughput made by the following two ports combined (Odessa and Novorossiysk, According to [1]).

Thus, shipping lines that connected markets in Ukraine, Bulgaria and Georgia with Far East were using port of Constanta in a hub and spoke system ([19]). The containers brought from Far East with large capacity vessels (mother vessels) were distributed from the Port of Constanta to other Black Sea ports, with smaller vessels (feeders), which in turn brought containerized goods and empty containers for export to the Far East area. Thereby, by occupying a focal point on a secondary route, the port of Constanta was integrated into a network of logistic chains, becoming a junction point of it.

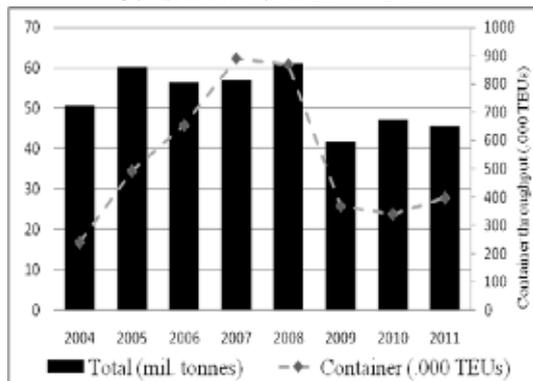
With the beginning of economic crisis in 2008, one of the first cost-cutting actions taken by container shipping lines was giving up at secondary routes and focus on main ones, so that the ports situated in the center of the Mediterranean basin, within a relatively small distance to the exit of the Suez Canal, became the terminus point for many ships that before were advancing into the Black Sea.

Another action taken by the shipping lines, with repercussions for the container traffic in the Black Sea was the changing of the eastbound leg of the commercial route Far East-Europe.

Thus they were not transiting the Suez Canal in the return voyage anymore, using instead the alternative route around the Cape of Good Hope in South African continent.

This action had the effects of concentrating a large part of commercial traffic on this route in the northern ports, as well as those located in the western Mediterranean. The concerted effect of both actions was a drop in container throughput in Port of Constanta in 2009 by 55% compared to 2008, while the throughput of other cargoes was down by 26% (Figure 5).

Figure 5: Total vs. Container throughput in Constanta Port: 2004-2011



Source: Author, based on various sources

The main explanation for the decrease in the volume of container throughput is given by the loss of transit traffic, the port of Constanta being no longer a regional center for distribution of containers in the Black Sea basin, rank lost in the benefit of Mediterranean ports, positioned near the main trade route Far East-Europe.

## 7. Conclusions

On the background of reorganization of shipping logistics activities occurred in the last decade, the immediate impact of the crisis was unexpected and stunning, transforming container transportation and handling capacities shortages in overcapacity in just a few months. Concepts that led to the development of the entire logistics system based on the container - the shorter the transit time, the lower the inventory level, hence significant cost reduction was the first sacrificed to maintain a minimum load of the ships and equipment now over-abundant. Maritime trade routes were limited by removing the secondary ones, keeping only the routes linking the best integrated ports in supply chains.

Effects of the first phase of economic imbalance on international supply system did not hesitate to appear in Romania, Port of Constanta registering the highest drop in container throughput in the first 39 ports of Europe. This reduction in container throughput is synonymous with loss of the status of regional platform for distribution of containerized cargo in the Black Sea basin, Port of Constanta coming in this first phase of the economic crisis out of the sight of the

major shipping lines linking Far East to Europe.

In the context of the post-crisis adjustments, in which the overcapacity problems will be overcome, the long-term effects are significant for maritime ports in general and Port of Constanta in particular, being linked especially with the way in which supply chains will resize and change their patterns. Judging by the extent and persistence of declines in container throughput, the port of Constanta post-crisis adjustments seem to have more of a paradigm shift than a temporary correction.

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## Influence of the Changes Brought by INCOTERMS 2010 to International Trade

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### Abstract

*This article examines the changes that have occurred in international trade terms – INCOTERMS 2010.*

*The authors make an analysis of the changes and the new clauses in international trade and divide these into two broad categories: structural changes and conceptual changes.*

*In this analysis we present an exhaustive approach, taking into account developments of International Commercial Terms from its first edition in 1936 to the latest revision in 2010.*

**Key words:** International Commercial Terms, domestic trade, clauses, DAT, DAP.

**J.E.L. Classification:** M16

### 1. Introduction

The complexity of the problems related to negotiating and signing goods sales contracts results in a special care while selecting and including the more favourable terms in these contracts for both the seller and the buyer. Some of these terms are specifically agreed upon, others are chosen from those used in the current, integrated practice of international trade.

### 2. The significance and evolution of the INCOTERMS delivery terms

**The delivery term** is one of the essential terms of the international trade contract, thereby specifying, in fact, the place and time in which takes place **the costs and risk transfer** from seller to buyer, including the

legal and economic consequences generated.[1]

The delivery term does not refer to the moment of transferring the ownership of goods, which is generally determined by the date of payment.

Given that the implementation of each specification, from the different ways of delivering the goods, represents costs that are not negligible; their inclusion in the contract must be clearly stated. To this end and to contribute to simplifying the negotiation and the conclusion of the commercial contracts, even since 1928, the International Chamber of Commerce of Paris has developed a number of 6 delivery terms (terms of trade) and laid the foundation of certain interpretation uniform rules of the international sales principles.

This was imposed by the fact that, in the interwar period, international trade and especially the transatlantic one have experienced extraordinary development. In the international trade practice there were some customs, but they did not have the same meaning for the traders from different countries. Thus, FOB for a trader in the UK means that the seller fulfils his/her obligations when loading the cargo on the ship in the port of embarkation and the trader in the U.S. could interpret FOB as the clause obligating the seller not only to load the cargo on the ship in the port of embarkation, but also to pay the freight to the port of destination. The difference in interpretation arises because it refers only to some practices which were not mentioned in writing.

In 1923 the International Court of Arbitration was created near the International Chamber of Commerce of Paris. It was

responsible for resolving the disputes arising between the participants in international trade. The different interpretation of the logistics practices in international trade has conditioned the steadily and galloping increase of the number of complaints to the International Court of Arbitration. Thus, the International Chamber of Commerce was forced to intervene and put on paper the customs relating to the transport of goods in international trade. Thus, in 1936 the international trade terms known as **INCOTERMS** (International Commercial Terms) were published for the first time and the traders, referring to one of these terms cannot interpret the rights and obligations other than as required by the International Chamber of Commerce. It is often wrongly considered that the INCOTERMS rules could replace the national laws governing the business operations in each country. They act only in contracts for carrying out transport operations.[2] In other words, INCOTERMS represent a set of rules that govern and describe the rights and obligations of the parties participating in international trade.

Since 1936 until today INCOTERMS have been revised seven times, approximately once every 10 years (in 1953, 1967, 1976, 1980, 1990, 2000 and 2010). The last review took place in 2010, being the subject of Publication no. 715 of the International Chamber of Commerce in Paris. It came into force on January 1, 2011 both nationally and internationally, marking a new beginning in international trade. However, the contracts signed before January 1, 2011 and which refer to INCOTERMS 2000 will be completed under the old provisions of the international trade terms.

**INCOTERMS 1936** contained eight delivery terms (EXW - ExWorks, FOR - Franco wagon, FAS - Free alongside ship, FOB - Free on board, C&F - Cost and freight, CIF - Cost, insurance and freight, EXQ - Ex quai, EXS - Ex ship). They have been changed to 13 in **INCOTERMS 2000** (EXW - ExWorks, FCA - Free carrier, FAS - Free alongside ship, FOB - Free on board, CFR - Cost and freight, CIF - Cost, insurance and freight, CPT - Carriage paid to, CIP - Carriage and insurance paid, DAF - Delivery at frontier, DES - Delivered ex ship, DEQ - Delivered ex quai, DDU - Delivered duty unpaid, DDP - Delivered

duty paid) and to 11 in **INCOTERMS 2010** (EXW - ExWorks, FCA - Free carrier, FAS - Free alongside ship, FOB - Free on board, CFR - Cost and freight, CIF - Cost, insurance and freight, CPT - Carriage paid to, CIP - Carriage and insurance paid, DAT - Delivered at terminal, DAP - Delivered at place, DDP - Delivered duty paid).

As legal power, these rules are optional; applying only if the parties have made express reference in the contract to a certain INCOTERMS rule. INCOTERMS rules were created to avoid any disputes that may arise as a result of the fact that the contracting parties are not aware of the different business practices in force in their partners' countries. The scope of INCOTERMS is limited to the issues related to the sales contract rights and obligations and to the delivery of the goods sold.

**The advantages** of using the INCOTERMS delivery terms are the following:

- saving contractual time and space – the parties instead of negotiating the content of the sales contract and the obligations of the seller and of the buyer, only negotiate the type of sale, namely the INCOTERMS rule they intend to apply;
- safety of the transaction; no matter how well the parties negotiate such a contract, they cannot eliminate the risk of inconsistency between the different provisions. INCOTERMS rules, being the work of specialists, totally eliminate these risks.

There are several reasons that justify the changing of the terms of international trade in 2010. The first argument is a new reality of the EU countries which no longer have borders for the movement of capital, goods and people. Thus the trade between, for example, Germany and the Czech Republic is not an international one anymore but a “domestic” (internal) one. Another argument in favour of the new edition of INCOTERMS is the need to adapt the language and the terms to the new realities of information technology. Thus, the new review takes into account electronic commerce and electronic billing and data transfer (Electronic Data Interchange). The changes in transportation practices, which are increasingly combined, used to lead to disputes and difficulties in interpreting the INCOTERMS 2000

rules. Thus, a new edition of these clauses eliminates these ambiguities. Terrorist attacks, becoming more frequent, condition a better security and monitoring of the freight transport, INCOTERMS 2010 managing to better comply with this reality. Another argument adds to the ones already mentioned, namely that of the usage because many of the Incoterms 2000 clauses were not used in practice.

The new delivery conditions defined by INCOTERMS 2010 clearly establish the obligations of the parties, thus reducing the risk of legal disputes between the parties. The variety of the goods subject to international transactions, the new methods and transportation technologies, the business practices and the national and international ports give a general character to INCOTERMS 2010, which allows their application in all cases with the help of additional provisions expressly stipulated by the partners in the international sales contracts. In addition to the 11 rules, Incoterms 2010 includes:

- Extensive guidance notes and illustrative graphics to help users efficiently choose the right rule for each transaction;
- New classification to help choose the most suitable rule in relation to the mode of transport;
- Advice for the use of electronic procedures;
- Information on security-related clearances for shipments;
- Advice for the use of Incoterms 2010 in domestic trade. [7]

### 3. Changes in INCOTERMS 2010

Compared with INCOTERMS 2000, INCOTERMS 2010 has undergone major changes, both conceptual and structural.

The main **structural changes** made by INCOTERMS 2010 are the following:

- reducing the clauses from 13 to 11 (Figures 1 and 2);
- within group D, out of five clauses only one remains, DDP (Delivered Duty Paid), and two other ones undergo radical changes. The DAF, DES, DDU clauses are replaced by DAP (Delivered at Place)

and DEQ by DAT (Delivered at Terminal). The two new clauses shall be applied to all modes of transport and they have the following meaning:

#### **DAP – Delivered at place – Delivered undischarged and unpaid upon import in named place of destination**

The seller shall bear all costs and risks for the delivery of the goods to the named place, the buyer assuming the costs and risks of discharging the cargo and the customs formalities to import it. [6]

Intrastat - Acquisitions: The value of transportation is subtracted from the Romanian border to the point of destination. Statistical value < Invoiced value

Intrastat - Deliveries: The amount of transport is subtracted from the point of dispatch to the Romanian border. Statistical value < Invoiced value. [8]

#### **DAT – Delivered at the terminal - Delivered unloaded and without clearance to import at named terminal**

The seller shall bear all costs and risks for delivery and unloading the goods at the named terminal, but not the import customs formalities. The terminal means any place, such as quay, warehouse, street, railroad terminal, CFR terminal. [6]

Intrastat - Acquisitions: The value of the transport from the Romanian border is subtracted until the point of destination. Statistical value < Invoiced value

Intrastat - Deliveries: The value of transport from point of dispatch is subtracted until the Romanian border. Statistical value < Invoiced value.[8]

- another change, which is at the intersection of the notions of structure and concept, refers to the adjustment of the trade terms to the realities of technological progress. Thus, electronic invoices and electronic signatures are recognized and may provide evidence in settling disputes, furthermore, the language itself of INCOTERMS 2010 aims at using the electronic interfaces in international trade.

**The conceptual changes** made by INCOTERMS 2010 are the following:

- INCOTERMS 2010 clauses are no longer only international trade clauses, but also



Although they were not designed to provide guidance on revenue recognition, INCOTERMS 2010 rules can be used to identify whether the revenue acknowledgment criteria are met or not (table 1).

*Table 1. The relationship between INCOTERMS 2010 rules and the acknowledgment of revenue and expenditure*

INCOTERMS 2010	Acknowledgment of revenue and expenditure
<i>All types of transport</i>	
EXW	When the products are available to the buyer and all the other terms for acknowledgment of the bill and of the sales on hold were met. If the billing and storage conditions are not met, the revenue is not acknowledged until the buyer pick up the goods.
FCA	When the products are cleared for export: - if the named place is the seller's warehouse/factory, then the revenue is acknowledged when the products are loaded for transport to that place; - otherwise, the revenue is acknowledged when the seller delivers the goods to the place specified.
CPT	When the products are delivered to the carrier employed by the seller, cleared for export.
CIP	When the products are delivered to the carrier employed by the seller, cleared for export and with complete insurance.
DAT	When the products are unloaded from the means of transport to the named terminal.
DAP	When the products are unloaded from the means of transport at the named

	place.
DDP	When the products have been delivered at the named place and have been cleared for import.
<b>Waterway Shipping</b>	
FAS	When the products are shipped over the ship in the port of embarkation and they are cleared for export.
FOB	When the products are loaded on the ship in the port of embarkation and they are cleared for export.
CFR	The revenue is acknowledged when the products have been loaded on board, they are cleared for export and the seller has contracted the transportation expense is acknowledged on the same date on which the acknowledgment of the revenue takes place, even if the transportation bill was not received.
CIF	The revenue is acknowledged when the products have been loaded on board, they are cleared for export and the seller has contracted the transport and insurance. The transport and insurance expense is acknowledged on the same date on which the acknowledgment of the revenue takes place, even if the transportation bill and/or insurance reimbursement were not received.

Source: [http://www.avocatnet.ro/content/articles/id\\_27883/Influenta-regulilor-INCOTERMS-asupra-contabilitatii-si-fiscalitatii.html](http://www.avocatnet.ro/content/articles/id_27883/Influenta-regulilor-INCOTERMS-asupra-contabilitatii-si-fiscalitatii.html)

From the fiscal point of view, INCOTERMS rules are particularly important for **triangular operations**. Thus,

in order to benefit from the simplification measures for these operations, one of the conditions is that the relationship of transportation of goods from the first Member State to the third Member State exists between supplier and reseller purchaser, either of them being likely to be responsible for the transport of goods, in accordance with INCOTERMS 2010 or in accordance with the contractual provisions. If the transport is covered by the beneficiary of the delivery, the simplification measures for the triangulation operations are not applicable. Therefore, if the application of the simplification measures in a triangular operation is desired, the use of INCOTERMS rules: EXW, FCA, FAS and FOB is not recommended.

## 5. Conclusions

In conclusion, we can say that the new structural and conceptual changes that the INCOTERMS 2010 delivery terms have undergone make them easier for use by traders, contributing to the ease of the business language.

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## The Anglo – Saxon Space in the Context of Globalization

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### Abstract

*The present work aims at presenting the impact of the Anglo-Saxon Space over the complex process of globalization.*

*The basic nucleus of this is Great Britain which, was successively, by colonial conquests, transformed into a vast Empire with a big hegemonic power. Its influence sphere was generated, inclusively, by the Industrial Revolution, by the capital accumulation and by the extension of trade and centralized markets. We must neither neglect the civilization elements with influence over the life – styles of the peoples from their former colonies. In the meantime, the British citizens obtained themselves affiliation reflexes with the peoples from the colonies.*

*The phenomenon of the Empire’s becoming lasted till the Second War when, following the newly constituted force reports, the supremacy began by the conquer of U.S.A. Presently, it is “de facto” successor of Great Britain, imposed by the “exceptionalist” with promoting, by assumes the legitimacy of imposing its own values at a planetary scale.*

**Key concepts:** globalization, colonialism, hegemonical power, civilization, “exceptionalist” myth

**J.E.L. classification:** F00 - General

### Introduction

This present work aims at analyzing the impact of the Anglo – Saxon space over the globalization process.

By its proportion, it seems to be the essential premise of valorizing the welfare chances for more and more peoples from all the continents.

In this context, we must neither neglect the fact that this process was constituted and matured in an organic way, as a result of the multiple changes succeeding at the scale of the history. It’s everywhere recognized the fact that this process may be studied by considering the necessity of identifying the economical and geographical nucleus of Great Britain and, then, of the British Empire. So, the Anglo-Saxon space extinction at a planetary scale is the result of an evolutive process unrolled over a few steps: the colonial conquests, the commercial treaties, the industrial revolution.

Then, the second world war marks the beginning of the British Empire unweaving, generated by the independence conquests by the colonies, at which we may add the modernization process determined by the international trade, technical progress and the post – industrial revolution. The Anglo-Saxon Space is still representing the principal link by which the specific culture and civilization elements are transmitted, situation which confirms the hegemonical power of Great Britain, with a big impact over the peoples’ daily life.

Nowadays, we are present at a taking of the influence sphere by USA which, in the meantime, it conquered the big power role. This situation is confirmed by the American multinationals proportion and extinction over the world.

### I. Historical and geographical references

Approaching globalization as a functional reality of the post-capitalist society by which the possibilities of valuing the chances of prosperity and civilization are multiplied for more peoples, firstly imposes the identification and the analysis of the factors that determined its growing and maturity. Though it seems as imposed by force process

which no one can refuse and which generates a relatively standardization of current life<sup>1</sup>, its complexity is given by the differences between nations, concerning traditions, cutumes, cultural, economical and political values and juridical systems.

The present work aims at understanding the evolutive process of globalization by identifying the economical and geographical nucleus and of the factors that determined its extension as well as the assimilation process at the world scale. The historical, economical and political research has it that the main part of the above mention phenomenon was played by the British Empire. The central point of this phenomenon is Great Britain, nominated for the first time during Queen Ann' s reign (1702)<sup>2</sup> by the union of England and Scotland. From this moment, both countries were having the same monarch the same parliament customs and trade laws. It is presently the largest island of Europe, made up of England, Scotland, Wales and Northern Ireland – they all make the United Kingdom of Great Britain and Northern Ireland (the name of Great Britain is used with reference to the whole United Kingdom)<sup>3</sup>.

The military forces contributed to the founding of the British Empire when they intervned into the Colonial War from 1655<sup>4</sup> and Jamaica was firstly conquered by Spain. Then, during the XVII<sup>th</sup> and XVIII<sup>th</sup> centuries, it was taken back by the English, who were interested in trade by practising a colonial conquering policy.

The appearance of the Second Empire takes place at the end of the XVIII<sup>th</sup> century, by conquering the colonies from India and Australia, followed by the colonies from Canada, China and Tibet. Then, a considerable surface from Africa, was colonized - the Head of Good Hope (using Africa as source of slave trade). It is the top period of the British Empire, when it becomes a super prower, due to the the development of the mercantile trade with the other coutries. And thanks to the English intervention, the Industrial Revolution became a reality. In fact, that contributed to the creation of the biggest empire of history which, at its best time, covered 1/5 of the world' s territory and ¼ of its population were the sailors, the traders, the explorers and the colonists.

After that, the period of Napoleon' s wars was marked by the transformation of the military glories into political victories of the European leaders. It was determined by the growing of the republican values promoted during the French Revolution and by Napoleon' s conquests. The Brithish foreign policy consequently became a means of maintaining “the power balance”. Any territory conquered by Britain, after Napoleon' s defeat - at the sea by Admiral Nelson, in Trafalgar 1805, and on the land by General Wellington in Waterloo 1815 – rather meant the other powers' control over the British territories. These territories of the post – Napoleon British Second Empire, from Asia, Africa and North America, which had a huge growing in the XIX<sup>th</sup> century, are considered by the historians rather parts of a political empire than of a commercial one<sup>5</sup>. This included India, Benegal, Ceylon and Singapore, the Mauritius Island, considered trans-oceanical strategic points which made Britain the supreme maritime power. Australia' s transformation into a penal colony and the incorporation of 13 American colonies from the French should not be neglected either. Also, by annexing Ireland in 1801, the local disorders and violences came to the end.

We can draw the conclusion that wars were used as a means of dividing the influence spheres or for buying new lands like the ones from the New World and Alaska (bought from Russia by the Tzar Alexander II).

Referring to Alaska, it is worth mentioning the contribution of the Romanian leutenant Gheorghe Pomut who, in 1866, was appointed as a U.S.A. Consul in Russia, at Sankt Petersburg. In 1866, Russia crosses a severe economical crisis which determined the Tzar Alexander II to agree with the selling of Alaska to the Americans for the sum of 7200 U.S.A. The Romanian born consul had personally led several negotiating rounds between the two powers. <sup>6</sup>

The extension of the British influence power also become possible thanks to the following wars: the Opium War at the end of 1830 (to ensure the free passing of the British to and from India), the Afganistan War (1839-1842) with the aim of controlling the influence of Russia and Asia, the Crimean War in 1854, in which Great Britain and

Turkey fought against Russia and the invasion of the Suez Channel made by the British, in 1882.

These territorial conquests are followed by profound movements of the industrial revolution, a phenomenon that led to the development of mass production corroborated with the growing of transports. In fact, the main economical progress is being represented by the building of the first iron bridge from the world (1776), by the connection of the industrial zones of railways and navigation from London (1863). The above mentioned progress was generated both by the tendency of isolation and by the growing continental ambitions, the British government being more preoccupied with obtaining maximal economical results, including the protection measures for the internal competition (Corn Laws)<sup>7</sup>. Yet, France succeeds in signing (1860) a commercial treat with England, which abolishes prohibition and cuts or reduces the custom taxes, an agreement that stayed at the genesis of liberalization in Europe.

## **II. The consolidation and the maturity of the Anglo-Saxon Space**

The period from after the Second World War is marked by the germs of the unweaving of the British Empire, a phenomenon inaugurated by the independence of India which was conquered in 1947. It was followed by other colonies in the next two decades (many of them stayed back in Commonwealth, having the same Queen as a leader). In 1956, Egypt nationalized the Suez Channel and, in 1962, Jamaica and Trinidad won their independence and the inhabitants of these islands became the first colour immigrants from Great Britain who found a workplace in the textile and automobile industries.

All these changes took place under the impact of the modernization<sup>8</sup> process which, at a historical scale, proved to be irreversible. From this perspective, we can state that the beginning of our modern world dates back to the XVII<sup>th</sup> century, and the multiple economical and social changes begin to be completed in the XIX<sup>th</sup> century, a period that witnesses the building of a radically changed world.

The first defining zone of modernization is connected to the transformation of the North-European economics from the form of survival to the form of multiplying changes. England, then Britain fully participated to these transformations, going through successive stages: passing from the subsistence agriculture to the extended properties or to the manufacturing of the raw material in order to use them as changing instruments with the whole world. After this evolution, the interest for the big economical entities for markets, became more important than the private and the family business. The commerce brought the first changes in agriculture, then in industry, generating the appearance of manufactures and centralized markets. Till the end of the XVIII<sup>th</sup> century, the commerce was managed by the companies created in the old world which contributed to the growing of the incomes of the European monarchies. But, by this time, gradually, the central control diminished and the new principles of changings were based upon the self – positioning of the market and upon the promotion of competition. Consequently, the free market economy starts to be the engine that puts production into moving, money and capital accumulation as an essential condition of the emergence of the industrial revolution from the XIX<sup>th</sup> century. It was followed by the promotion of some economical and financial power of the middle-class. In the XIX<sup>th</sup> century, the progress of technology, guided by the market and money, determined two new revolutions: the communication revolution, spread by media and the post-industrial revolution, which channelled the efforts of society towards monitorizing information and extension of services.

The extension of economical competition between countries generated profound moments in society, which puts its seal both upon civilizations and life – styles so the Anglo-Saxon space seems to dispute its priority.

For instance, the first coffee house from Western Europe opened in the university town of Oxford, where a Libian started a business with this product in 1660 and was followed two years later by the one from Pasqua Rose, from London, opened by the Armenian servant of the English salesman, Daniel Edward. He started to like coffee

during his travellings in the Middle East<sup>9</sup>. This phenomenon caused the overthrowing of Amsterdam as the biggest financial center of the world, by London (by socializing businessmen). It is also worth mentioning that Adam Smith inclusively, the father of political economy, wrote a good part of his book “The wealth of Nations” in the British Coffee House.

The British Empire also contributed to the coagulation of the “tea civilization”, the first loading of green tea being brought in England in 1650.<sup>10</sup> Until the XVII<sup>th</sup> century, it was a luxury product, one cup of tea being five times more expensive than a cup of coffee. The main delivery of tea in England was the Oriental Indian Company, which had at that time a much bigger income than the British government’s budget. Along centuries, Great Britain influenced its former colonies to use this drink. Ireland, Australia, New Zealand were among the first consuming countries from the world.

Later on, Coca - Cola<sup>11</sup> invented in 1886 by John Pemberton, a chemist from Atlanta, is spreading all over the world, without particular preferences among the social categories. Currently, this drink is the result of a serial product and it is being sold everywhere, without any need of adapting itself to each country’s specific, this contributing to the extension of globalization.

This picture is completed by the American show-bizz that had its debute by imposing jazz and mute films in the noisy years 20<sup>ies</sup> of the last century. Coming back to the Brithish territory, the celebrity of the Beatles has to be mentioned, a group that had turned the city of Liverpool into a pilgrimage place. All these phenomena have not only passed unattended but have produced major changes in economy and society, confirming the military hegemony of Great Britain (in the XX<sup>th</sup> century) and U.S.A. (in the second half of the XX<sup>th</sup> century).

As far as Great Britain concerns, the tendency of hegemonic extension is also reflected into the political reflexes of the British citizens based on the arhipelago’s unity, on the colonial imperialism and on the naval supremacy.<sup>12</sup> Subsequently, in London, the news about Zimbabwe, Sri Lanka, India or Pakistan have a different impact than the news coming from Paris, Berlin or from some other world capital. The reason is

connected to the fact that on the British territory are living many communities coming from these countries and, even more than that, they were under the imperial power of Great Britain. On the other hand, the British know quite well that the time of empires has gone and the former colonies are independent and their interests are not the same with their ex – conquerors.

The relationship with the white Commonwealth countries is quite different. It is now consisting of 48 states, organised into an “association”.<sup>13</sup> The passing from the imperial formula to the association goes back to 1931, after the winning of independence by Australia, Canada, New Zealand and South Africa which continue to recognize the monarch as their chief of state. The profound movements are being brought by the adoption of The Atlantic Cart, in 1941, which contained common principles of English and American policies. By means of this, England transferred its hegemonic role to a recovered America, after the economical shock from 1929-1933, confident in its power and in her destiny. This transfer was accompanied by a general overtaking of the positions once detained by the British in the whole world by the Americans.

Presently, the U.S.A. holds the main role on the international scene, a situation mostly relevated by the fact that one of 100 newly founded multinationals, 24 were based in U.S.A.

All these tendencies operate the same way for both countries, U.S.A., being today the “de facto” successor of Great Britain by the role it plays into the Anglophone world. Today the Anglophone space has no full significance and develop its whole power only by America’s participation, as an ultimate order factor, into the chaos of the global interdependence.<sup>14</sup> This tendency is generated by the “exceptionalist”<sup>15</sup> myth – a phenomenon with deep roots into the enlightenment, but in the case of U.S.A., it is founded upon the idea that “the greatest nation from the history of humanity” can assume anything, including the right of modelling the world as it wishes. Though, in order to stay exceptional, U.S.A. has to answer efficiently the four major provocations of the XXI<sup>th</sup> century: globalization, information technology

revolution, growing budgetary deficit, and huge energetical consume.

In the future, history will confirm the possibility that another American government should emerge from the “globalization trap” by creating a balanced report of forces at the world economy scale, able to generate a competition based upon the equality of chances. As for the part Great Britain plays, we are indebted to its contribution to the development of modern philosophies, to the extension and promoting democracy, to the upholding of individual values as essential assets of progress and civilization.

### Conclusions

It may be appreciated that the globalization phenomenon is old and complex, determined by the competition between the countries for economic supremacy. This motivated the peoples from all over the world to fight for the resources control, for new territorial conquests and, implicit, for the influence sphere division. The fact that the primordial role was played by the British Empire and, then, by the Anglo-saxon Space is linked by its assuming the winner conscience and its own values supremacy.

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## Rate of Economic and Financial Profitability – Basic Indicator in Industrial Projects Economic Evaluation

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### Abstract

*The economic and financial evaluation of industrial investment projects in developed countries with market economy is based on the combined use of traditional and modern, rational methods, characterized by the scientific and reliability, tested and validated by long practice.*

*This article present the indicator of economic evaluation of industrial projects, economical and financial rate of profitability and its method of calculation through a case study. The rate of profitability is a significant indicator in assessing the economic and financial performance of a project or a company both internally and in the diagnostic tests requested by external partners. Also, the results of the enterprise activity in all the stages of the economic cycle are reflected in the profit and the rate of profitability. The results of the case study can be put into practice as they have been, or may be interpreted depending on the nature of the project.*

**Key words:** industrial project, economic evaluation, rate of profitability, management

**J.E.L. classification:** M21, G31

### 1. Introduction

In recent decades extensive studies have been undertaken to establish principles and research methods and techniques and improving economic and financial analysis of projects in phase of initial investment. Analysts currently operate with concepts and techniques generally accepted in all

developed countries and are taken up by other countries, including Romania [1].

The decision to invest is born of necessity or interest to make an investment. Any decision to invest must be subordinated of the private finance objective, which of the maximization company value. The way in which an organization grow and develop, the ability to survive and even being competitive will depend on the ability to generate steady streams of ideas for new products, better products or lower costs, that is to get the best investment decisions [1] and [2].

Regardless of the method of approach, there are four basic concepts that guide an investment analysis [3]:

- the ability to create value for the enterprise and shareholders;
- its profitability, defined by its ability to generate results from the effort;
- investment recovery period, which is intended to be as small;
- risk, which also must be as small.

Evaluation of investment projects is done through a system of indicators. The system contain efficiency indicators designed in economic and technical specifics of the area in which the project is realized, with economic significance and relevance for the characterization and expression of purpose and investor interests. In formulating the system of indicators for evaluating projects is taken into account also the relative importance that decision-maker is giving one or other of the indicators of efficiency, compared with other possible indicators to use, develop or use of economic theory in practice [4].

Study of profit in absolute sizes is only a preliminary stage of profitability analysis, for

relevance of rationament is required the reporting to other indicators, the results providing information of economic and financial problems. The rates method consist mainly, in the possibility of making a simple and efficient way of comparison in all three dimensions: rules, time and space [3].

In all economic and financial indicators, the rate of economic profitability ranks among the most efficient synthetic indicators of activity of the enterprise. The results of enterprise activity in all stages of the process are reflected in profit and profitability rate. Compared with the costs per product, which reflected the results of the stage production, the rate of profitability summarizes also the results of the stage distribution.

## 2. Rate of economical and financial profitability

Profitability rate as an indicator of efficiency, can gain different forms, as in considering the gross profit or net income from char, or change the reporting effort or expense, which express the process of production. The various models used for expressing the rate of profitability have different informative power, reflecting on the different sides of economical activity of the enterprise. The indicators build depending on the advanced or occupied capital, express the interests of investors predominantly, and while the indicators build depending on the consumed resource express the economic interests of the enterprise managers.

The rate of economical and financial profitability of investment projects,  $r_i$ , is determined based on average annual economic benefit of the project and investment efforts, on project versions [2] and [3]:

$$r_i = \frac{\overline{R}_g}{I_j},$$

where:  $\overline{R}_g$  - represents the annually average value of economic advantage

$$(\overline{PB}_g, \overline{PN}_g, \overline{CFB}_g, \overline{CFN}_g);$$

$I_j$  - investment effort, in euros;

$\overline{PB}_g$  - gross profit;

$\overline{PN}_g$  - net profit after tax;

$\overline{CFB}_g$  - gross cash-flow;

$\overline{CFN}_g$  - net cash-flow;

It is assumed that proceeds from the liquidation value of fixed assets is zero, so:

$$\overline{R}_g = \frac{\sum R_g}{D},$$

where:  $D$  - economic life or expected life of efficient production and service capabilities, years;

$R_g$  - value of economic advantage in  $g$  year determined based on expected values of incomes and annual costs.

Will be calculated:

$$r_1 = \frac{\overline{PB}_g}{I_j} \cdot 100; r_2 = \frac{\overline{PN}_g}{I_j} \cdot 100;$$

$$r_3 = \frac{\overline{CFB}_g}{I_j} \cdot 100; r_4 = \frac{\overline{CFN}_g}{I_j} \cdot 100;$$

Project / investment option is considered acceptable and are retained for further economic and financial analysis, along with other options or projects, if the conditions are meet  $r_i > (r_0, r_s, r_{need})$ , where [5]:

- $r_o$  – rate of return actually achieved in the entity or other projects of the investor;
- $r_s$  – idem, in sector or area the investment project belongs to, which is analyzed;
- $r_{need}$  – idem, considered by investors as an acceptable or desired limit by him.

In the literature of our country, it is recommended the use of “e” coefficient of efficiency for characterize the profitability of investment project [4] and [6]:

$$e = \frac{P}{I_j},$$

where:  $P$  - annual income, average or constant.

The coefficient of efficiency ( $e$ ) compares the annual flow of profit that is obtained from the evaluated project with the volume of initial effort and investment required to achieve that project.

When evaluating investment projects aimed at upgrading, modernizing existing capacities would be incorrect to attribute the entire volume of new investment benefits, profit will be obtained after achieving of those projects [8] and [9]. Therefore, in such

cases, the coefficient of efficiency ( $e$ ) shall be calculated by the relationship:

$$e = \frac{\Delta P}{I_j},$$

where:  $\Delta P$  - increase annual profit volume produced by modernization investment project, complete endowment, development, restructuring and re-engineering existing production capacity.

### 3. Case study

A company wants to increase the production, so it needs another industrial building. The investment project involves a financial effort of 400 thousands euros. The time of project execution is two years.

Timing of investments is scheduled as follows: first year - 150 thousand euros, second year - 250 thousands euros, which the working capital fund is 100 thousands euros. Expected duration of use is  $D = 10$  years.

The gross cash flow stream determined based on projected revenues and operating costs ( $V_g, CE_g$ ) during the 10 years is characterized by the following levels (table 1) in thousands euros/year:

Table 1. Evolution's gross cash flow

Year $g$	1	2	3	4	5
$CFB_g$	350	400	400	390	380
Year $g$	6	7	8	9	10
$CFB_g$	370	360	330	300	280

We calculate:

$$r_0 = 0,45; r_s = 0,5; r_{need} = 0,55.$$

$$\overline{R}_g = \frac{\sum_{g=1}^{10} CFB_g}{10} = 356000 \text{ euros};$$

$$r_3 = \frac{CFB_g}{I_j} \cdot 100 = \frac{356}{400} \cdot 100 = 89\% ;$$

We observe that :

$r_3 = 0,89 > (r_0 = 0,45; r_s = 0,5; r_{need} = 0,55)$ , and the project is acceptable to the investor.

### 4. Conclusions

Investment rate of economic profitability indicator is commonly used in project fundamentation; it is easily to calculate, is simple and can be easily perceives by the

decision makers, it direct linking between economic benefit that the investor wants to acquire and necessary investment effort, respectively the future fixed capital. This indicator is a static one, although it is calculated based on average annual economic effects produced in  $D$  years. It characterizes the intensity of the benefits on 1 euro investment costs. The higher rate and coefficient of efficiency, the project is more attractive.

Among the weaknesses of the indicator include the following aspects:

- it doesn't take into consideration the impact of time between realizing the works stipulated in projects, and doesn't reflect the size of the execution duration;

- it doesn't make contact with the opportunity cost of the goods or investments acquires capitalised;

- it doesn't reflect the actual dynamics of investments and economic benefits, and the financial and economic situation in time;

- in assessing the results of calculations are necessary levels of reference of this indicator ( $r_0, r_s, r_{need}$ ), that often are hard to set properly.

The case study shows clearly how the indicator is applied on a particular project, according to the initial data, and how the results are interpreting.

The article can be useful for managers, economists, engineers, etc. and for all who learn to evaluate an investment project, by presenting one of the most important indicators of economic evaluation and a way of calculating it.

### 5. Acknowledgements

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## Quality of Life in United Kingdom and Romania. A Comparative Study in Rural Areas

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### Abstract

*Between United Kingdom and Romania there are strong economic differences. A comparative study upon the most representative macroeconomic indicators was run, using statistics. The study revealed the gap between the two economies and, in the same time, two different approaches for macroeconomic policies. While British rural areas are seek given their life conditions, in general, Romanian rural areas are not attractive for any inhabitant. It is true that the traditions are diverse and the premises of the countries were never similar. But the expectancy of their inhabitants, no matter the urban or rural environment, for quality of life is the same: high.*

**Key words:** quality of life, rural development, agriculture, public policies, comparative study

**J.E.L. Classification:** O52, E01, E21

### 1. Introduction

According to First European Quality of Life Survey: Quality of life in Bulgaria and Romania, quality of life has three main strengths, after Fahley, Nolan and Whelan (2003):

- it is, mainly, at individual level, while authorities' actions for increasing quality of life have macro perspectives;
- it is a multi-dimensional concept and encompasses many life domains, like economic, health, social care, education, environment, alimentation, and, in the same time, confronts their inter-actions;

- it is measured using both subjective living conditions and objective well-being, succeeding or, at least, trying to succeed in harmonizing authority's policy to individuals' expectations.

Quality of life may represent what a person cumulates in order to have economic security, social care, and a general welfare impression. Thus, studies (Stiglitz, J. and co., 2009) demonstrate the differences between what authorities think about the offered quality of life and people's expectations.

### 2. The research methodology

Between United Kingdom and Romania there are strong economic differences. A comparative study upon the most representative macroeconomic indicators was run, using data from National Institute of statistics and Eurostat. The study revealed the gap between the two economies and, in the same time, two different approaches for macroeconomic policies.

The Organisation for Economic Cooperation and Development (OECD) on a regular basis reports the quality of life in the OECD countries. Meanwhile, Romania is not part of this study, even if is EU member.

Starting this point, the research question naturally appeared: what are the differences between quality of life in United Kingdom and in Romania, especially in rural areas, so important for both countries.

The research runs a comparative analysis between United Kingdom and OECD indexes values. Afterword, a comparative analysis between British and Romanian ruralities was conducted.

The conclusions reveal that United Kingdom is one of the countries reporting the

best values on quality of life indexes, and the gap between British and Romanian ruralities is huge. In order for Romanian rural areas to fulfil the same quality of life, the approach for public policy should become more pragmatic.

### 3. Data analysis and interpretation

United Kingdom had at 1<sup>st</sup> of January 2012 62 million inhabitants, and around 30.2 million visitors/year, uses 3,33% of the total energy consumption from alternative sources.

In the same time, Romania has 21,5 million inhabitants and more less visitors.

*Table 1 – Population at 1st of January (million inhabitants)*

Item	2000	2008	2009	2010
UE 27	482,8	497,7	499,7	501,1
United Kingdom	58,8	61,2	61,6	62,0
Romania	22,5	21,5	21,5	21,5

*Source: România în cifre 2011, National Institute of Statistics; Eurostat*

The two analysed economies have strong differences. During 2008-2009 economic crises, the United Kingdom succeeded in obtaining a low inflation average, while Romania skips over 7% in 2008. These may be caused by the two different types of economies: the British one based on production, while Romanian was, or even is, based on consumption (Table 2).

*Table 2 – Inflation average rate (%)*

Item	2000	2008	2009	2010
UE 27	1,9	3,7	1,0	2,1
United Kingdom	0,8	3,6	2,2	3,3
Romania	45,7	7,9	5,6	6,1

*Source: România în cifre 2011, National Institute of Statistics; Eurostat*

It is true that United Kingdom was the country that applied anti-clicle economic policies, while Romania applied the International Monetary Fund policy which was the partner during this crisis. The effects are quite obvious. The British GDP/capita is

considerably higher than the EU-27 average; while Romanian GDP/Capita is twice lower (Table 3).

*Table 3 – Gross Domestic Product / inhabitants (in PPS)*

Item	2000	2008	2009
UE 27	19100	25100	23600
United Kingdom	22700	28700	26500
Romania	5000	12000	10700

*Source: România în cifre 2011, National Institute of Statistics; Eurostat*

The annually GDP growth rate was negative in both countries over the last three years, but the decreasing rate was higher in Romania (Table 4).

*Table 4 - GDP growth rate (%) (last year =100)*

Item	2000	2008	2009	2010
UE 27	3,9	0,5	-4,2	1,8
United Kingdom	3,9	-0,1	-4,9	1,3
Romania	2,4	7,3	-7,1	-1,3

*Source: România în cifre 2011, National Institute of Statistics; Eurostat*

The industrial production indices (Table 5) and agricultural production indices (Table 6) revel that Romania has better results than United Kingdom.

*Table 5 - Industrial production indices (without constructions)*

Item	2008	2009	2010
United Kingdom	98,07	88,12	90,53
Romania	123,74	116,95	123,36

*Source: România în cifre 2011, National Institute of Statistics; Eurostat*

If we correlate these results with GDP situation, we may consider that United Kingdom added value is much higher for both sectors, industry and agriculture.

Table 6 - Agricultural production indices  
(1999-2001=100)

Item	2000	2007	2008	2009
United Kingdom	101	95	100	98
Romania (1)	88	97	118	115

Source: FAO Statistical Database; (1) According Eurostat

Another explanation may be that United Kingdom productivity is much higher than in Romania, British being more efficient (Table 7).

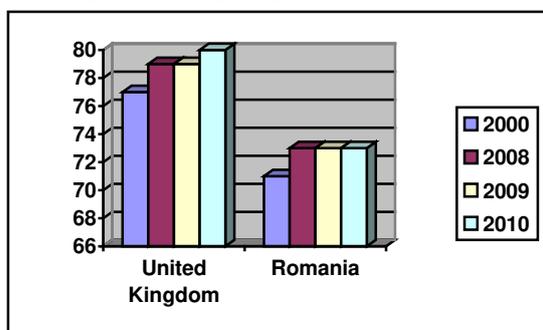
Table 7 - Labour productivity per employee  
(GDP in PS per employee (UE 27 = 100))

Item	2000	2007	2008	2009
United Kingdom	110,7	109,5	108,6	106,6
Romania	23,6	43,2	48,7	47,9

Source: România în cifre 2011, National Institute of Statistics; Eurostat

And, because we are talking about efficiency, the results that the two countries obtain are strongly different.

Figure 1 – Life expectancy (years)



Source: România în cifre 2011, National Institute of Statistics; Eurostat

The life expectancy is in United Kingdom with seven years higher than in Romania.

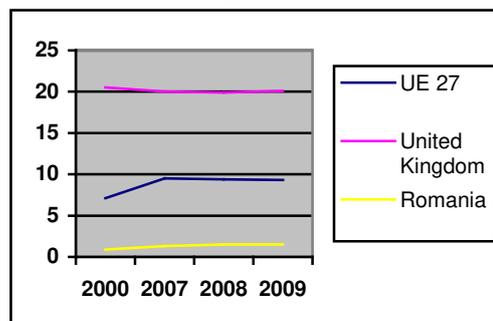
Table 8 - Average annual gross earnings  
(Euro)

Item	2000	2007
United Kingdom	37676,5	46050,5
Romania	1732,0	5062,0

Source: România în cifre 2011, National Institute of Statistics; Eurostat

In the same time, the British average annual gross earnings is almost ten times bigger than Romanian. The quality of life, even just from this perspective, is better for United Kingdom.

Figure 2 - The degree of participation in the educational or training of persons aged 25-64 years (%)



Source: România în cifre 2011, National Institute of Statistics; Eurostat

And the high standards of quality of life are supported by the degree of participation in the educational training of persons aged 25-64 years (Figure 2). The EU-27 average is 9,3, while United Kingdom has a degree of 20,1, meaning twice higher, and Romania has only 1,5, which is almost ten times less.

Doubtless, these are strong enough reasons for the existence of United Kingdom in the OECD analysis of quality of life reports, and for the absence of Romania from the same reports.

OECD developed the OECD Better Life index, a sum of 11 “topics reflect what the OECD has identified as essential to well-being in terms of *material living conditions* (housing, income, jobs) and *quality of life* (community, education, environment, governance, health, life satisfaction, safety and work-life balance)” (<http://oecdbetterlifeindex.org/about/better-life-initiative/>, accessed on 20th of April 2012).

Each index will be analysed further in order to reveal the situation on United Kingdom compared to OECD average.

For *Housing*: 74% of British inhabitants live in their own house, while the OECD average is 67%. The rents are high and not affordable for each person. Given the credit policy and the economic growth before the financial crisis, British accessed their own houses.

For *Income*: the Household Net-Adjusted Disposable Income in United Kingdom is 27208 USD/year, while OECD average is 22284 USD. The *Household Financial Wealth* is 60382 USD bigger than OECD average of 36808 USD. The economic and social levels may be empirically observed while you are in United Kingdom. For each of them there are certain supermarkets for food and dairy products, brands for clothes to be brought and worn, different neighbourhoods, ways of spending free time etc.

For *Jobs*: 70% of the persons between 15-64 years old have a paid job. The Long-term Unemployment Rate is 2,59%, slightly lower than the OECD average. This index will be further analysed together with the *Work-Life balance*.

For *Community*: 95% of British declare that they know one person that they can rely on in time of need, more than the OECD average. 59% of them reported having helped a stranger in the last month, also higher than the OECD average and 5% of people in the United Kingdom, lower than in most OECD countries, reported ‘rarely’ or ‘never’ spending time with friends, colleagues or others in social settings. If we take into consideration the number of visitors, the history of United Kingdom, we will find reasons for this approach: the tolerance and the acceptance are not qualified, but they exist at high levels in the United Kingdom.

For *Education*: 70% of adults aged 25-64 have earned the equivalent of a high-school degree, close to the OECD average of 73%. British curricula enforce that children and pupils and even students spend more and more time in schools and universities, and less time in holidays and days off. Only three weeks in August are free of compulsory presence in schools and universities. Also, the individual study has a great importance and time during each day. All these results were reached after several reforms of the educational system, as the Blair administration’s recruitment campaign run in order to fight against shortages of teachers.

For *Environment*: PM10, tiny particulate matter small enough to be inhaled into the deepest part of the lung, levels are 12.7 micrograms per cubic meter, lower than the OECD average of 22 micrograms per cubic meter. United Kingdom has tradition in the

field of air pollution, especially in London. The local policy imposes the congestion charge, a tax for each car entering the heart of the city, except cabs, buses, and local riparians, which pay a less tax. This is a measurement able to fight against pollution as well as traffic congestions.

For *Governance*: 65% of inhabitants trust political institutions, compared with 56% the OECD average, and voter turnout in the United Kingdom was 61% of those registered. This figure is lower than the OECD average of 72%. The existence of monarchy may facilitate the trust in public institutions, as they are not changing one at every four years.

For *Health*: life expectancy at birth in the United Kingdom was 79.7 years, just above the OECD average of 79 years. Higher than the OECD average of 69%, more than 76% of inhabitants declare that they are in good health. At macroeconomic level: the total health spending accounted for 8.7% of GDP.

For *Life satisfaction*: 68% of British were satisfied with their life and 79% believe that their life will be satisfying five years later. An index with a major qualitative component is that 76% of people in the United Kingdom reported having more positive experiences in an average day than negative ones, and the OECD average is 72%.

For *Safety*: 2% of people reported falling victim to assault over the previous 12 months, lower than the OECD average of 4%, and 31% of people feel unsafe on the street after dark, higher than the OECD average of 26%.

For *Work-Life Balance*: People in the United Kingdom work 1 647 hours a year, lower than the OECD average of 1 749 hours. People in the United Kingdom devote 66% of their day, or 14.8 hours, to personal care (eating, sleeping, etc.) and leisure (socializing with friends and family, hobbies, games, computer and television use, etc.) – in line with the OECD average of 14.8 hours, according to the same report.

All these situations and all these public policies that were applied for United Kingdom and Romania determined high differences in rural areas.

For Romania, rural areas are weak points considering the economic situation, the unemployment and the quality of life indicators:

- there is a lack of job opportunities and the infrastructure is neither available, nor time and cost efficient for commuters; in United Kingdom majority of rural inhabitants are commuters, or work at their desk at home;

- there are bad living condition, or the investments for higher living conditions are huge and have no source, in general; in United Kingdom there is no difference between living conditions in urban or rural areas, according to house needs;

- there is a bad safety, given the public cuts that affected the number of policemen for each village, and the return of the delinquents from other EU countries were they emigrated over the last years;

- there is a huge abandon of education, at primary and secondary schools, and insignificant number of high-schools in rural areas, just to determine an increased number of uneducated inhabitants, with no true possibility of obtaining a well-paid job;

- there is no easy access to medical services in rural areas and a big pressure on the number of beds from urban areas;

- there is almost no access to cultural activities, a poor existence of cinemas, theatres, museums, exhibitions etc., the community relations are based on participation to weddings and funerals, and some fairs occasionally organised.

The nominalization may continue, these being just few of the weaknesses that were revealed.

While British rural areas are seek given their clean air, unpolluted waters and soil, silence and life conditions, in general, Romanian rural areas are not attractive for any inhabitant.

#### 4. Conclusions

The differences between United Kingdom and Romania are important, even the two countries are partners within European Union.

Different public policies in the field during time, different approaches of the same situation with opposite solutions determined the current different situation.

It is true that the traditions are diverse and the premises of the countries were never similar. But the expectancy of their inhabitants, no matter the urban or rural

environment, for quality of life is the same: high.

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## A Financial Instability’s Theory in the Global Economy

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### Abstract

*Financial instability is a phenomenon which disconcerts business environments, in general, and banking-financial business environments, in particular. The generalization which acts in a evaluated capitalist system, in the phase of market determination, represents a factor which potentiates the financial crises, daring at any time to cause the big disintegration. The financial instability is determined by a mechanism which influences it and sends disturbing factors, thus: the increasing of those incertitude, the competition could determine the companies not to found provisions for unpredicted risks, the lack of strategy on long term, the competition of capital on the market.*

*The continuance of the global market development, of the intertrade, in general and of the international intertrade, in particular, has slowly conducted, but surely, to some mutations in the economical plan being detected the disappearance of many small businesses and of the low range companies, but without increasing noticeably the markets. Making an analysis of the money market, it turns out that international integration “is less conceived by the very specialized or capitalistic companies, the expansion at global scale puts spurs to the multinational companies to accelerate the concentration with the purpose of reducing the fixed expenditures [1].*

**Key words:** financial instability, global economy, financial market, financial flood  
**JEL clasifications** F15, G15

### 1. Global market development

Complied to this continuous pressure, small companies have two options: to leave the

market or to interfuse with groups or with more important and more powerful companies. This way, company position on the market appears as an element which determines the duration and its price. The appearance of the unique European market has constituted an example in what concerns the interest of the large groups for acquisitions and fusions “overcharging the small companies”.

Starting with the last decade of the past century, the the global integration has fortified. Some authors of economical theory have transformed the global integration process into a real market determination [2].

Market determination, as a new concept of the economical doctrine, flowed from the perfect competition theory. In the perfect competition model “the markets reach their standing balance through a correct and fair rapport of the demand with the supply, and the price represents the most efficient allocation of the resources, at a specific moment [3].

Market determination appears as a exaggeration of the market adjusting role, a belief in the “laissez faire” ideologies and in the Hayekian conception over the freedom. The notion has its genesis in perfection, in absolute values and in the conviction that everything can be made to functionate better, in the man’s need of security and authority, expressed in the balance state, balance which can be economical, social, political etc. The determination is a remanence of the conservation instinct, of the “either...or” judgments, in which is absent the third variant, and in economical plan, the judgment of value have concentrated in the conception of “self adjusting of the global markets by the act of the invisible hand, considered the best natural mechanism of function and adjustment of the economy [4].

*Global economy has conferred the currency a global value, characterized through three classical functions: method of measuring the value, method of change and method of*

hoarding/depositary of the wealth. From all that, the function of measuring the value and depositary of the wealth have developed to superior dimensions, in the global economical system.

According to the classical theory, money's value reflects the value of the interchangeable assets and services, based on a finite diversity of goods and services, complied to the rational choice, in which people estimated for a relative long period of time, the necessities which needed to be satisfied, so that the acceptance of the change was realizing, according to some traditional methods, the values of change being better outlined, and the money represented the method of reaching the purpose and not a purpose as it self.

For the global world or in progress of becoming global, the values are not easy to appreciate, traditionist models have collapsed, arising a diversity of goods and services in exponential increase, which are continuously multiplying and they are complied to some updating and re-updating, on a shorter and shorter period of time. People have a bigger and bigger freedom of choice, they are challenged by more proposals, the choice involving, besides rationality, a lot of energy expense. Some chose money-as purpose as it self, demonstrating the tendency of replacing the values of interchange-of the goods and services, with the money as itself- the tendency to liquidities, while others need confidence to invest in productive activities or to speculate (bull) on money markets. This way, the market determination is educating the most concrete in the need of confidence, still the need could create excesses as well, and the confidence can be obtained through attraction or through the presentation of the financial information in a different format, at some specific periods of time.

## 2. Financial instability phenomenon

*Financial instability* is a phenomenon which soars permanently over the financial system, creating perplexities in the business environments, in general and in the financial-banking environment, in particular. Referring to the phenomenon of financial instability there is a whole and a true literature of speciality [5] which studies the different theories of the financial instability, each theory having its own contribution to the

comprehension of the financial crises. The global integration which acts in a developed capitalist system, in the phase of market determination, represents, on itself, a factor which potentiates the financial crises, taking the chance at all times to produce the great disintegration.

## 3. The mechanism which influences financial instability

Financial instability is determined by a mechanism which influences it and sends disturbing factors, thus:

- *The expansion of the new entries' activity on the financial markets* could induce the creditors a change of the way of appraisal of the credit relations and the offering of some credits at low prices (extracredit), based on the existence of some information less pertinent. It is what it is called “the cannibalism of the new creditors” which tend to offer credits based on some asymmetric information during the initial stages of the lending, in their wish to “eat”, all that is possible in the specific market, which in the final conducts to the credit standards relaxation, as well for the new entries, as for the other creditors;
- *The incertitude could be increased by the new entries.* The new entries' lack of experience could create a even larger incertitude. The incognizance of the market, respective of the demand and supply dynamics, could encourage the appearance of hoarding (herding?) (the lending of the same type of customer), which takes to the non-division of the credit risk;
- *The competition could determine the companies not to constitute adequate provisions for unpredicted risks,* such as financial crises for ignorance reason or for the desire not to lose the competitive advantages (the provisions conduct to the decrease of the shareholders' profit in the establishment moment;
- *The lack of strategy on long term, the sufficiency and the activity planning on short term* conduct the companies towards a deficient calculation of the risks that could appear during the

economical circle , and again, through the competitors, helps to reduce prudential standards for the entire market;

- *The competition for capital, on the market, stimulated by “the game” of frequent efforts, adopted by the new entries or the markets’ development, could conduct to a cumulative reduction of the market prices, until these are changed with losses for the participants and with a retreating of those from the market or even a re-lay.*

The increase of financial instability, inside of the global capitalist system, in was superimposed as well on the background of an acute need for resources of the great companies –SUA, European Union, Japan-reality which flows from the system entropy itself which is 500 years old and which tends to transform “the centre” into an enormous black hole, ready to swallow up the system’s periphery, inside of some deep mutations.

#### **4. International financial floods**

Referring to the international financial floods, the literature of speciality focused on the apprehension of the financial instability on the exchange rate crisis[6] which makes possible gains from speculations against the depreciation at fixed parity of some currencies, reported at the monetary stocks of some countries, at the variation of some factors, among those: external net assets and the expenditures balance<sup>7</sup> [Ibidem.]. The contribution of the international floods of capital to the financial instability has introduced a group of additional elements which affects the mechanism of transmission of the crises, among those:

The authorities policy of counter-balancing the pressure over the exchange rate, through the interest rate increase, fact which could conduct towards an aggravation of the financial instability.

The complications introduced by the financing of the public and private sector, in external values, consists in the fact that the standing balance position is sensitive to the exchange rate and conducts to a potential link between depreciation, in the context of a monetary crisis, and financial instability. The danger is as acute as the monetary funds in external values are low for covering the

external debts or are already consumed by the precedent crises. It can be remarked the fact that the creation of a more liberal financial institutions has accomplished, many times, connected to a surveillance over the movements of capital, allowing the new financial liberal mediators to acknowledge more the risk of lending in foreign currency.

#### **5. The role of international investors**

Thirdly, the role of international investors increased, once with the increase of the migration of the international capital floods, which determine an increased pressure over the markets, being possible to appear fast retreats of this investors from the markets being in decline process, making unstable internal finances and the exchange rates. Also, it is possible a markets contagion, explained by a homogeneity of the paternalistic models [8].

#### **6. Conclusions**

In conclusion, we can say that the features remarked by the internal theories of the financial instability can be generalized at international level, as much as the new financial institutions, entered on the credit market could not meet good enough their customers, to that it is added the role of confidence, banking panic and the contagion at international level, the credit’s limitation and the moral hazard.

The cantitative analisys of the influencing factors highlight the factors presents in unlocking all the financial crises-factors of great frequency and factors which acted only in the case of certain crises [9]. Among the first it can be mentioned: the debts increase, the change of the regime, the concentration of the risk, the decline of the financial institutions solvability, the entrance of the new mediators, the act of settlement of the authorities, the monetary policy and the credit limitation (the collapse of liquidities), banking panic, and in the second category of factors: the increase of assets expenditure, evinced, during the great Depression, as well as in the collapse of the market [10], in the American economies crises, in the collapse of the stock market, in 1987 and in the banking system crises from Australia, Norway, Sweden, Finland and Japan.

Once with the capital floods became international, new factors appeared, such as: the import of financial crises, the macroeconomic impact, derangements of the financial systems, economical crises.

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## Internationalization of Tourism Services and Their Role in World Economy

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### Abstract

*At the beginning of the new millennium, tourism has been noted as one of the most dynamic areas of activity, generating jobs and foreign exchange resources.*

*Every country is interested to develop its tourism industry and to turn to profit its natural, cultural and economic potential on the global market. Tourism could be a source of economic development only for those countries which, yet undeveloped, could attract a large number of tourists so as to generate a sufficient volume of receipts in order to contribute either to the remission of trade deficit or to the stimulation of other upstream activities in the tourism industry.*

*This paper aims at highlighting the premises of tourism internationalization, the scale and impact of international tourism growth, the overall situation of the global tourism industry as well as an analysis of the international tourism as seen as a component of foreign economic relations.*

**Key-words:** globalization, internationalization, tourism, tourism services

**Clasificare JEL:** L83, M16, M21, N10

### 1. Introduction

The production of "recreational goods" has had a special role in the doubling of the world product in terms of international trade. In the collective organizational structures and within

requirements of profitability, tourism economy also develops its own forces in order to integrate in interested and pressure groups, such as the ones which are most important in the shaping of the global market, so as to benefit from a number of privileges.

In addition, it is sustained by a new logistics in what concerns the field of transportation and interchange, despite the fact that many industrial and commercial groups, such as SMEs, heavily depend upon networks of subcontractors both in the country of origin and country of destination. Therefore, a real trend of "de-territorialization" has occurred as a result of "space homogenization," as influenced by the development of transportation and informational systems, an evolution marked by numerous asynchronies between the transformational rate and the process of activity coordination. Hence, the main programmes - as for example, those of air transport networks - recompose space and are likely to perfectly coordinate the poles which drive the global economy as well as to marginalize irrelevant territories.

### 2. The dimensions of tourism internationalization

Tourism internationalization relies on the actions and reactions of large pools likable of issuing and receiving flows of tourists. Industrialized societies, capable of providing the capital and technology necessary for providing travel packages to consumers who afford to pay the travel costs, place themselves at the incipit with regards to these exchanges and continue to fuel the flows of people seeking leisure.

Major cultural, sport, scientific, business events, etc. keep on being touristically exploited and turned to profit, in creating new market segments, evincing once again the originality of tourism activities [7].

The emergence of mass tourism has made it possible to overcome the limitation of the service to the so-called privileged class, so that from the 1950s the number of international visitors plainly increased from 25 to 919 million in 2010.

Fig.nr.1. The worldwide evolution of in-comers and income for international tourism

	1950	2010
<b>In-comers (millions)</b>	25.3	940
<b>Variation from the 1950s</b>	1.00	37.15
<b>Income(billions- dollars)</b>	2.1	919
<b>Variation from the 1950s</b>	1.00	437.62

Source: *Tourism highlights*, 2011, UNWT, Publications Department

While in the first three postwar decades, whether it was international or domestic travel, tourist flows focused on the triad U.S. - Western Europe - Japan, new regions of the world now appear to enter the list of preferences for tourist destinations.

Fig. nr.2. The zone distribution of international tourist flows and their alteration in time

Zone	Year	
	1960	2010
<b>Africa</b>		
-in-comers	1.1	5,4
-income	2.6	3,4
<b>America (N+S)</b>		
-in-comers	24.1	15,9
-income	35.7	19,8
<b>Asia and the Pacific</b>		
-in-comers	1.3	21,7
-income	3.4	27,1
<b>Europe</b>		
-in-comers	72.5	50,7
-income	56.8	44,2
<b>Middle East</b>		
-in-comers	1.0	6,3
-income	1.5	5,5

Source: *Tourism highlights*, 2011, UNWT, Publications Department

Invisible flows in general and of tourists in particular are characterized by a concentration in developed countries (two thirds of the world tourist flow), the fact that the factors of

dynamism are of economic and especially non-economic nature (such as political, psychological, natural); that they are measured in units and with specific physical indicators (usually indirectly, by making use of units of time and space), have a bidirectional nature (for each country is at the same time, both importing and exporting), the sign of balance of payments being relatively stable at large intervals[2].

The internationalization of tourism services is achieved by moving across the border the consumers from the importing country towards the exporting tourism country. As part of the international flow of services, the international institutions involved in the regulation and liberalization of service-based trade focus their attention on tourism, and the main role here is attributed to the General Agreement on Trade in Services - GATS [6].

The internationalization of the touristic offer was part of the strategy of developing countries. With exotic destinations they could fold to the consumers' demand. A number of regions have been and are less prepared for receiving large tourist flows, for cultural or economic reasons. "Hard" tourism, as opposed to "soft" tourism - which respects the local values and characteristics - has caused many critical reactions [9]. It was shown that globalization cannot dismiss the socio - cultural roots of the communities involved in the management of tourism activities.

The internationalization of tourism has thus faced the protests of those supporting the environment and calling for an alignment of these activities to the principles embodied in the concept of *global environment*. The environment, before being a physical element is first of all the existential space of the whole society, communities and individuals, which in turn belong to certain cultures that rely on physical environment [10].

### 3. The effects of the international mass tourism expansion

Like any phenomenon of this magnitude, mass tourism has both positive and negative effects. It is of high importance not to completely remove the negative ones (an objective that would be unrealistic), but to reduce them and opportunities be seized and exploited.

Among *the positive effects of an increase of foreign investments in tourism* one might

include the *creation of job positions, rising incomes and improving living standards*. But the opening to foreign investors does not necessarily have immediate major positive effects: "In the Mediterranean countries, over 65% of revenues in tourism go into the pockets of approximately ten companies from countries which send the tourists, as they own or control the touring and air transport companies, along with the hotel structures" [1].

So the money will not go to the respective country but in a very small amount and even then, those who benefit from these profits are some large hotel and transportation companies etc. Foreign investment proves thus less profitable than one could ever hope. Obviously, the increasing number of foreign investors also leads to an improvement of country image, whose greater credibility in the eyes of other potential investors will expand afterwards. To help develop the local tourism industry and thus reduce the external control, national authorities of many countries have come to the support of local entrepreneurs through counseling, granting and subsidy programs. Mention should be made upon the fact that such policies can be regarded as protectionist unless they meet certain conditions stipulated in international agreements such as GATS (General Agreement on Trade in Services).

The very fact that certain countries or regions are touristically attractive, gave them an extra chance in their fight for survival. Perhaps one of the most important merits of tourism is the promotion of cultural exchanges, peace, understanding between peoples and the idea of "global community" [5]. Many see tourism as a means of saving the national economy, which is a mistake, because a "healthy" economy cannot rely only on one economic sector. Countries that exclusively depend on tourism are considered fragile environments, and any outdoor event adversely affecting tourism, can thus have devastating effects on them.

Tourism cannot develop unless its social and economic environment is favorable [8]. Once the necessary foundation for its development exists, it will directly contribute to economic growth and the improvement of living conditions. It is difficult to make a clear distinction between what is positive and negative with regards to tourism development because quite often the short-term impact is positive while on the long-term it turns to be detrimental. Let us consider a very attractive natural area.

Tourists will come, attracted by the natural beauty of the scenery, but if this wealth is not protected, the environment will degrade and the destination will lose its attractions. One should not forget that a country's natural heritage might attract tourists, but once it is degraded, tourists will depart as quickly as they came, leaving behind a population that must bear the consequences of a degraded living environment, of scarce natural resources and decline in revenues in the tourism sector. Sometimes, in spite of a first sight positive impact, further analyses reveal that things are not indeed so. Thus, although the development of the tourism industry could create new jobs, most times it is a seasonal and poorly paid work [4].

The following table shows what main positive and negative effects the development of mass tourism within the context of globalization might have. Since the causal relationship between two complex events is difficult to prove and given the fact that each field is influenced by many others factors, one could not accurately 'measure' the impact of tourism development. Therefore, in most studies, the assessment takes into account various "actors" involved in tourism activities: local residents, hoteliers, transporters, local authorities etc., as well as the comments made by international bodies, researchers and experts in tourism.

*Fig.nr.3. The main positive and negative effects of the mass tourism development within the context of globalization*

<b>Positive</b>
- The slowing down of youth emigration and even the return of some migrants to work in the tourism industry
- Creation of job positions
- Increased income and higher living standards
- Contact with other cultures. Intercultural changes
- Protection of natural areas that were doomed to degradation and, ultimately, extinction
<b>Negative</b>

- Rising prices, preventing the access of local people to tourism products
- Tourists are money-bringing actors, but not development agents
- Local people complain that the Government has not created the infrastructure necessary for the improvement of the living standards, particularly in terms of health, education and transport
- The abandonment of certain occupations, resulting in a loss of traditional jobs, especially in agriculture and fisheries
- Differences between the rich and the poor are becoming larger and more obvious
- Degradation of morality
- Young people are attracted by the modernism of foreign tourists, adopting their behavior
- Creating a negative image of the "Northern" tourist\*
- The degradation of the environment
- Sex tourism, involving children
- Loss of regional and national identity
- Tourism maintains inequalities between people

Source: Tsartas, P. Socio-economic Impacts of Tourism on Two Greek Islands, *Annals of Tourism Research*, vol. 4, n<sup>o</sup>2, 2005: 74-105; WTO, Service trade: [http://www.wto.org/english/tratop\\_e/serv\\_e/serv\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/serv_e.htm)

#### 4. The general condition of the global tourism industry (T&T - Travel and Tourism)

The transport and international tourism services T & T - Travel and Tourism make two separate entries in the balance of payments (i.e. in the TSA - Travel & Tourism Satellite Account). This particular feature stems from the fact that the activity of T & T is not characterized by uniformity, since the industry offers to consumers both goods (including durables) and services (transportation, accommodation, food, cultural services, etc.).

*Fig.nr.4. Indicators of the T& T industry worldwide (estimates for 2007/ forecast for 2017)*

World Total	US\$ bn 2007	US\$ bn 2017
Personal Travel & Tourism	2,977	5,169
Business travel	743	1,314
Government expenditures	334	546
Capital investment	1,155	2,393
Visitor Export	968	1,805
Other Exports	880	2,001

T&T demand	7060	13,232
Direct industry GDP	1851	3,122
T&T economy GDP	5391	9,781
Direct industry employment	76,083.6	86,637.4
T&T economy employment	231,222.2	262,634.4

Source: World Travel&Tourism Council, The 2007 Travel&Tourism Economic research, Spain

There are two concepts used in this field in reference to the T & T activities: *the T & T industry* (which reflects only the direct contribution of these activities at the macroeconomic level and it is strictly linked to touristic consumption) and *the concept of the T&T economy*, encompassing both the direct and indirect effects of the T & T activities, and reflecting their ability to also stimulate other industries in the economic system.

The world demand for tourism services in 2007 stood at approximately U.S. \$ 7060 billion and its projection of increase for 2017 is up to U.S. \$ 13, 232 billion.

The contribution of tourism industry (T & T - Travel and Tourism) to the creation of a global product in 2007 was of 3.6%.

In what concerns the "labor" factor, T & T is an intensive industry, it requires trained personnel and it is listed among the activities with great potential to generate jobs. In 2017, one of 11 jobs worldwide will be generated by tourism and transport activities. Currently this industry directly generates a number of 76.08 million jobs worldwide and is expected to create further 2.4 million jobs by the year 2017.

T & T is a large export activity, the inbound tourism ensuring the injection of significant foreign exchange resources in the receiving economies. Moreover, the T & T is an industrial catalyst for manufactured products and constructions. Thus, the overall public and private investments in the T & T sector reached the level of US \$ 1.155 billion in 2007 (9.5% of world investments) and will grow, during the next 10 years, up to 2.393 billion in 2017 (representing 9.9% of the world's total investment).

T & T is both a generator and a recipient of government funds. Around US \$ 334 billion were allocated from government resources for the T & T sector worldwide and by 2017 the T & T government expenditure will amount to approx. US \$ 546 billion.

### 5. International tourism– a component of foreign economic relations

International tourism is part of the service-based trade, counting all activities generated by the tourists who cross the borders in order to visit certain touristic destinations.

International tourism is an important source of foreign currency without requiring special internal efforts, a source of more favorable conditions for the production of means designed for export out of domestic resources; the tourism activity manifests itself as an important chapter of exports, called " internal export", giving outlet to a wide range of products and services which in other circumstances, may not be exported in such large quantities without great efforts and high risks – due to the perishability of goods, the seasonality of products, the huge distances to the consumer markets, the uncompetitive prices[10]. Tourism services are consumed at the very moment of production, in accommodations, during catering, therapies and recreational activities. Other goods are bought by tourists to be taken home (souvenirs, electrical goods) or to be offered as gifts to friends and relatives. These services and goods, for which foreign tourists visiting the country pay in foreign currency, represent, for the host country, exports of goods and services, and constitute importation for the country of origin.

Certain transport-, promotion-, customs charge, and fee-related expenses are eliminated through these types of internal exports or inbound tourism forms, expenses which are to be absorbed by any export transaction of goods and services subject to touristic activities.

Tourism could be a source of economic development for those countries which, although underdeveloped, could attract a large number of tourists likable to generate a sufficient income volume so as to contribute either to the remission of trade deficit or to the stimulation of other upstream activities in the tourism industry.

A landmark of quality tourism exports is the unit price charged for each export and respectively by in-comer, on visitor arrival.

Fig. nr.5. Average outgo per tourist (touristic export)

	Country Category	Outgo units(\$)
1.	Underdeveloped countries with low income per capita	296
2.	Countries with low income per	319

	capita	
3.	Developing countries	404
4.	Countries with medium income per capita	416
5.	Industrialized Countries	695

Source: worldbank.org

The low efficiency of tourism exports in countries with low income per capita obstructs the financing of tourism infrastructure projects; the quality of service is rather poor, particularly for accommodation services, so that tourism, as part of national exports, does not have the capacity to contribute to the growth of the economy. In addition, countries in this category are forced to import most products needed for tourist consumption. The competitiveness of the touristic offer is almost exclusively represented by the low cost of labor, which also gives way to the marketing of the touristic offer at low prices onto the world market.

An analysis of the world trade structure in general, and of services in particular, highlights that tourism plays an important role. Although it is not yet possible to measure the entire volume in the structure of touristic trade, this role is related in particular to the touristic income, which largely corresponds to external consumption, as well as to the international transport and travel income.

According to the international statistics compiled by the World Trade Organization (WTO), the total tourism revenue, including those arising from international affairs, were constituted by the most important domestic exports worldwide. In 2008, international tourism has accounted for over 4.8% of the total world exports and 25% of the total services exports.

Fig.nr.6. Tourism services in the world trade of goods and services

	Amount
	2008
Goods	15775
Services	3730
- transport	875
<b>- international tourism (i. t.)</b>	<b>945</b>
% i.t. of total	4,8
% i.t. of services	25,3
- other services	1910

Source: World Trade Report 2009, Trade Policy Commitments and Contingency Measures, WTO, p.30

International tourism accounts for US \$ 945 billion, placing tourism on an enviable position among the most exported goods.

World Travel and Tourism Council (WTTC) has quantified on the basis of the Tourism Satellite Account methodology and shown that in fact, that contribution is much larger, international tourism accounting for 11% of total exports, the equivalent of US \$ 2103 billion, and a remission up to 10.3% is expected in the year of 2018, which is up to US \$ 4174 billion [11].

The value of all services which presuppose exchanges between countries is noted down in the balance of payments, in the service balance. The exceptions are *international tourism* and international transport, which are marked in separate posts [3].

As regards the transactions with international tourism, these accounted in 2008 for over 25.3% of the international service-based trade, tourism taking the first place in the classification of business services.

## 6. Conclusions

In the context of a rapidly expanding internationalization of the service sectors, the size and scale of operation of a country's firms are important attributes of their competitive position in the global market, which also explains for the *dominance of transnational corporations on the international market of tourist services*. But equally true is the fact that *the need for local service providers will always exist*, given that the latter have specialized knowledge about the local market which international companies do not have.

Therefore, the process of internationalization of the service sector,

including tourism, will not rely solely on the giant service companies, which imitate the companies from the manufacturing industry in their global expansion, but will also include *a network of smaller service providers on the local markets*.

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## **Financing of Investments – A Starting Point for the Economy Development Practical Application of EOP Biodiesel**

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### **Abstract**

*Liquidation is one of the most important indicators of the companies.*

*The fact, that the financial resources, as well as the valutory or the material ones are limited, and the destinations are competitive, claims their usage under extremelly efficient conditions. On expenses commitment for accomplishment of an objective or of an action, there must be carefully analyzed all the susceptible solutions worthing to be taken into consideration for choosing the optimum variant that presents the most advantageous report between the required effort and the obtained effort as its result. The financial policy must follow the systematic growth of all expenses efficiency.*

**Keywords:** own financing sources, profitability, capital, biodiesel industry, investment project.

**JEL Classification :** D24; M21.

### **1. Introduction**

Without a capital adequacy, any small or middle business has less chances to be successfully marketed and to be developed. But attraction of the necessary financial funds raises several problems to the enterpriser, both under the discovering and access aspect to the financing sources, and under the aspect of advantages and disadvantages implied in each source separately. The main disadvantage that results in case of using funds, other than the own ones, is the decreasing of the rights of control and property of the enterpriser upon the business.

The own funds represent the most frequent starting point in case of small and new business. The financial institutions are less opened – especially during periods of economic instability – to the firms that are at the beginning than to those with a “history” already known.[3]

Size decrease of the assets balance-sheet items or increase of the liabilities balance-sheet items value is equivalent to ready money release for the enterprise, and as a result, it can be considered a ready money source.[5]

Thus, in the category of ready money source, it is included: the sale of fixed assets from the enterprise ownership, the clearance of the stocks of raw materials and/or finished goods, the decrease of receivables volume, the increase of the contracting credits from the third parties or of the capitals attracted from the shareholders, the increase of payment gaps towards providers, employees, associates.[4]

### **2. The historical evolution of EOP Biodiesel and delimitation of its object**

EOP Biodiesel, a German producer of biofuel, anticipated a high potential of development in the baltic countries, like Romania and Bulgaria, countries that do not have sufficient capacities of production in order to comply with the objectives of the European Union concerning the use of the alternative fuels. The Beteiligungs EOP Division operates in Romania by EOP Farms și EOP Siloz that work with rapeseeds.

After 1973, when the first important world oil crisis took place, the scientists and specialists turned their attention, searches and researches towards finding any inexpensive

and promising alternatives for the limited crude oil reserves of the Earth. Lately, these efforts have been added to the ones for the environmental protection whose pollution reached life-threatening levels in some parts of the world.

And thus, as a result of these sustained researches of the specialists all over the world, it appeared one of the saving solutions: Biodiesel! This is an alternative, non-polluting fuel which is obtained from regenerable resources (crops of rape, corn, etc.) and can successfully be used in diesel engines, being combined in different proportions with diesel fuel in order to create, thus, a mixture of fuel for the vehicles.

More foreign companies showed their intention to produce biodiesel in Romania. Likewise, the businessmen from Romania can see an opportunity in biodiesel production for their own companies as well as for Romania, that, according to the European Directives, they must take measures for replacing the gasoline and diesel fuel used in transportation with biofuel, from 2% in 2006 to 20 % in 2020.

A company listed at the Stock Exchange since 14.09.2005, EOP Biodiesel AG has been producing more than 400000 liters per day of quality biodiesel based on rape oil. This corresponds to the highest quality standards.

### **3. Description of the investment project**

The main working hypothesis include both estimations at the macroeconomical level for the general evolution of national economy, and estimations specific to the biodiesel industry from Romania.

#### **3.1. The main working hypothesis**

##### ***1) Hypothesis at the macroeconomical level***

Basic macroeconomical data used in construction and evaluation of the investment pattern, are:

- a) Evolution of inflation rate in Romania during planification. Estimations of this indicator are made by international forecasting institutions and are based on a short-medium term horizon reflected through the prism of the current market

situation (corresponding to the situation at the moment of evaluation).

- b) The medium exchange rate RON-EUR during planification period is based on the current futures quotes, for different maturities, and it is provided by the Bloomberg financial information network. The necessity of selecting a medium rate exchange derives from the complete calculation of the investment rentability proposed in EURO currency, fact that corresponds to a normal calculation option from the perspective of an EU investor in the Romanian economical environment and to the emission of initial capital in the European currency. Choosing a specific temporary rate exchange, instead of a fixed rate exchange for all period, is convenient due to inclusion of a considerable time horizon (in comparison with the present value, affected by the current market situation).

##### ***2) Hypothesis at the level of biodiesel market from Romania***

The working hypothesis specific to biodiesel refer to the sustainable volume of biodiesel production in Romania and to the share evolution held by the EOP investment on the local market of biodiesel.

By sustainable production, it is referred to the accomplishment of a lasting development of biodiesel industry, without any negative impact on other economical branches. The main raw material for obtaining biodiesel is vegetable oil, a good but with a wide use also in the alimentary field, respectively in securing the human food necessity.

The main steps followed in estimation of the working hypothesis specific to the biodiesel market from Romania, are:

***Step 1 : Forecastings regarding the national production of biodiesel during the analysis period*** – are based on the national production of oleaginous seeds, estimations regarding the level of exports of these goods and the conversion rates for seeds – vegetable oil and respectively vegetable oil – biodiesel.

A basic influence factor in the positive evolution of biodiesel production is the agricultural yield of the oleaginous seeds,

expressed in accordance with the quantity obtained per a hectare cultivated with these seeds. In comparison with an EU average, the actual level of this yield is over 2, lowered, fact that reflects not only the low efficiency of the agricultural branch, but also an opportunity of getting more efficiency and obtaining a higher production of seeds, without having a negative impact on the alimentary branch (in the working hypothesis, the cultivated surface is not modified, thus, the increase of the obtained quantity being only by means of a superior agricultural efficiency).

The main factors with a direct influence on the sustainable biodiesel production from the internal resources of raw material are not only the efficiency of oleaginous seeds but also the level of these seeds export (being high at present, due to the requests from other EU members for covering the own biodiesel need)

**Step 2 : Forecastings regarding the market ratio held by the investment project of EOP in Romania** - are based on estimations made in the previous step for the national biodiesel production, and on the production capacity taken into consideration by the EOP investment from Romania.

The market ratio held by EOP Romania has a positive evolution till 2011, when it reaches approximately 27%, corresponding to the capacity of maximum production of investment (*45 thousand tones*).

After 2011, the market ratio decreases and reaches the level of 18,5% in 2015. The negative evolution of the ratio is due to a constant level of EOP production, limited at the maximum capacity of investment, while the market is recording a continuous increase of the national production.

**Step 3: Estimation of the investment project earnings and of the main variable cost positions.**

The main earnings of the investment project come from the sale of biodiesel as a base product, and of glycerine as an alternative product.

The produced and traded quantities of biodiesel by EOP Romania correspond to the level estimated in the previous step. The trade price for 2009 corresponds to the current market price, and for the following

planned years, the price was adjusted by the annual inflation previously estimated.

The final price forecasting of biodiesel used in the financial planification is based on the Euro currency and transformation of the national price in an Euro equivalent price, by means of the futures quotes.

The glycerine price is directly expressed in Euro currency due to the European outlet and it has been yearly adjusted by a constant annual inflation of 1%, as the glycerine price reports to the entire European market, and only limitedly to the Romanian one.

The glycerine quantity resulted from the biodiesel manufacturing process is forecasted to approximately 10% from the quantity of used vegetable oil.

The main variable expenses of biodiesel production are connected to the vegetable oil acquisition, with the highest contribution to the cost structure, and to those for methanol.

Calculation of vegetable oil price is similar to that for biodiesel trade price (National price - > Adaptation to the inflation level - > Conversion of national price in Euro currency).

The necessary volume of methanol for securing the biodiesel production is estimated to 10,4% from the necessary quantity of vegetable oil.

### 3.2 Structure of the project financing

For the achievement of the EOP investment project, there are taken into consideration 3 financing sources:

- **Equity capital:** it is constituted from the initial capital inflow and the distribution of the annual net profit / loss (working hypothesis: no other capital accretion)

- **Initial bank loan:** it is performed for covering - the financial gap, due to an insufficient capital inflow, - the initial investment in acquisition and development of the investment placement infrastructure and the necessary production equipments. The initial bank loan has a redemption period of 6 years, with rate payment at the end of each calendar year. The interest taken for this loan is 10%.

- **Bank credit line:** it is made for covering the current necessity of ready money for a normal functioning of biodiesel production (securing the working capital), and the loan redemption is flexible, according to the

EOP needs. The interest taken for this loan is **11%**.

The equity capital inflow has an unfavourable evolution due to the loss reported during the first years of the financial planning and of the working hypothesis regarding the dividends distribution (100% of the net profit distribution is starting in 2011).

The bank loan should be totally repaid till the end of 2013, while the volume of the credit line increases considerably, due to the covering of the ready money need for the project.

### **3.3. Planning of the investment performance**

The main earning sources (biodiesel and glycerin) and the sources generating variable expenses (vegetable oil and methanol) were presented in the previous sections.

Project evolution during the first years was negatively affected by a low level of production, mainly caused by the installation and operation process at normal parameters of production (in these calculations there were also included the initial production loss as a result of some technical problems, specific to a starting investment or to a local level of an insufficiently developed know-how). Other direct expenses are forecasted at a constant annual level, depending on the obtained earnings and they correspond, in percentage, to the research results in the field of biodiesel (feasibility and research study at a scientific level).

EBITDA margin was negative in 2009 as a result of a low production level corroborated with a high level of the fixed expenses, corresponding to a production of maximum capacity or close to it.

A normalized EBITDA margin is to be recorded in 2011, when the market is penetrated by EOP products and the equipment of production operates at high parameters. EBIT margin records a similar evolution, but it is additionally affected by the fixed expenses for amortization.

As a result of the loss recorded in 2009 and 2010, and of the opportunity to use the accumulated loss from the calculation of the profit tax in 2011 (hypothesis of deductibility of loss from the profit of the following 5 years), the planning forecasts tax expenses only starting from 2012. The complete tax

ratio of 16%, proper to the fiscal field from Romania, is applied to the profit before tax (EBT) from 2012.

### **3.4. Capital cost**

The capital cost was estimated by means of the weighted average cost of capital on the basis of the initial capital structure, mentioned here as WACC (57% - loan capital, 43% - equity capital)

The cost of the equity capital for investment in biodiesel market from Romania was estimated by CAPM. Their basic elements are:

- **The risk free-rate** - corresponds to the yield offered by the Austrian government bonds, the main outlet market for biodiesel production from the source company, with a long-life maturity (the life period of investment project in biodiesel is considerable).
- **The country risk premium** - corresponds to the spread between the financial instruments issued in a developed country and a country of investment placement, in this instance, Romania.
- **The Unlevered Beta** - was estimated on the basis of the linear regression of 60 samplings of monthly observations, by means of of a company group listed at the Stock Exchange, having the same field of activity as EOP biodiesel. The final value of this indicator corresponds to an arithmetic average of beta values obtained for each company from the group, and the ulterior elimination of the effect upon beta, due to the particular financing structure. Thus, the resulted value reflects only the operational risk.
- **The relevering process** - is based on reintroduction in the beta indicator of the risk caused by the structure specific to the financing of investment in the local production of biodiesel (D/E 1.33 due to an initial superior level of the loan capital for financing the equipments and the placement of location).
- **The market risk premium** - is forecasted to 5,5% and corresponds to the recommendations of The Auditors Chamber from Austria for a long period of time, for a mature capital market (a

standard reached by Romania on a medium-long term).

#### 4. Conclusions

Maintenance of the investment activity in Romania, as well as valorization of the oportunities specific to the present situation, can constitute important measures for reducing the impact of the economical and financial crisis.

In the present international situation, it has been highly emphasised the strategic orientation of investments which implies that, the managers must know not only the present social-economical environment, but also the future one, and identify the causes of changes. There shall be accomplished only those projects that have successful chances, that means, the ones which will generate useful effects during their entire economical life, in a social-economical environment that is in a continuous change and that is sometimes hostile.

This approach is of greater importance in the public working field, where each project must fit in the strategic axis of the social-economical development on a local and/or national plan.

In grounding of the investments decisions, the emphasis is put on the quantitative techniques of modification and quantification. The analysis on the basis of the cash flow generated by the project becomes a classical in the field from now on.

Whether the time limit of the project is longer, (the case of the research development projects of the territorial placement ones) the traditional techniques of decisions grounding are difficult to apply and do not give the best results.

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# Recent Evolution and Forecast of International Tourism in Europe

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## Abstract

*In spite of numerous challenges and threats faced in recent years, international tourism has managed to recover from the decline caused by the global financial and economic crisis. Rates of growth in the number of arrivals and tourism receipts, international tourism recorded in 2010 and 2011 entitle hopes that in the next period will be no such increase, even if rates will be more modest.*

*Analyzing the most important studies and forecasts of international tourism organizations, we find that Europe continues to be the most visited regional destination of the world, but is expected to reduce their market share in coming years due to new competition of the World especially in countries belonging to Asia-Pacific region, but also because of the weakness of many European economies, especially the countries of the Eurozone.*

**Key words:** international tourism, evolution, Forecast

**J.E.L. Classification:** L 83

## 1. Introduction

Tourism, as economic activity began to develop in Europe, then in other Western countries (especially U.S. and Canada), before becoming an extensive business on all continents.

After more than two decades of almost uninterrupted growth in the number of international tourism arrivals, the impact of the terrorist attacks of September 11, 2001 was not as strongly felt in 2002, but especially in 2003 when they are registered worldwide, 691 million international tourists, from 702 million in 2002.

There was a continuous period of increase in arrivals between 2003 and 2008, then in

2009, a decline of 4% worldwide, Europe being the most affected tourist destination, with the Middle East (lower being 6% in 2009 compared to 2008).

The returning in 2010, however, was spectacular, and growth continued in 2011, being anticipated a continuation of growth, however modest pace, and in 2012, the year is expected to reach number "magic" of one billion arrivals of international tourists[2].

The World Tourism Organization and World Travel & Tourism Council predicts that, in 2012 and beyond, will be a growing number of international tourist arrivals, although growth will be lower, to the last two years. Europe will continue to be the main tourist destination in the world, but loses gradually its market share due to increased attractiveness of other destinations in the world, particularly Asia-Pacific region.

## 2. Recent developments in international and european tourism

After four years of continuous growth of international tourism (from 2003 to 2007), due to the manifestation of economic and financial crisis, 2008 saw, in the second half of his, beginning a decline that was experienced and strong in 2009.

### 2.1. The evolution of international tourism worldwide

According to World Tourism Organization (UNWTO Tourism Barometer World), the evolution of international tourist arrivals in the period 2008-2011 was as follows[9]:

- In 2008 was a relatively modest increase (+2.1%) worldwide over the previous year based on increases of 2.7%, the Americas region, 3.4% in Africa and 20, 1% in the Middle East, while in Europe the increase was only 0.5% and Asia-Pacific 1.2 %.

The evolution of international tourism in 2008 was spectacularly. So, after the first half, tourism activity was supported following growth trends from previous years, in the second quarter saw a strong rebound, a trend that was maintained even increased in the first half of 2009.

Even the evolution of the number of jobs in tourism declined in 2008, but not as brutal as the decrease in industrial sectors. But the situation was much different from one country to another. In countries like the Netherlands, Ireland, Iceland, Czech Republic, New Zealand, Japan have dropped by over 2% of the number of jobs. On the other hand, in countries such as Portugal, Finland, Mexico, Slovakia, Sweden, Switzerland, Germany and Italy there were substantial growth in the number of jobs, 2% or more [6].

- In 2009 there was a decrease of 3.8% worldwide by continuing increases achieved during 2004 to 2008. If the 1.5% decrease in the number of international tourist arrivals worldwide, was due to cumulative effects of the Gulf War and the SARS – epidemic in 2009, lower - more severe (- 3.8%), to due to economic and financial crisis, triggered from the second half of 2008. Regionally, the most significant decreases were registered in 2009 in Europe and the Americas (by - 4.9%), followed by Middle East (- 4.6%) and Asia - Pacific (- 1.6 %), while in Africa there was an increase of 3,2 %.

- In 2010, tourism, global recovered much better than expected after the shock, in 2008 and 2009 financial crisis and global economic recession.

In 2010, growth of 6.5%, the number of arrivals of international tourists, worldwide exceeded the most optimistic expectations of tourism professionals, the highest increases were recorded in the Middle East (+ 15.1%) , Asia - Pacific (+ 12.9%) and Africa (+ 6.7%), followed by the Americas (+6.5%), the modest increase being in Europe (+ 2,9 %).[10].

- Despite economic difficulties, registered in most countries in 2011 recorded significant increases in the number of arrivals of international tourists, worldwide expansion was 4.4%, based,

in particular, the growth of 6%, in Europe, followed by the Asia - Pacific (+ 5.6%) and the Americas region (+ 4.2%), while in Africa there have been increases over the previous year due to crisis and social movements some countries of North Africa and the Middle East was a significant decrease of 7,9 %.

According to World Tourism Barometer, published by the WTO[8], international tourist arrivals amounted to 980 million in 2011 worldwide, compared to 2010, when there were 939 million arrivals.

2011 was characterized by a mild global economic recovery, the major political changes in the Middle East and North Africa as well as major natural disasters in Japan.

The most significant increases in international tourist arrivals were registered in 2011, in South America (+10%) and Europe (+ 6 %). Contrary to developments in previous years, growth was stronger in 2011, in advanced economies (+5%) than in emerging economies (where growth was only 3.8%), which is mainly explained by evolution good of Europe and the decline in the Middle East and North Africa.

Secretary General of WTO, Mr. Taleb Rifai, noted that international tourism has marked new records in 2011 despite the difficult conjuncture: “For a sector directly responsible for 5% of the world’s GDP, 6% of total exports and employing one out of every 12 people in advanced and emerging economies alike, these results are encouraging, coming as they do at a time in which we urgently need levers to stimulate growth and job creation”[7].

On receipts from international tourism, which, as tourist spending in 2011, followed closely the positive developments in the number of arrivals. Of countries considered to be top 10 tourist destinations of the world, revenue increased more strongly in 2011, the U.S. (+ 12%), Spain (+ 9%), in Hong Kong - China (25%) and the United Kingdom (+ 7 %).

Even if costs increase from Germany (+4%) and U.S. (+5%) was higher than in recent years, the highest increases in tourism expenditure occurred

transmitters emerging markets: China (+ 38%), Brazil (+ 32%), India (+ 32%) and Russia (+ 21%), followed by traditional markets.

## 2.2. Evolution in Europe

In Europe, in recent decades, tourism has been relatively modest, the growth rate of international tourist arrivals compared to other tourist regions of the world. The weakest performance in this regard were recorded in Western Europe, which continues to receive, however, the most important actual tourists. Instead, the countries of Central and Eastern have registered strong growth, while growth remained significant even countries of South and North Europe.

In Central and Eastern Europe, increasing inbound tourism has gained momentum in the early '90s, after the fall of the Berlin Wall.

South, especially the countries bordering the Mediterranean, has always been an area with a strong inbound tourism. In the last decade, however, was felt, for these countries, an increasingly strong competition from countries of North Africa (Egypt, Tunisia, Morocco) and even other new destinations such as Croatia or Slovenia. Despite this competition, the most visited traditional destinations such as Spain and Italy, have managed to maintain their positions held, registering growth rates of about 3% per year, even higher in Spain. Also, Turkey and Greece have recorded growth rates above average in this area [5].

Despite persistent economic uncertainty, international tourist arrivals in Europe, have reached 503 million in 2011, capturing 28 of the 41 million additional arrivals recorded worldwide. The best results occurred in destinations in Central and Eastern and Southern Europe around the Mediterranean (with 8% increments), and removing the tourists took advantage of high-risk destinations in Africa North and Middle East. European destinations in the Mediterranean have also benefited by increases in the number of arrivals of tourists from issuing markets and Scandinavian countries, Germany and the Russian Federation.

## 3. Forecast for 2012

According to WTO forecast (WTO - World Tourism Barometer), international tourism will continue its expansion in 2012, although there will be a slower growth. So, we expected an increase of 3-4% in the number of arrivals of international tourists, so it is expected that during 2012 to achieve the long awaited psychological threshold of one billion arrivals.[8]. The most significant growth rates are expected to register in emerging economies in Asia - Pacific region and in Africa (between 4% and 6%), followed by the Americas (between 2% and 4%), while the Middle East will have to begin to regain some lost ground in 2011.

### 3.1. WTTC estimates the evolution of international tourism in 2012

World Travel & Tourism Council, in his World Economic Impact Report [12], is expected to turn that 2012 will mark a milestone in the history of international tourism, since the contribution of tourism and travel the world economy is expected to exceed 2 000 billion in GDP and amounted to over 100 million jobs.

According to WTTC forecasts, global tourism and travel industry [the Global Travel & Tourism (T & T) Industry] will increase by 2.8% during 2012, slightly above the projected growth rate of the global economy, 2,5 %.

Taking into account the indirect impact of tourism and travel industry, WTTC estimates that globally, the contribution to the world economy in this sector will be USD 615 000 million and will generate about 260 million jobs (that is one of 12 existing jobs worldwide).

According to estimates by David Scowsill, WTTC President, “In 2012, when international travellers are expected to surpass one billion for the first time, the industry will pass two other major milestones: a direct contribution of \$ 2 trillion to the world economy and 100 million jobs. But these numbers are dwarfed by the total forecast contribution of the industry - \$ 6,5 trillion to the global economy and 260 million jobs”. [11]

Predicted increase in T & T in Europe, in 2012, shows a poor growth of only 0.3% of

the sector's direct contribution to GDP of the region, overall, led growth, however, the contribution of some growth based on of the "new economies" like Poland and, in particular Russia, because, across EU countries, is expected to fall 0,3 %

Consumer spending will continue to decline, due to austerity measures taken by governments in most European countries and the evolution of these costs remains uncertain about the future of the Eurozone countries, especially in countries like Greece, Spain, Italy and Portugal.

In the medium term, WTTC forecasts are more optimistic, anticipated to average annual growth of 4% by 2022, when the Tourism & Travel Industry will employ 328 million people, or one of 10 existing jobs at the time the globe.

### **3.2. Prospects for international tourism development in EU**

Tourism is a key sector of European economy. The UE tourism industry generates more than 5 % of the EU G.D.P., with about 1,8 million enterprises employing around 5,2 % of the total labour force (about 9,7 million jobs). Taking into account the indirect contribution of tourism to GDP creation, it is estimated that it generates over 10% of the European Union GDP and provides about 12 % of the labour force in EU[4].

According to Eurobarometer in tourism research, conducted by the European Commission [3] 72% of EU citizens have traveled, in 2011 and 80% of them stated that they intend to travel in 2012, whether they choose to travel by short term or spend long vacations.

Eurobarometer also shows that, from the previous period in 2011, many EU citizens chose to remain in Europe to spend their holidays, and even more said they would do the same in 2012.

The European continent has sufficient natural and cultural attractions to attract Europeans (and not only them) to visit and travel and tourism is Powerful drivers for the European economic recovery.

In many EU countries, European travelers preferred to spend their holidays in their own countries (Greece 80%), Italy 74%, Croatia 73%) or have chosen to visit another EU country. The most visited country in Europe

was, in 2011, Spain (11%), followed by Italy (9%), France (8%), Germany and Austria (5%) and Greece (4 %).

Eurobarometer also showed that 73% of the respondents said that in 2012 despite the crisis, will not give up going to leave, even if 33% of them had to change their original plans for the destination.

In the holiday period, 41% of respondents who intend to travel in 2012 plan to have longer holidays (having from 4 to 13 nights), compared to 27% who plan short stays. Preference will be still be their own countries (52%) or other EU countries (37%). Most preferred destinations are expected to be in 2012, Spain (10%), Italy (7%), France (6%), Greece (4%), Austria, Britain and Germany (with 3% of options).

Given the current economic situation EU countries, these estimates of future demand for tourism in member countries for 2012 seem to have slightly optimistic.

Following the severe measures to strengthen public finances in many EU countries, the purchasing power of most inhabitants of these countries (not just budgetary employees, but also retirees and even some employees of private companies) has decreased considerably and is expected to decline further, especially in countries like Greece, Spain, Portugal and Italy.

If spending cuts will continue to apply measures of availability of a significant number of state employees, they complained, they will intensify protests (demonstrations, strikes - the sectors, localities and even general).When these demonstrations become violent and the strikes paralyze the activity in airports and train stations, when all the roads are blocked, all these disturb the tourist activity.

How many tourists from Europe or other regions will want to spend vacations or holidays in Greece, for example, when they know that it will be may remain trapped for days at an airport due to strikes? Or how many of them will like to walk the streets of Madrid or Barcelona knowing that whenever they can break protests in a country (Spain) the unemployment rate exceeded 24% - the highest in Europe? Obviously no one can have a precise answer to such questions.

Holiday budget cuts, the effect of economic recession, will inevitably lead to shorter stays and travel, reducing travel

during the year and the abandonment by a significant proportion of tourists (of the disadvantaged as income), to a certain degree of comfort, so they accept lodging in the structures of more modest economic class. If Europe is to maintain world leadership, as a tourist destination, it will need to increase efforts to promote and simultaneously pay attention to reducing operating costs in the tourist reception, to launch the most tempting offers factor price sensitive tourists.

#### 4. Conclusions

Europe's leadership in international tourism remains undoubted, given that, in 2010, registering 50.7% of arrivals and 44.2% of the proceeds international benefit. Intra-European tourist flows are not only important in size, but complex, diverse as motivation, and many European countries are situated at the crossroads of such flows and benefit from exceptional tourist attractions such as the Alps and the Mediterranean beaches [1], and the true treasures of world culture and civilization. All these are just some of the reasons why forecasts are entitled according to which Europe will maintain its position as the most visited tourist region of the world, even if will diminish in coming years the market share held worldwide.

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## Creation of Cross-Border Tourist Products – Practice Aimed at Building-Up Tourism in Dobrudzha Region

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### Abstract

*The Romania-Bulgaria Cross Border Cooperation Programme 2007-2013 is co-financed by the European Union European through the European Regional Development Fund. Under this program, the project “TRANS-TOUR-NET: Creation and Marketing of Pilot Cross Border Tourist Products in Dobrudzha” has been developed between September 2010 and February 2012. The five project partners (represented by high-school and university education institutions, business and cultural organizations) participated in research activities aimed at achieving through tourism the exploitation of historical, cultural and natural heritage of the Dobrudzha region shared by Romania and Bulgaria. The promotion of cross-border tourism activity has been regarded as an optimal way to achieve cohesion in the region, the project aiming at creating new tourism products, achieving awareness of this common heritage and intensifying the socio-economical development of the region.*

**Key words:** marketing, tourism potential, Dobrudzha

**J.E.L. classification:** M 31

### 1. Introduction

The project *TRANS-TOUR-NET: Creation and Marketing of Pilot Cross Border Tourist Products in Dobrudzha* has been developed over a period of 18 months (September 2010-February 2012) and has been financed by the Romania-Bulgaria Cross Border Cooperation Programme 2007-2013. The Romanian

partners in this project are: Constanta Chamber of Commerce, Industry, Shipping and Agriculture; Ovidius University of Constanta and Ovidius High School of Constanta; and the Bulgarian ones are: Higher School International College – Dobrich and the Regional Museum of History – Dobrich. The project budget is 459 010, 52 Euro.

The project proposed to implement its activities in the territory of North Dobrudzha (in Romania) and South Dobrudzha (in Bulgaria), which have in common a unique cultural-historical destiny and a common natural heritage, insufficiently explored and fairly unknown especially in the inland of the region. These resources have been identified, explored and promoted within the project framework.

The membership of Bulgaria and Romania in the European Union allows both countries and to overcome the historical past and to construct active exchange and cooperation on new grounds. The implementation of the project aimed to bring together the cross-border communities and stakeholders towards sustainable cooperation in the field of tourism development and to make important progress on their common actions oriented toward overcoming long-time existing socio-economic and cultural barriers.

The project also intended to create new partnerships and to deepen the existing ones between Academic Institutions (International College in Dobrich and Ovidius University in Constanta), with expertise in tourism related educational courses and research, the Historical Museum in Dobrich and Ovidius high school in Constanta which have studies on the ethnical and cultural features of Dobrudzha. Moreover, it was meant to be a continuation of the currently implemented

project “Establishment of Bulgarian-Romanian Research Center for Sustainable Tourism” funded under the CBC program “Sustainable development and Biodiversity conservation”.

The project aimed at developing the cooperation with the local and regional authorities and relevant NGOs, concerned with the environment, cultural and historical heritage and nature conservation. It has also involved the active participation of other public bodies at all levels, like ministries, local authorities, scientific institutes, museums and tourist offices, some of whom might be suitable for a wider partnership. Tour operators, hotels and restaurants have been also consulted and, later, trained to embrace the new opportunities.

The Romanian-Bulgarian cross-border region is in an increased need for implementing joint actions as response to the identified needs, obstacles and problems of the area. The proposed activities initiated with the common efforts of all Bulgarian and Romanian partners to contribute to finding solution to the problem related to: unbalanced development of the tourist sector in the Dobrudzha region; lack of professionalism in marketing and low quality of the services provided by the tourism SMEs in the cross-border region; the unequal distribution of tourism income; the poor promotion and valorization of the tourism potential.

## 2. Project overall objective

The overall objective of the project is to integrate the natural, ethnic, historical and cultural resources of Dobrudzha into joint tourist products that emphasize the common identity of the region, and to encourage joint initiatives among both public and private regional stakeholders in order to bring those tourist products to the market. The project also aims at developing a sustainable partnership between tourism entrepreneurs, local and regional authorities, educational institutions and organizations that administrate tourist sites belonging to the national heritage, as well as to improve communication and coordination among stakeholders both in Romania and Bulgaria. At the same time, it seeks to promote and draw attention to the Dobrudzha region as a

tourist destination. The valorization of the historical, cultural and natural heritage of North and South Dobrudzha, separated by the Romanian-Bulgarian border, as well as the promotion of joint tourism have been regarded as an optimal way to achieve cohesion in the region. Besides the creation of new tourism products, the project aims at raising awareness of this common cultural heritage and at enhancing the socio-economical development of the entire region.

## 3. Project specific objects

The specific objects of the project are:

- (1) To develop 5 integrated pilot tourist products (tourist routes) based on Dobrudzha’s 50 most attractive tourist sites: a cultural/historical route; a craft route; an eco route; a culinary route and a festival route;
- (2) To increase the capacity of the administration of the identified 50 tourist sites and the related businesses to offer better services and advertise their products;
- (3) To raise awareness on the tourism advantages of Dobrudzha region among the local population and potential tourists.

A group of eight Romanian and eight Bulgarian experts, selected according to their experience and professional competence has been set up. The main task of the expert group was to identify the 50 most attractive tourist sites of Dobrudzha and to include them in the five tourist products (tourist routes). After an extensive individual study these 16 experts had two meetings, one in Dobrich and the other in Constanta. The aim of the meetings was to adopt the common list of objectives underlying the creation of pilot tourist products.

The list made by the expert working group includes the following tourism objectives:

### *I. Cultural and historical sites in Romania:*

- (1) The Museum of National History and Archaeology in Constanta – The Roman Edifice with Mosaic;
- (2) Callatis Archaeological Museum in Mangalia;
- (3) The Romanian Navy Museum in Constanta;
- (4) The Archaeological Complex Trophaeum Traiani in Adamclisi;
- (5) Histria Fortress.

### *II. Cultural and historical sites in Bulgaria:*

- (1) The Historical and Archaeological Complex in Durostorum – Silistra including the National Archaeological Reserve

Durostorum- Drustar, the Roman Tomb – Durostorum and the Mejidi Tabiya Fortress; (2) Kaliakra Archaeological Reserve (near Kavarna); (3) The Historical and Archaeological Complex in Balchik including Balchik Historical Museum and the exhibits found at the temple of Cybele; (4) The Historical Complex in Dobrich including the Regional Historical Museum, the Ethnographic Complex and the collection of icons in the Art Gallery; (5) The Historical Complex in Tutrakan: “Tutrakan Epopee” Memorial Cemetery in the village of Shumentsi, the Ethnographic Museum “Danube Fishing” and the Historical Museum in Tutrakan; (6) The Tekke of Akyazili Baba – St. Atanas in Obrochishte in the region of Dobrich; (7) Thraco-Roman Cult Complex – “The Sacred Valley of Zalmoxis” build in rocks, near Strelkovo in the region of Silistra.

*III. Culinary sites in Romania:* (1) Crama Murfatlar; (2) “Nunta Zamfirei” Restaurant – Eforie Nord Resort; (3) “La Protap” Restaurant – Constanta; (4) Insula Neptun Restaurant – Neptun Resort; (5) ”On Plonge” Restaurant– Tomis Tourist Port, Constanta.

*IV. Culinary sites in Bulgaria:* (1) Dalboka Mussel Farm – near the village of Balgarevo in Kavarna; (2) the Ethnographic Complex Chukurovo Chiflik - village of Prilep in the region of Dobrich; (3) The restaurant of “Drastar” Hotel – Silistra; (4) The Restaurant complex at the Open-air Theatre in Dobrich; (5) HRC Culinary Academy- Dobrich.

*V. Festivals in Romania:* (1) ”Mamaia” Pop Music Festival; (2) The Marine Days; (3) Mangalia Music Festival; (4) Stufstock Festival in Vama Veche; (5) The Liberty Parade.

*VI. Festivals in Bulgaria:* (1) International Youth Music Festival "Hopes, Talents, Masters" Dobrich – Albena Resort; (2) International Youth Music Festival “Folklore without Borders” Festival - Dobrich and Albena; (3) Rock Fest – Kavarna; (4) National Kukeri Festival – village of Kalipetrovo; (5) International Children’s Dance Festival entitled “Peace of Tomorrow Begins with Friendship Today” – Silistra.

*VII. Sites presenting traditional crafts in Romaia* – (1) The Folk Art Museum in Constanta; (2) Handcrafts Fair in Mamaia; (3) The Vine and Wine Museum in

Murfatlar; (4) Mihail Kogalniceanu Rural Crafts Workshop and Museum; (5) The Folk Art Music and Dance Festival – Mamaia.

*VIII. Sites presenting traditional crafts in Bulgaria* – (1) Open-air Ethnographic Museum “Old Dobrich” in Dobrich; (2) The Guesthouse in the village of Bezmer – Tervel municipality in Dobrich District; (3) The Dobrudzhian House in the village of Dabovik – Toshevo municipality in Dobrich District.

*IX. Eco Tourism Sites in Romania:* (1) Vama Veche – Marine Aquatorium; (2) Techirghiol Lake; (3) Histria Ornithological Reserve; (4) Hagieni Forest;(5) Fantanita Murfatlar Reserve.

*X. Eco Tourism Sites in Bulgaria:* (1) Srebarna Biosphere Reservation (Srebarna Lake, near Silistra); (2) Yaylata Archaeological and Nature Reserve (near Kavarna); (3) Green Training Center – Shabla (Dobrich region); (4) Botanical Garden in the Balchik Castle; (5) The Center for the Protection of Nature and Animals – Dobrich.

#### **4. The Project Activities**

The activities of the Trans-Tour-Net project have been developed in three stages. The first stage lasted from September 2010 until April 2011 and included:

(1) The management activities – it has been established the project management structure and the Steering Committee has been constituted; Kick-off meeting was held to launch the project preparation (30<sup>th</sup> September) and an international conference in Dobrich with 50 participants (10<sup>th</sup> December 2010). Moreover, a working group involving 8 Bulgarian and 8 Romanian experts has been formed; and the communication campaign was launched on the site: <http://www.dobrudzhatour.net>

(2) Identification of criteria, studying and mapping out the 50 tourist attractions of Dobrudzha. It has been organized an initial meeting of the working group in Dobrich and then a meeting in Constanta to summarize the results: there have been three information meetings (Dobrich, Silistra and Constanta) with 30 participants each and a public consultation has been launched.

The second analysis stage of the project took place between March and June 2011 and included: study of the objects with regard to

infrastructure development, accessibility, level of promotion, administrative capacity, training needs of the involved human resources; partners meeting and a meeting of the Steering Committee in Constanta; two roundtables with regional stakeholders (in Bulgaria and Romania with 40 participants each); elaboration of Final Analysis by the project’s experts and evaluation workshop in Constanta with 30 participants each.

(3) The third implementation stage took place between June and September 2011 and represents the development of 5 common integrated pilot tourist products and formation of clusters. It has been accomplished a direct study of the objects and the related services, as well as two workshops with the regional stakeholders (in Romania and in Bulgaria with 30 participants each). There was an elaboration of five integrated products and producing a report, followed by the meeting of the Steering Committee and the project management team in Constanta.

Between September and November 2011 the Dobrudzha’s 50 tourist attractions network has been established. There have been organized two workshops with the regional stakeholders (in Romania and in Bulgaria with 40 participants each) and a networking event in Dobrich. It has been created a database of network organisations and there was also the market implementation of the integrated tourist products. Moreover, training sessions have been organized (one in Bulgaria and one in Romania) involving 40 school and university students.

Of great importance are the promotional activities undertaken between December 2010 and February 2012. Out of these we should remember the preparation of five DVD films (one for each route) in each of the languages – Bulgarian, Romanian and English and the development of bilingual marketing brochures of the five tourist routes.

In this stage also took place the development of network identification tools such as: identification sign for each of the 50 tourist attractions; training of touristic guides for each of the 50 tourist attractions; and booklets for each of these sights. Also for promotional purposes, there have been organized two demonstration tours for media

and tour-operators (one in each country) and a pilot dissemination event in Dobrich – a mobile Fair “The Colours of Dobrudzha” for promotion of the 50 tourist attractions, as a show of music, traditions and crafts specific to Dobrudzha, which aims to facilitate access of the Romanian participants to the objectives in Bulgaria and access of Bulgarians to the objectives of the Romanian Dobrogea.

### **5. The activity of the Ovidius University of Constanta - partner in the Trans-Tour-Net project**

The Ovidius University of Constanta, partner in the Trans-Tour-Net Project, has participated in all project’s meetings and events organized by the project manager and the other partners; it has selected 3 experts in the cultural-historical, ecological and festivals – events related fields; it has contributed to the selection of the 50 tourist attractions in the Romanian region of Dobrudzha; it has visited all sights (cities, museums, culinary sites) together with the Bulgarian partners and experts and it was involved in the organisation of info trips in Constanta for media and tour-operators.

As a partner in this project Ovidius University organized on 20<sup>th</sup> and 21<sup>st</sup> of February 2012 a training seminar entitled “Tourism Marketing and Strategy for Implementation of the Cross-border Tourist Networks in Dobrudzha. This training seminar attended by more than 40 persons (representatives of the selected sights, tour-operators, local administration representatives and media operators) aimed at developing the tourism marketing related skills of the organizations that manage the selected tourist objects within the project, as well as of all stakeholders involved in the local tourism. The training was also directed towards the combination of theoretical and practical elements in order to offer the participants the opportunity to use subsequently this knowledge in the field of tourism marketing within their professional activities. It can be argued that the objective of the seminar was to send information dynamically about the tourism marketing activity and to develop strategies of effective implementation of joint tourism products that

integrate Dobrudzha located attractions in both Romania and Bulgaria.

## 6. Target groups

Among the project's target groups we can mention: the administration of municipal tourist objects and tourist offices; the SMEs in the inland area offering tourist services in the cross border region; the local communities in the Dobrudzha region; and the tourists visiting the region.

The tourist objects are the first contact point for the tourist and local populations. This is why they must provide competent information on the developed alternative products and services planned in the project. There have been trainings planned in the project schedule in order to inform the personnel of the municipal tourist sites on the specificity and advantages of the pilot tourist products.

The SMEs are the main business structures which provide tourist services and products. They suffer from an economic and social isolation. This project was a significant opportunity to encourage the SMEs to enlarge the range of their offered products and to motivate them to be more innovative and to increase the quality of their business activities. Moreover, we should acknowledge that the local population of the inland area is facing all economic, social and demographic obstacles typical of the region. This is why the project purpose was to develop its activities in target communities from the cross border area in order to contribute to their economic and social progress by benefiting from the project advantages.

The free movement of people between Romania and Bulgaria increases the number of the tourists flow in Dobrudzha region, while an important number of foreign tourists from the coastal regions are close to the Dobrudzha region. The enlargement of the perimeter of target tourists groups will contribute to the wider promotion of the alternative tourist products and will increase the international interest in these products. As a consequence, there will be a multiplication of the tourist visits in the region and the local tourist products will increase their business competitiveness at international level.

## 7. Project expected results

The project aimed in the first place to develop a successful partnership that will benefit the tourism related business, local and regional authorities, educational institutions and institutions responsible for national heritage objects in the trans-border area. Therefore, the planned project activities included the participation of different highly qualified specialists and decision makers from North and South Dobrudzha who actively communicated and worked together. During the project implementation, the established partnership relations have been upgraded while new ones arose. The project has established a network of the 50 tourist attractions of Dobrudzha. The contacts established during the network maintenance and upgrading has created sustainable cooperation.

It was also expected that the border region to be better presented and information to be disseminated among interested parties. In this respect, the project promotional materials have served to overcome communication barriers and information lack about the resources of the target region, and have been preconditions for increased interest and motivation for active tourist exchange. For this purpose there have been made and distributed DVDs containing five films of the tourist routes selected within the project in each of the languages: Bulgarian, Romanian and English. Moreover, there have been edited brochures of the individual tourist sites and of the 5 tourist routes.

The tourist motivation to visit the 50 attractions was laid on the ground of the so called people's "collection passion" – collecting symbolic signs from the 50 Dobrudzha tourist attractions in order to be rewarded for this. It was one of the implicit strategies and innovative approaches for increasing the tourist flow.

Another expected result was to improve image and raise awareness among the tourists for the potential of the border region. Viewed by the tourism perspective, the tangible border between North and South Dobrudzha has been "demolished" through the elaboration of the 5 integrated routes which are thematic and not geographical. In this way the tourists have been able to get closer to the region nature, culture, history and

habits. Nonetheless, the strong marketing campaign intends to play a very important role in the process of raising the awareness of the tourists on the hidden treasures in the region of Dobrudzha.

The project also aimed to improve communication and coordination between regional stakeholders on both sides of the border with regard to sustainable tourism development and regional tourism planning. Therefore, the survey on the tourist attractions state which was presented to the stakeholders summarizes important information for better planning of their development as well as of the tourism supporting activities on national and on trans-border level. The trainings of the different target groups supported the creation of a common approach for promotion of the developed project products and the building of a unique communication platform.

Nevertheless, the project sought to improve interaction and cooperation between business, tourist offices, tour-operators, managers of public objects of national cultural heritage on both sides of the border. The common work among the stakeholders planned in the project brought them together to build the grounds of an innovative network including the 50 Dobrudzha tourist attractions disseminated in five tourist routes. During the planned seminars and trainings, the professionals from the tourism business have been permanently involved in actively interacting and exchanging information, know-how and experience. Thus, they have been able to adjust their activities to each

other in order to provide a more coherent and strategic tourism policy.

## 8. Conclusions

The research conducted within the Tran-Tour-Net project proves that both the Romania and Bulgarian region of Dobrudzha has a powerful tourism potential and a unique character in Europe, but it is, unfortunately, poorly exploited and almost unknown. This situation is due to several causes; however both countries are aware of the fact that a solution would be practicing good marketing in terms of structuring and promoting cross-border tourism products.

Among the project results we can mention: the elaboration of a list with the 50 tourist sights (25 for each country); dissemination research in project undertaken by partners; and promotion of the selected tourist sights in order to improve the image of Dobrudzha as a cross-border tourist destination.

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## Theoretical Considerations Regarding the Influences of Exports over the Economic Growth of Romania

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### Abstract

*As it has been noticed, the global economic crisis has affected seriously commerce, not only at global level, but also at regional level, aspect valid also in the case of Romania. These aspects have been noticed also in the estimates made by the World Trade Organization which have showed that the trade flows of goods at global level have been compressed in the first three quarters of the year 2009 with 30% in comparison with the annual average.*

*The theme of the article falls within a topic discussed and analyzed on the influences of exports on economic growth of Romania. The purpose of this article is to highlight a number of issues relating to the influences of exports from Romania. We can state that an increase of export in Romania will represent one of the most important engines of the economic growth.*

**Key words:** exports, imports, economic growth, crisis.

**J.E.L. Classification:** F4 Macroeconomic Aspects of International Trade and Finance

### 1.Introduction

Foreign trade for all nations is one of the main ways to connect to the global economy and at the same time, the culture and development world. Undoubtedly in this development, whether it is viewed nationally or internationally, the economic opening is a consequence of the natural development of human society and is a fundamental requirement for all nations who are proposing to keep pace with global developments. [2]

The international context of trade has

changed dramatically in the years in which Romania has done efforts to access the European Union. The liberalization and globalization have induced a higher mobility of the factors, quick reallocation, higher fragmentation and specialization of the activities on the values chains of products and services. It has also been extended the services trade area. Retaining value at national level becomes even more difficult to obtain due to the proliferation of global value chains in the attempt to minimize costs and maximize profits.[1]

The competition between countries, regions, groups of companies and individual companies is becoming increasingly complex due to the globalization and liberalization of trade. Constraints on the level of competitiveness of firms, in particular SMEs, are more difficult to identify and overcome. In a world increasingly globalized, companies tend to realize late many of the new constraints that may arise as a result of the modification of some conditions of access to markets, the introduction of new regulations such as those related to reducing greenhouse emissions or even related to the emergence of new business models focused on information technology, to cite only a few. Even more, few companies realize the opportunities arising from such constraints if they do not adopt a creative position in business.[7]

Globalization and liberalization have determined the transformation of international trade into a powerful engine of growth and an important mechanism for integrating countries into the global economy. A large number of developing countries have taken advantage of opportunities obtaining a rapid growth of their economies. Still, not all countries have been able to benefit from these opportunities.

In the same time, it is widely recognized that the accession and full participation of them and of other developing countries and in transition to the world economy would contribute substantially to the expansion of world trade of economic relationships.

In the strategy of any economy, using the most efficient use of external economic relationships as exogenous factor of production growth, revenues and consumption is the synthetic expression of national quality management, firstly of the macroeconomic one.[1]

## **2. Body of the paper**

### **2.1.General considerations regarding exports of Romania**

International trade is one of the most important areas of economic reform in countries in transition. From this point of view, Romania has adopted a series of economic policies aimed at adjusting its geographical and commercial exchanges aimed at improving the terms of trade through a cross-branch restructuring of the goods exported. However, Romania is currently a net importer which records a permanently trade deficit. This is caused by the insufficient restructuring of the economy and the high share of State enterprises in the production of goods for export.[8]

The current context requires radical changes both in the way of involvement in international trade and also in export, both at the level of companies, groups, and in the manner in which institutions support to companies to apply for the best solutions for creating and maintaining some durable competitive advantages. We must remind that both in the perspective of the European Union, and also in the national one, important changes in the world trade (appearance of new commercial powers and increasing importance of non-UE markets), redirecting a part of the exports towards non-UE target markets, is extremely important.[10]

We all know that the volume of exports has always influenced the economic growth of Romania, these creating a complex process that regards not only the Romanian economic system in its ensemble, but also in its dynamics. An economic growth means

always a positive evolution, upward of a national economy, without excluding the cyclical oscillations and even some temporary regressions.

Speaking of the particularly important role of exports in boosting the economy it is desired that these should lead to a process of training the economy, meaning export companies should make investments, develop activities and not last should pay their employees better.

Exports can be viewed as the sum of commercial relationships that Romania has with the countries from the European Union, but also with those from outside it. The role of exports in the development of the Romanian economy is that of progress factor that puts its mark in all the existent domains, from economy to politics and culture.

### **2.2.The analysis of the context and exports situation in Romania**

Exporters have saved Romania from the recession last year and have also assured an economic increase of 2,5%, situation which is not the same in the year 2012.

According to the European regulation, a country enters into recession if it has, in two consecutive quarters, a negative increase of the economy. The Romanian economy has contracted in the forth quarter from 2011 with 0, 2% and is expected a similar tendency in the first three months of the year 2012, the exact data appear in April. The only in which our country could have a positive economic increase would be the stimulation of consumption.

„Romania has too much consumption and less production, which means that any stimulation of the consumption produces the imbalance that it has to overcome. It is a vicious circle created by the foreign banks trough the loans given to the population and not to companies”, has stated the analyst Ilie Serbanescu.[11]

The economist Aurelia Dochia has drawn the attention over the fact that we are too dependent of the European market, which has many problems, and the consumption should not be stimulated trough unsustainable decisions.” The most important is not to make mistakes because it is an election year. In Romania it is noticed a favorable evolution of internal consumption and we

could, on this basis, hope that we will have an increase, even if exports will not have the same evolution. But the internal consumption should not be stimulated artificially, through revenues increases, that prove to be unsustainable and could have unfavorable impact on the budget”, has explained Aurelian Dochia.[11]

The economic growth from last year, only frail, Romania has recorded an economic growth of 2,5% in 2011, the main engine being the agricultural production, which has been based on favorable weather conditions. But this factor is an unstable one and hard to predict, so that our country can not expect to have the same performances in 2012 as last year, especially because the snow from the winter months has destroyed many greenhouses and plantations.

”But not only the weather has had consequences, we notice a reduction on other plans, exports have slowed, as the industrial production, foreign investments do not give too encouraging signs, so even if we eliminate the weather factor, there are still concerns in what regards the possibility of economic growth in the next months, has warned Aurelian Dochia. Also, he has stated that we are, greatly, dependent on what happens in Europe, although the perspectives have improved in some countries from the old continent, especially with the intervention of the European Central Bank, which has injected a large amount of liquidities in the banking system.[11]

From the issues above results that there is a tendency to minimize this evolution, but must be taken seriously, because there are some indicators that have a high inertia, dynamic of exports, foreign investments, industrial production, all these are slowing from a large period, which means that there can not exist, by miracle, a reversal of the factors.

The analyst Ilie Serbanescu has stated that the advance of the economy has been a fragile one, in 2011. The crisis is a structure question, the recession is a question of time. We have moved out from the recession slowly, and as proof is the fact that immediately when it has intervened an unfavorable factor we have come back to the recession. If it were a healthy increase, of 3-4%, we could have avoided this thing. [11]

Romania can not reach the targets planned

for the budgetary plan of 2012. In the conditions in which the economic indicators are decreasing, it will be difficult for Romania to reach its planned targets in the budgetary plan for 2012.

Already the Government, through the National Forecasting Commission, has revised the economic growth of Romania, at 1,7%, from the interval 1,8-2,3%.

### **2.3.Main causes that have lead to the reduction of exports and measures for their recovery**

As we know the crisis has put its mark also on the exports from Romania. The main sectors on which the crisis has put its mark determining the reduction of exports are: metallurgy, chemistry, construction materials, but also furniture and glassware. But, as a replica of this reduction it appears also an increase of the following branches: cosmetics industry, medicine, and of telecommunication equipments, which have obtained increases of the sales outside the country.

The main causes that have lead to the reduction of exports have been:

- the decrease of external demand towards national products as a result of the economic crisis and also the decrease of the internal demand in the countries that are commercial partners for Romania;
- ending export commercial relationships with some external partners;
- the decrease of product and services quality on the Romanian market and lack of continuity in delivering the quantities requested by the foreign partners
- reducing investments activities of exporting companies, situation which has been reflected over the process of employment and procurement of new equipment and in this way influences the local demand for imports from Romania;
- the crisis, that has affected negatively the process of credits, by limiting the access to necessary finances for consumers and commercial intermediaries;
- improper actions of the authorities from Romania which can not influence in a direct way Romania’s exports, but which can adopt an efficient set of measures intended for promoting this activity of exports as : giving special credits or with low interest, preferred

exchange rate and tax exemptions, fiscal facilities, etc.

The trade and stimulation policy of exports results in the sum of instruments and measures adopted both by the state, and by the producing and export companies, with the purpose of pushing the global export of a country. The purpose of these regulations is to influence potential importers, of increasing exported goods competitiveness and of interesting exporting companies.

A series of stimulating measures for exports in Romania can be the following:

- budgetary measures that have as purpose increasing competitiveness of exported goods and increasing interest for producers and exporters;
- fiscal measures that follow the increase of the exports competitiveness by reducing or eliminating some taxes or duties, having as aim interest for exporters by increasing net earning realized at export.
- financial-banking measures with a higher applicability due to the increase of competition at global level.
- currency measures that follow to increase competitiveness of exported merchandise through the reduction of external prices and through the increase of interest exporters, due to additional earnings in national currency.

The main measures that will be at the basis of the national export strategy of Romania 2010-2014 in the current internal and international context are: [7]

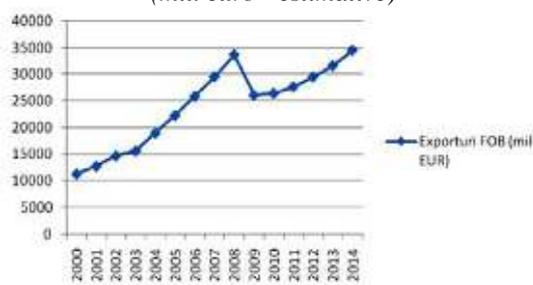
- increasing the export culture in the local business community;
- consolidating the institutional collaboration for a better efficiency of SNE;
- the approach of the initiatives in programs and projects that should be the object of a multi-year approach from the perspective of project management;
- the capitalization of resources in a sustainable way in the export activity;
- the consolidation of national value chains in order to increase value added of exports;
- promoting innovative local companies;
- the continuous and efficient approach of resources on long term;
- the consolidation of the actual market share and exploring new international markets.

### 3. Conclusions

A demand for Romanian exports is determined by the variations of the gross domestic product of the main commercial partners of Romania in direct relationship and of the variation of the price competitiveness. The exchange rate of the national currency appreciates the exports tend to decrease, the same thing happens when the ratio between internal prices and those from the world market increase.

An important element of the macroeconomic development is the evolution of foreign trade, reflected through the volume of exports and imports, as also their structure on sales and products markets. In this sense, it can be noticed, from the following figure, the evolution of the Romanian exports.

Figure no.1: Romanian Exports in the period  
2000-2014  
(mil. euro - estimative)



Source: INSSE, National Forecasting Commission (2009).

It is obvious the increase tendency of the volume of exports, in the total of the national economy, in an average rhythm of 16, 71% during the period 1998-2008. Also, it should be noticed the restraint of the export activity in the period of the economic-financial crisis from 2007-2009, and also the optimism in forecasting a comeback of them starting with 2009.

In what regards the National Forecasting Commission, this forecasts in a certain matter the international trade in 2012. So that it anticipates that exports will increase this year with 3,3 bill. Euro, while imports will increase with almost 6 bills. Euro, which will lead to the deepening of the commercial deficit with 2,5 nil. Euro and to a deterioration of the current account deficit with 1% from GDP, to 7,2 bill. euro.

The increase rhythm of exports will

decrease significantly, from 20, 5% to 7, 4% as a consequence of entering in recession of the euro area, the main commercial partner of Romania. In the same time, the National Forecasting Commission estimates that imports will reduce their advance with only 5, 6%, to 11, 1 %. This, the commercial deficit is expected to increase almost 10 bill. euro (FOB/FOB), or to 12,5 bill. euro (FOB/CIF). The National Forecasting Commission anticipates that the current account deficit will not take over the entire shock of the commercial balance and will increase with only 1,6 bill. euro, to 7,2 bills. euro, respectively 4,2% from GDP to 5,2% from the gross internal product.

Exports continue to be a point of support for Romania and have to remain the engine of the national economic growth. There must be a tight relationship between expectations regarding the economic growth of a country and its capacity of attracting investments; Romania should attract more foreign investments through comparison with the gross domestic product. For Romania to record a growth tendency it is necessary that internal demand to record more and more a positive evolution and take step by step the role that industrial production and exports have had until now. The growth rhythm of private consumption will depend on the comeback of the population buying power. Romania has to be aware of the important role of Romanian exports in the process of reviving the economy.

In the last years there have been highlighted important modifications in the structure of the commercial activity, as a consequence of the macroeconomic context, the new economic context has imposed, to all the economic agents that perform in the trade area, a reflection both of their economic role, and of the initiation and implementation of adaptation strategies. The different structure of the export in comparison with the import materializes the transfer function of foreign trade, resulting in changing the structure of national production outcomes, some of the social product created in the entire national economy being exported and imported replaced by other values, leading to diversification fund required domestic goods.[5]

Thus, in conclusion, the importance of trade as factor of growth and development

becomes more obvious for the European Union. Also, trade policies, if they are accompanied by a favorable internal policy and if they are used correctly, can offer clear opportunities of promoting economic development and of reducing poverty.

The development should remain the fundamental principle of the external trade strategy of the European Union, and its scope on medium term- the gradual integration of emerging economies in the multilateral commercial system, where, due to the regulatory framework and the one of multilateral negotiations, the European Union will fight with more success for trade principles to be respected by all its competitors and for the liberalization of their trade, with the purpose of ensuring the development of the trade potential that the member states of the European Union have, among which is our country. [1]

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## Globalization Between Agony and Ecstasy

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### Abstract

*Globalization is a mix of opportunities and perils for the national economies. The countries are more and more vulnerable to external shocks and they don't know how to fight against these new dangers. Globalization is affecting the efforts of the states and private agents through velocity and amplitude of change, both internationally and at the domestic level. Domestic institutional reform must be done in order to be able to capitalize the external opportunities, without the associated risks. In this paper we make an analysis of some of the risks of globalization and then we discuss how these risks can be minimized. Globalization should work both for the elites but also for the non-elites.*

**Keywords:** globalization, economic development, international trade.

**J.E.L. classification:** F43, F50.

### 1. Introduction

The debate about globalization has evolved from a general recognition that it does not work very well and there is real fundamentals for at least one part of the unsatisfied ones at a profoundly analysis that associates certain strategies with some failures. Globalization is not the problem, but how it was carried so far. As we shall see, a part of the problem are the international economic institutions, the IMF, World Bank and WTO, which participate to the establishment of the rules of the game.

The reform of globalization is a mainly political issue, referring to: future chances of unskilled workers and the impact of globalization on inequality, democratic

deficit in global economic institutions, which impaires even democracy and the human tendency to think from a local perspective, while we live in an increasingly globalized economy.

According to the „*Dictionary of International Relations*”, the term globalization expresses the fact that certain phenomena are global, go beyond solving at the state level and involve appeal to international or supranational authority. It is, somehow, about applying the concept of economies of scale, but also the idea that once the Cold War ended and bipolar world disappeared, the economic liberalism and democracy triumphs spread all over the planet. The result of the development of trade, financial flows and creating global information networking, the globalization questions the international division of labor, marked by the emergence of new regional powers and of the default relocation of which multinational companies profit. However, the globalization also involves other types of exchanges than the economic ones from culture to information, through technology, so the world becomes the global village, of which the Canadian McLuhan was talking about. Through international financial institutions, the G7 group and its avatars and the GATT, the globalization affects a large number of actors from industrialized countries to less developed countries, that live from delocalizations and multinational strategies [1].”

Professor Robert Gilpin from Princeton, USA, uses the term globalization to refer to "connections more and more stronger between national economies through trade, financial flows and FDI of multinationals" [2].

The globalization is a multifaceted concept, as this trend includes both economic

phenomena and social political and distributive consequences. Strictly economic the globalization can be measurable by international flows of goods, services, capital and migration of international labor .

A sense of globalization, made by Ritzer is: "the global spread of practices, the widening of relationships beyond the continents, global organization of social life and the increase of a shared global consciousness." According to Stiglitz, "the phenomenon of globalization is the greater integration of countries and their populations due to significant reduction of transport and communication costs and the elimination of artificial barriers in the path of movement of goods, services, capital, knowledge and (in a lesser extent) people between states. George Soros is an ardent proponent of the globalization, as the *global-opened society* can provide a greater freedom than any other individual state." According to Soros, the globalization represents the free movement of capital accompanied by the increasing dominance of global financial markets and multinational corporations on national economies. The primary feature of the globalization is that it allows financial capital to shift free. Conversely, the movement of individuals is strongly regulated. Because the capital is an essential ingredient in the production, the countries must compete in order to attract it, which results in a reduction of their capacity to tax and regulate it. The globalization is desirable from many points of view. The private enterprise is able to produce wealth more than the State. The globalization offers a degree of individual freedom that no state can provide. (...) Globalization has been uneven. (...) I think that the global capitalist system under its current form is a distortion of what global open society should be [3]. ” Other authors assert that at the base of the process of globalization and regional integration are two phenomena: one of technological nature (in particular explosive progress of transport and telecommunications infrastructure), the other one of economic essence, reflected by the reducing or removing of barriers [4].

Globalization has been accompanied by the creation of institutions that have already joined those existing on the world stage. Globalization is determined in a large measure by international corporations, which

doesn't move only capital and goods between states, but also technology [5].”

## 2. Poverty and economic inequality

In less developed countries, many have suffered from globalization without receiving support for social security system. Many others have been marginalized by the global markets. Globalization has produced a poor allocation of the resources between private and public goods. The markets are able to create wealth, but are not intended to address to other social needs. (...) Markets are amoral: they allow individuals to act in accordance with their interests and impose some rules on how to express them, but without issuing any moral judgment about the interests. (...) But society can not work without distinguishing between good and bad.” Markets themselves have nothing in them in order to ensure a humane attitude: on competitive markets, wages are determined by the junction between supply and demand, with no guarantee that the "balance salary" will be the minimum necessary for a decent living. Workers who are desperate for a job will finally accept to work for a company that does not meet health and safety standards. Although Henry Ford (1863-1947) believed that people needed to go about their work and not look beyond the functional parapets, and introduced the \$ 5 wage for his workers, representing about twice the industry average at that time [6].

In Romania, hundreds of workers die on construction sites (seasonal work), „working under the table”. The rules of the game that govern the globalization are unfair, as they are in the benefit of advanced industrial countries. About 80% of the world habitate in developing countries. People's vulnerability to risks depends largely on the goods they have on hand. Approximately 70% of people who live with less than a dollar a day are women. Women, especially those in rural areas, are responsible for half of world food production, achieving 60-80% of food in most developing countries. The developed countries use 90% of world's resources - water, food, energy and capital. The income inequality has widened over three-quarters of OECD countries between 1985 and 2005 and in the last five years we are witnessing the increasing of poverty and inequality in two

thirds of OECD countries. In this respect, in September 2000, 150 heads of states or government attended the Millennium Summit, organized by the United Nations in New York, signing the Millennium Development Goals, a commitment in order to reduce poverty by half by 2015. It should be noted that opening markets alone will not solve the poverty issue, but also it may worsen it. It needs more support and a foreign trade regime more equitable. There are some who say that the UN is an independent body, as it is claimed in its statute, because its decisions can be countered by a veto of any of the five permanent members, the richest countries in the world: U.S.A., UK, France, China, Russia. Its noble goals are expressed in the Preamble of the Charter, being preceded by the words, "We the people". After episode 11, the U.S.A felt the need for action outside the UNP, whenever it desired.

### **3. Globalization puts material values in front of other values such as the concern for the environment**

Environmental activists in developed countries call for universal standards for the environment, but poor countries will not meet these standards. (...) Where global participation is required, such as in the case of tropical forests or endangered species, public funding can be justified<sup>15</sup>. The first important step is to promote an international political action on climate and gender discrimination. Negotiations on putting in place a structure for climate action after 2012, under aegis of United Nations Framework Convention on Climate Change (United Nations Framework Convention on Climate Change - UNFCCC), should include equity programs and equality between genders at all stages, from research and analysis to design and implementation of attenuation strategies of climate changes and adaptation to new climate conditions [7].

While China enjoys a national savings rate over 40% of GDP, the U.S.A stands at about 14%. The ratio between federal debt and GDP in the U.S. increased from 35% in 2000, to about 60% in 2009 and it is expected that this report will reach 70% in 2019. Even at a moderate rate of 5%, the debt service

will swallow 3.5% of GDP the counterpart of 20% of tax revenues.

Within the theory of Modigliani - Miller, the companies could reduce the amount of taxes due to corporate and individual buying back their actions, rather than to provide dividends („the dividend paradox"). In Singapore, it was required the investment of 42% of wage income in a savings fund. Those who militate against the nets to catch shrimp, but nets which catch also turtles (endangered species), WTO says that such regulation would be an unwarranted interference in free trade development [5].

The doctors reported that 24% of men and 27% of women are obese. Four populations of penguins in Antarctica are under pressure because of climate change and loss of habitation areas and overfishing affects their patterns of reproduction and feeding. Nuclear disaster caused by the biggest earthquake in the documentary recorded history of Japan and tsunami from nuclear plant Daichii Fukushima in Japan, March 2011, caused the emissions of radiations in both air and water, which were impossible to annihilate, despite international support . Over 22,000 people were killed and entire towns in the north-east of the country were devastated. In December 2007 - January 2008, Chinese officials say they are facing the worst drought in a decade. China has issued reports which show that congenital malformations have increased by 40% compared to 2001 due to pollution and worsening of environmental degradation phenomena [7].

### **4. Flagrant inequalities in health care, crime and global corruption**

In Romania in 2012 dozens of drugs used to treat cancer are missing, missing that could bring malpractice lawsuits for doctors. Romania losses about 18.6 billion euros, meaning 15% of GDP in 2010 due to poor health conditions, and if public health would reach the EU average, Romania would have the economic surplus of 6.7 billion euros.

In 2007, the proportion of Americans detained in prison was among the highest in the world. Although the U.S.A. enjoys the best university system in the world, it's students (tomorrow's workers) are weaker in math and science than the average of most industrialized countries. James Canton

warns: "Young Americans will lack the necessary education for the future in order to be competitive in the global economy [8]."

Apparently, it is assumed that if something is legal, then it is morally correct. Perhaps the citizens of developed countries do not care about the hypocrisy of leaders who talk about a free trade, eradication of hunger and poverty and other topics, however, citizens of states who barely "have pulse" are not indifferent. The fact is that prisons are crowded with people belonging to lower caste of society, who have committed loosely defined, "traditional" crimes, which are difficult to detect and especially difficult to prove. They seek people joined by mutual complicity („*esprit de corps*"- Solidarity), people who take effective measures to identify, to put in silence or eliminate potential informers. Global elite enjoys an advantage: when "local laws" are not favorable, they call on the version of movement from locality, to "global laws, mobility meaning the ability to escape [9].

Armed conflict financed by mineral and oil resources is worse than corruption. We all know, but prefer silence over the fact that all weapons designed to transform the distance areas in the theaters of war, massacres and civil wars, have been provided by the weapons plants in the world, proud of their productivity and global competitiveness. The five permanent members of UNO Security Council - the U.S.A., Great Britain, France, China and Russia are the largest weapons manufacturers in the world. Of these, China has made profits from the sale of nuclear technology and export of weapons and long-range missiles to Iran, Pakistan, North Korea, etc., in exchange for energy supply contracts on long term [10]. International community has the responsibility to check the supply at source (producers of weapons) and origin of the money with which payments are made.

A worrying fact is the frauds committed by banks employees, the resultant of two forces: the emergence of online transactions and fierce competition between banks. For example, Great Britain lost 1.5 billion dollars annually because of these frauds.

##### **5. The negative impact of globalization on agricultural life and on environment**

The statement of Mario Puzo should be noted ('The Godfather'), 1920-1999 "Behind a great wealth is always a great crime". In 1979, National Academy of Science in U.S.A, issued in „Charney Report " its first warning about global warming. United Nations Framework Convention on Climate Change was adopted on May 9, 1992 and signed at the Earth Summit in Rio de Janeiro, enjoying almost universal participation, with over 190 signatory countries. The climate change and global food security are closely linked. Moreover, food production and natural fibers are the main sources of emissions of greenhouse effect gases, they have a „climate mark" larger than the transport sector. Also, buildings are responsible for 40% of global energy consumption and it is for them, almost as in greenhouse effect emissions. Great Britain required that all homes which will be built after 2016 and all commercial buildings built after 2019 to be zero- carbon emissions buildings. Note that there is no general agreement on environmental issues, it was even suggested the establishment of a World Environment Organization, but without any echo. On March 29, 2008, 50 million people worldwide participated in Earth Hour, extinguishing the lights in 370 cities in more than 35 countries, aiming to increase the awareness on climate change. On June 1st, 2008, China prohibits the production and use of plastic bags in supermarkets and shops, part of the campaign against „white pollution". The year 2010 meant the end of a decade, the warmest in the history. Hardly replaceable natural resources are treated as if they still are not lacking. Prices expressed on the market do not reflect the rarity of these natural resources. In Romania, after all these years of „local and government efforts", how many blocks are insulated, thereby reducing gas consumption? The world is facing a huge threat in the long run, the one of the stability from the ecological perspective. Global warming has become a real challenge of globalization. We can mention the efforts made in this respect, "Earth Summit in Rio" in 1992, "Kyoto Protocol" in 1997 and, "the Copenhagen Summit" in November 30th to December 11th, 2009. „ Joint Implementation " is an initiative of the Kyoto Protocol that allows industrialized countries to obtain credits by investing in emissions

reduction projects in other industrialized countries, it is related to the Clean Development Mechanism (established in Kyoto), which involves reduction projects in developing countries. Kyoto Protocol, signed by over 180 countries, had as an effect the assertion of a number of 37 countries and the EC to reduce greenhouse effect gas emissions by 2008-2012 produced by humanity to 5% below the year 1990. The fight between the developed and underdeveloped countries show a global conflict that will lead to permanent differences, as long as we allow the proliferation of threats to the environment.

The concept of "additionality" refers to greater emissions reductions than those which would have occurred in a context where economic practices go as usual. For example, in order to grant emission credits, the projects ruled in the Clean Development Mechanism or Joint Implementation must show that any emission reductions are additional to any that would have occurred without the project. The additionality can also be used in order to describe other added benefits resulting from the projects, including financing, investment and technology.

*Environmental technology* represents that smart public relations strategy, complying with consumers' requests, meaning higher profits for environmental cleaning. Recently, *the profile of the consumer of organic products was outlined*. The business environment will realize that balance environmental restoration is an opportunity and an obligation at the same time as the world's consumers will choose brands offered by companies concerned by environmental protection. Unlike the other problems associated with globalization, global environmental issues affect both developed and developing ones. We could say that the atmosphere is unbiased: it takes carbon dioxide and other greenhouse effect gases that trap heat, produced by man, and disperses them evenly around the world. However, this feature of the atmosphere can be interpreted as a sign of inequality. Pollution has no boundaries and there is no other planet to migrate, we have to stay here, on the Blue Planet, which we celebrate annually on April 22 („Earth Day"). In late 1980, the world has experienced a further test in climate talks, because nations have

negotiated and ratified the Vienna Convention for the Protection of the ozone layer and then the Montreal Protocol (1989) on substances that deplete the ozone layer. Kyoto Protocol was adopted in 1997 and became effective on February 16, 2005. The refusal of the American Senate to ratify this protocol should be noted.

## 6. Conclusions

The nation-state is responsible to make globalization feasible both nationally and internationally. Following the economic crises, a new wave of regulation is installed across the world. The nation-state must collaborate with the private actors and other international bodies.

The national economic policies remain very important even if the methods, the principles and the functions did change. The international cooperation favors the stability of certain policies because of their predictability and uniformity. However the nation-states must work together overcome the challenges described in this paper.

The globalization is important but more important is show globalization will be in practice. The global market is a source of profit and opportunities but in the same time is an opportunity for growth and economic growth. It is the role of regulations to ensure that the opportunities are valued and that the perils can be avoided.

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## Economic Sanctions – Weapon or Instrument of Diplomatic Relations

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### Abstract

*The most important implication of international law, in particular human rights and humanitarian law, as regards the sanctions is that the right to impose sanctions is not unlimited. The theory behind economic sanctions implies that economic pressure on civilians will in turn evolve in pressure on the government, thus requiring a change within the framework of it*

**Key words:** weapon, economicrelations, policy.

**Clasificare J.E.L.:** C70 – General

"The era of globalization has dissipated. The reason is the Americanization of globalization as a political project, the outcome of the foreign policy of the Bush president with the focus more on the protection of American interests and less on promoting the values of democracy toward far placed locations of the planet."

John Gray observed that globalization missionaries did not take into account its dark facet, thus interfusing the ephemeral successes of the grant with the total victory of globalization and the end of history. In addition, economic protectionism practiced by Americans, along with anti-Kyoto policy caused disappointment in Europe, that had seen the years after the fall of the Berlin Wall as a period of spreading "democratic capitalism" in the world by Americans.

But what if globalization was never a intended as project of a charitable company?

Perhaps such a vision would have saved from deception university scholars, namely Ulrich Beck, Gray's colleague at LSE. The article that was written soon after the terrorist attack of September 11, 2001, *Chernobyl of globalization*, with reference to the wave of distrust in point of nuclear power after Chernobyl. Beck goes further than

Gray: suicide terrorist attacks have revealed the world "vulnerability of Western civilization", and not just American, thus highlighting conflicts that globalization can poke.

Beck identifies the neoliberal perspective, according to which to economy prevails over politics along with the diminishing role of the state in a globalized world. The idea of a free market economy is the panacea of universal human problems that has proved the lack of foundation, and furthermore, it is a "dangerous illusion".

The issue might be more complex if we consider the actors on international stage. The role of the U.S. State is likely to diminish on local ground but in no way can afford the same thing abroad. The same cannot be said about small states without high ambitions. In their case, it would be impossible to anticipate a strengthening of the state in a globalized world that requires permeable boundaries. Globalization might be said to be characterized by a wide range of speeds. Unfortunately, Beck considers all countries altogether, that have not been and will never be equal, and in addition, antagonism of globalization might create tension and even terrorism. Is globalization itself the cause of terrorism? Beck wonders. Article 39 of the UN Charter allows the Security Council to take measures, namely the sanctions that are applied only "to maintain and restore international peace and security" after their determination.

The most important implication of international law, in particular human rights and humanitarian law, as regards the sanctions is that the right to impose sanctions is not unlimited. Therefore, an examination of relevant international law standards involves the review of the inherent limitations in respect of sanctions, especially international law operations. Moreover, the "threat" can not be determined in subsequent political grounds – there must be an

"international concern" that underlie real sanctions, not political considerations and internal politics of a State or group of States.

Sanctions might not be imposed to ensure everything but Purposes and Principles of the United Nations as they were established in Article 1 of the Charter, unless there is a credible determination of a threat, breach of peace or act of aggression. In addition to these limitations, other projections which will limit the sanctions are found within the lines of the Charter. Article 24 requires the Security Council to "act in accordance with the Purposes and United Nations Principles ". So, any act of the Security Council can not be exempted from verification so as to determine if agrees the Purposes and Principles of the United Nations.

The theory behind economic sanctions implies that economic pressure on civilians will in turn evolve in pressure on the government, thus requiring a change within the framework of it. This "theory" is not functionable both legally and practically, because of many acts that stand for the inefficiency of comprehensive economic sanctions as a coercive measure. Traditional calculation that analyses the suffering of civilians in comparison with the desired political effects provides means of achieving of the fact according to which the effectiveness of economic sanctions is inversely proportional to the adverse impact on civilians.

The case of Iraq reveals serious issues in the traditional theory of the economic sanctions. In regimes where political decision making is not democratic, there is no way to pressure civilians to bring changes in the Government.

The government target, especially if is marked by a strong control over mass- media will eventually determine the citizens to unite in an act of defiance as regards the foreign states. Sanctions might be used by the government target as a scapegoat for its problems and as material for political extremism.

"Under sanctions, the middle class is eliminated, and the poor become poorer and the rich get richer if they make use of the black market and illicit trafficking. Government and elite might benefit economically from the sanctions due to the monopoly on illegal trade. As many

commentators have indicated, on long term, as democratic participation, independent institutions and middle class are weakened and under the circumstances in which social destruction leaves population in a position that cannot resist the government, the likelihood of democratization decreases. In conclusion, the suffering of civilians that is regarded as a factor of economic sanctions determines sanctions to become inefficient and might so aw even strengthen the government and its policies ".

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# Trade Flows of Emerging Economies in The Current Economic Context- Developments and Trends

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## Abstract

*Consumption is currently soaring within rapid growth markets, due to demographic evolutions and an increase in real income.*

*As economic growth has been very low in developed countries, investors turned their foreign capital inputs towards emerging countries. It is estimated that emerging economies will stand for more than half of the global increase in the following three years.*

*BRICS countries (Brazil, Russia, India, China and South Africa) are especially important within the group of emerging countries, but also at a worldwide commercial level, as they include about 45% of the world's population and stand for a quarter of the global economy (13,500 billion \$).*

**Key words:** emerging economy, BRICS, sustainability, economic growth.

**JEL classification:** F14, F17.

## 1. Introduction

Whereas, in the past, **the concept of emerging economy** was considered a euphemism for the optimistic presentation of poor countries, an emerging economy is currently seen as an economy undergoing economic and financial structuring, able to provide for both internal sustainability and mitigation of external economic shocks.

Emerging economies are experiencing a strong development phase, in comparison to developed economies. One should not forget that an unanimously accepted definition of emerging economies is difficult to provide, given the complexity and variety of such economies. When talking about emerging economies, we are currently referring to

countries such as Brazil, Russia, India, China, Mexico, Argentina, etc. However, these are only some of the emerging economies.

Moreover, various economic specialists and political stakeholders refer to an emerging country as “a country which is too poor for being rich and too rich for being poor”.

Emerging economies have lately been the actual drive of global economic growth, with far better results than industrialised economies. Thus, their public debt was much lower and their tax policies were satisfactory, so that they captured the interest of financial markets.

**The main features of emerging economies** are the following:

- the goods market, but also the labour, capital and money market have a great extension potentials, so that an economic behaviour requiring outlets is boosting;

- the intrinsic goal of emerging economies refers to recovering the delay between them and developed economies; this is why the main nominal variables (inflation, bank interest rates, national currency depreciation rates, etc.) are still high;

- a tendency to adopt pro-cyclical measures at an economic level, with a view to obtaining immediate advantages;

- a high percentage of consumption within internal aggregated demand;

- a wide use of discretionary policies, to the detriment of implicit macro-stabilisation policies, i.e. the design and implementation of automatic stabilisers.

## 2. The Place and Importance of Emerging Economies in a Global Context

It is expected that emerging economies should increase by approximately 5.3% during 2012, while an increase of 6.3% is

foreseen for 2013. According to the “Rapid-Growth Markets Forecast Spring edition” report of Ernst&Young, these forecasts are accomplished giving due consideration to the fact that the financial decline of June-December 2011 is still balanced by the impressive progress of consumption on rapid growth markets, determined by demographic evolutions and an increase in actual income. At the same time, after an expected growth of 1.4%, the International Monetary Fund reconsidered the issue and currently estimates a 0.1% decline of economy for 2012. Comparatively, the United States of America expect their economy to grow by 1.8% this year.

Thus, demand and commercial flows will develop between rapid growth markets, especially in Asia, due to the extension of the middle class within these countries. The Ernst&Young report provides an example to this purpose: the number of Chinese households with an income ranging from 30,000 to 50,000\$/year will increase from 1.6 million in 2010 to about 26 million by 2020.[1]

It is currently seen that, in most emerging countries, consumption is higher than the consumption of developed economies. This trend is likely to continue in the future as well. Economists consider that the increase of consumption in rapid growth countries will be twice as quick as increase in the United States of America. Remarkably, China will display a four times quicker increase of consumption.

The issue of oil supply is worrying in the current context of globalisation and geopolitical tensions, especially as the economic and financial crisis of the Euro zone bears a negative influence upon the oil demand. For this reason, any fluctuation or unexpected progress in the price of oil will increase the vulnerability of markets, given a limited offer thereof.

The deliveries of the Organization of Petroleum Exporting Countries (OPEC) will increase with the decrease of geopolitical tensions, so that global growth will remain at a low level, in the short term. The above mentioned report estimates an average price of 112\$/barrel of oil for 2012. However, a decrease of 7\$ may occur by the end of the year. The forecasts of economists show that the price of oil will increase in 2013,

reaching 135\$ by 2020.

The importance of emerging economies will display an impressive rhythm of growth in the following 3 years, so that they will generate more than 50% of the global growth. The best results for 2013 are expected from economies such as Brazil (+5%) and Chile (+4.8%) – South America; Kazakhstan (+7%) and Qatar (+7%) – Middle East and Africa; India (+8.5%), China, Hong Kong (+8.6%) and Vietnam (+7.1%) – Asia. Negative values of development shall also be recorded, as well as reductions in FDI in Egypt and some emerging European countries. A reduction in the increase is also foreseen for Poland and Czech Republic, while a high inflation is expected in Vietnam, Egypt, Turkey, Nigeria and Indonesia.

*Table no.1: Economic Growth and Inflation in the Main Emerging Countries - Forecast for 2012 and 2013 -*

Country	Economic growth		Inflation (%)	
	Year 2012	Year 2013	Year 2012	Year 2013
Argentina	3,9	11,4	9,7	4
Brazil	3,1	5,5	4,8	5
Chile	3,8	3,1	2,9	4,8
Continental China	8,4	3,5	2,6	8,8
Czech Republic	-0,3	3,2	2,4	1,5
India	6,1	6	5	8,5
Kazakhstan	5,8	5,9	6,3	7
Poland	2,4	3,8	2,6	2,7
Russia	4	5,6	7,2	3,3
Turkey	2,2	9,4	5,5	5

Source: Data processed by the author, based on the Ernst&Young report, “Rapid-Growth Markets Forecast Spring edition”, April 2012.

As it can be noticed, the data displayed in table 1 is obtained based on the estimation of a lower demand on the Argentinean market, a reduction in competitiveness and offer-related restrictions in comparison to the official forecast, of 5%. Moreover, Brazilian economy is likely to witness decrease, due to a worsening of global economic conditions. However, the gross domestic product may increase faster than it was initially forecast, due to the counter-cyclical policies.

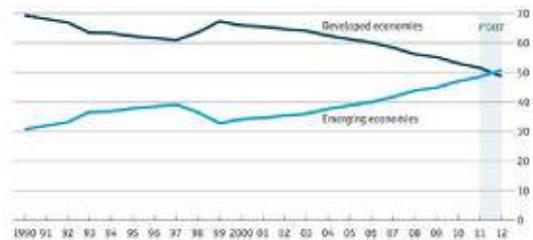
As for the Chinese state, a fall of the real estate sector is apparent, as the price of

houses decreased at the beginning of 2012 for 48 cities out of 70. Tax transfers could come to the rescue, if the above mentioned situation actually occurs.

The president of the European Central Bank (ECB) and the head of the US Federal Reserve (Fed) declared that emerging economies are fundamental to global financial stability. They consider that global economy is more dependent than ever on emerging markets, for maintaining a solid internal growth and for financial and economic stability.[2]

An interesting situation for 2012, in comparison to 2000, when rapid growth markets imported less than half of the total imports of developed economies, is related to the fact that emerging economies will come to import goods and services to a higher extent than all developed countries. However, it is hoped that this will be helpful for developed countries as well, so that the profits of companies established on developed markets should increase simultaneously with the development of purchase power in emerging countries.

Chart no. 1: Global Imports (% of the total)

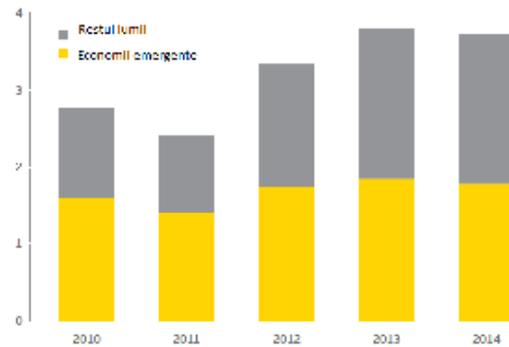


Source: WTO, The Economist, 2011

Remarkably, rapid growth countries (China, India, Saudi Arabia) are not willing to help the West if they do not get more influence in global economy-related decisions. Thus, as it has been noticed, an acute economic and financial crisis appeared and soared in the West, affecting the whole globe nevertheless. This is why I consider that this is relevant to the fact that emerging powers should be better represented within global bodies, such as G20 (the group of large industrialised countries) and the Financial Stability Council (for the regulation of banks and financial markets). The conclusion is simple: if emerging economies are allowed to have more influence within global bodies, the possibility that they should

make a financial contribution to the fight against the economic and financial world crisis increases as well.

Figure no. 1: The Contribution of Emerging Economies to the Growth of Global GDP



Source: Ernst&Young report, “Rapid-Growth Markets Forecast Spring edition”, April 2012.

### 3. The Part of BRICS within Global Economy

The BRICS group is highly significant among emerging countries. This group reunites the strongest emerging markets of the world, as follows: Brazil, Russia, India, China and South Africa. The most recent BRICS summit took place on March 29, 2012, in New Delhi, India. One of the outcomes of the summit was the decision to establish a joint development bank, for purposes of a better connection between local stock exchanges. Such an achievement would allow countries to obtain infrastructure resources, as the development bank, similarly to the European one, would act as a lender in times of financial crisis.

A joint stock exchange index was launched at the above mentioned summit, for all BRICS countries. The index will be listed in all five countries and shares may be acquired in local currency.

Even though important trade exchanges occur between BRICS countries, the representatives of these economies consider that a solution for the economic problems on the European continent would be an ever higher increase of the trade exchanges between member states, especially as BRICS reunite 40% of the world’s population. Thus, emerging countries still displayed a high

level of growth, while demand is decreasing on European markets.

BRICS representatives consider that Western countries managed the financial crisis in the wrong way. They are of the opinion that Westerners adopted aggressive expansionist monetary policies (such as the reduction of the key interest), resulting in a decrease of the global competitiveness of emerging countries. Likewise, the leaders of emerging countries consider that measures of austerity, tax consolidation or even quantitative easing are not proper solutions for the current situation.

Opposite to the opinions of BRICS leaders, IMF representatives are of the opinion that rapid growth emerging economies are starting to display signs of overheating. This is the case of China, but also of other emerging economies, who make every effort to keep inflation under control and manage the massive cash flow.

After the global economic decline of 2008-2009, recovery takes place at different steps, with a quicker rhythm for emerging markets and a slower one for developed economies. Provided that the economic growth of developed countries was unusually low, investors assaulted emerging markets, supplying the extremely necessary foreign capitals, but also inflationary risks [3].

After analysing the current situation, one may reach the conclusion that emerging European markets have succeeded due to the taken reforms. Thus, whereas highly developed economies were hit by crisis, enhanced growth, living standard improvements and an increase in the investors' confidence marked the economy of emerging European countries. However, one must be cautious, as the private sector may display sudden and unpredictable behaviour changes. It is, hence, better to prevent than to cure.

BRICS countries may represent the new global economic equilibrium. This is the opinion of economists, who consider that BRICS countries are the new force that may reorganise the global financial order.

#### 4. Conclusions

Pursuant to the presented and analysed data, we may reach the conclusion that the current growth of emerging economies

proves the importance of the adopted tax policies and discipline, as well as the advantages of the free market.

For this reason, most of these economies must not be considered small markets, without a major influence on neighbouring markets, but they should play a more important part in the stability of world economy.

Therefore, emerging economies aim at promoting a sustained and balanced economic growth at a world level.

#### 5. Acknowledgement

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## Infringements Related to Capital Market. European and National Regulations

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### Abstract

*Criminality is nowadays a current phenomenon in everyday life. Understanding the way it manifests itself can be a prerequisite but that is not enough to avoid or decrease the negative effects it may have upon people.*

*Each human pursues the identification of investment instruments providing a guarantee of proper profit regarding the amounts invested and the risks taken. In this respect, capital market supports such concerns by various instruments. Building and keeping a high level of trust are attributes of the market regulatory and supervisory authorities.*

**Key words:** capital market, market abuse, manipulation, privileged information.

**JEL classification:** G02, G28

### Introduction

Globalization is a phenomenon characterizing the current economic and financial society. To speak about globalization nowadays means to understand both the positive and the negative effects which are generated by the phenomenon as such.

This is a society where business takes place rapidly, where a mere keyboard click can transpose one into a real, yet unreal world from the perspectives of earnings and also losses which might occur. In this

context, investors, either authorized or unauthorized people, are concerned with the financial system’s stability from the perspective of legislative risks.

Ensuring the right investment instruments has generated the development of capital markets within financial markets. Besides, such as it is necessary for each country to have an airport, one can equally appreciate the need for capital markets because they will be able to ensure economic growth from the perspective of the benefits they supply to all players (issuers, investors and brokers).

As far as the capital market concept is concerned, two approaches are used: capital market – for the systems organized according to the European standard, or financial market – for the systems set according to the Anglo-Saxon model.

Attracting investment capital is an ordinary issue. The governments of many countries involved in privatization programmes have lately used global placement techniques in order to attract portfolio investments. These investments best respond to the complementary concerns shown by national and international investors, involving restructuring and modernization by means of funds received from foreign markets.

Capital market importance can be evaluated by various indicators, either absolute or relative degrees. It is believed that an important indicator is the one related to the share of stock exchange capitalization in GDP.

Table 1. Importance of capital market

Country	Market capitalization; % of GDP			
	2001	2006	2008	2010
Belgium	71.3	99.6	33.0	57.4
Bulgaria	3.6	31.6	17.1	15.2
Canada	97.9	133.0	66.7	137.0
China	39.5	89.4	61.8	80.4
France	87.8	107.7	52.7	75.3
Germany	57.0	56.4	30.6	43.6
Greece	66.5	79.5	26.5	24.1
Hungary	19.7	37.3	12.0	21.5
Japan	55.0	108.3	66.0	75.1
The Netherlands	114.4	115.0	44.5	84.8
Poland	13.7	43.6	17.0	40.5
Romania	5.3	26.7	10.0	20.0
Russia	24.9	106.8	23.9	67.9
England	147.2	155.2	70.3	137.4
USA	135.2	145.7	82.9	117.5

Source : [www.data.worldbank.org](http://www.data.worldbank.org)

Table 1 shows three periods of capital market growth: period between 2001 – 2006 characterized by increases often due to transactions’ rising prices, the year 2008 which had a decrease, and subsequent to it, the situation began to improve but did not reach the level of 2006.

The data mentioned above emphasize the decreases faced by capital markets as a consequence of the economic-financial crisis commencement. It started in the USA, in the banking sector, and then it expanded onto capital markets, therefore the economic-financial crisis has proven once more that one cannot touch the sky on a capital market.

The economic and financial crisis has had not only objective, but also subjective effects which are related to the trust in capital markets, and in the funding and investment opportunities they entail.

There are opinions in the financial world according to which capital markets’ collapse is not only the consequence of the banking market crisis, but it is also the effect of market abuses (market manipulation, use of privileged information).

Economic and financial criminality in its complexity has actually covered all the areas of a national economy, starting with the technical, material supply in the economy and ending with the process of privatization and development of banking, financial operations. It is more and more often seen there is an intercrossing of violent criminality

(murders, burglaries, kidnappings etc.) with financial-economic criminality. Authorities are trying to cope with such a phenomenon of economic-financial criminality and their attitude is often reactive, rather than proactive. As far as criminal deeds occurring on capital market are concerned, the authorities regulating and overseeing the market are making special efforts both to legalize the phenomenon and to identify criminal and common actions with each EU member state in order to reduce or remove this trend.

Thus, the present paper aims at explaining criminality manifested on the capital market by means of market abuses and to exemplify its regulatory way in the EU in general, and in Romania, in particular.

## 1. Market abuses

If one wants to make a transaction on the capital market, then one should generally try and contact an authorized broker who is to transpose one’s goal into reality. Investors’ decisions to act on the market rely on certain information related to:

- ◆ the historical development of an asset price which is about to be transacted;
- ◆ the financial, economic growth of an asset issuer;
- ◆ the status of a market where the transaction is meant to take place;
- ◆ the status of national and/or foreign economy.

Certainly, it could be stated that all this information along with everyone’s hunch can lead to making the wisest decision.

However, financial reality proves there are circumstances where market growth may be entirely inadequate to the decision one has communicated to a broker due to certain aspects which could take the form of criminal deeds, namely market abuses. Those who perform activities beyond legality can be people among issuers or the brokers themselves. As far as employees are concerned, fraud circumstances can be caused by the access to privileged information referring to the economic and financial performance of companies, and as to brokers, manipulation occurs when they conclude transactions for others, purchasing significant stocks before such information is made public. As a rule, this type of

information positively influences the price of assets' transaction on the market.

The situations when somebody attempts to infringe the capital market can be:

a) the position of transaction originators in a company/public institution personnel – namely, their chance to access information which is unknown by others and whose publication would considerably influence prices both in terms of going up and going down.

An example in this respect is the case of Claudiu Eugen Iuliu Silaghi, the former Vicepresident of Transylvania Bank's Board of Directors who, during 15 May - 10 December 2009, acted in conformity with the privileged information procured from Sergiu Dan Dască, namely he repeatedly acquired a total number of 43,646,740 securities of Transylvania Bank issuer on the Bucharest Stock Exchange (BVB), in the account of his mother-in-law, an amount which was worth almost 75 million Lei in order to ensure his dominant position over these securities' supply and demand and to set improper transaction circumstances, hide the identity of their true holder, and to use the privileged information which he had known ever since the autumn of 2008 (as he was a Member in Transylvania Bank Management Council), all referring to the intention of Bank of Cyprus to acquire a significant stock of Transylvania Bank (dealt with the symbol of TLV). On 7 December 2009, Silaghi by means of a specialized company sold all the shares acquired that he was holding at that time (33,600,000 TLV securities) at the price of about 80 million Lei to the Bank of Cyprus, the buyer, thus raising a profit of 5 million Lei. Another example in this respect is Wolfgang Rutenstorfer, the manager of OMV, investigated by Austria's Regulatory Authority of Financial Markets for having manipulated the capital market. Wolfgang Rutenstorfer was suspected of having bought company shares of more than 600,000 Euros when he precisely knew their value would rise, by selling the Austrian company's participation to MOL. The German press stated that after the announcement, OMV shares rose by 3.33% and the virtual profit made by Rutenstorfer was almost 45,000 Euros.

b) the easy access to monetary resources – here, the mechanism is as follows: since the

access to banking resources is more facile, manipulators borrow on the banking market and use the amounts obtained this way on the capital market by acquiring assets. Including more acquisition than sale orders shall generate the increase in prices, therefore manipulators shall decide to sell their assets and thus the history repeats itself.

## 2. Related legislation

The phenomenon of capital market manipulation is especially important from the perspective of the effects it leads to and that is why the authorities that regulate and oversee capital market have included adequate regulations in the related legislation.

As a matter of fact, Directive 2003/6/EC in the European Union indicates that ensuring true economic growth relies on the proper operation of securities markets and on the people's trust in these markets, as market abuses affect the integrity of financial markets and impair people's trust in securities and derivatives. The adoption of this Directive has pursued the implementation of several common norms to fight against the abusive use of confidential information and market manipulations because it is believed this is how the same framework within the Community would be provided to distribute responsibilities, apply norms, and cooperate.

Using confidential information can mean acquiring or supplying financial instruments by a party involved that knows or should know the information it holds is strictly confidential. The mere fact that market creators, bodies entitled to act as counterparties, or people authorized to execute orders for third parties that have confidential information confine, as far as the first two categories are concerned, to running legitimate activities of buying or selling financial instruments, or, as to the last type, to executing an order in conformity with applicable norms, should not be regarded as use of confidential information.

In order to implement the European Directive regarding market abuses, the Committee of European Securities Regulators (CESR) has drawn up two series of measures so far. The former CESR guideline (CESR, April 2007) aims at

explaining three issues regarded as priorities: market practices accepted in connection with market manipulation, suggestions of CESR members referring to what they think of as market manipulation, and also the way suspicious transactions can be reported when they are identified. The latter guideline (CESR, July 2007, p.4) aims at clarifying the way “privileged information” is perceived by the Directive regarding market abuses.

Market abuses must be analyzed from the perspective of the type of market practices which are accepted by each regulatory and monitoring authority for capital market. Thus, preamble 20 of Directive 2003/6/ concerning market abuses states that a person making transactions or issuing orders for market manipulations can decide that the reasons for making the respective transactions are legal and the transactions and orders comply with the practices allowed on the respective regulated market. “Market allowed practices” mean the practices which are difficult for being used on one or several financial markets and are accepted by a competent authority in compliance with the orientations adopted by the Commission. Allowed market practices “make up a process set up at national level, that is why a practice which a competent authority regards as accepted may be seen otherwise by another competent authority, and the purpose of including the accepted market practice is to avoid the penalization of operations which could mean market manipulation but can be justified in certain circumstances, whereas the people doing such things can be exonerated from administrative responsibility or criminal responsibility, if necessary.

It is well-known that criminal organizations use a financial system for their illegal activities.

In order to improve measures’ efficiency and transparency for preventing economic crimes, it is requested that states and international organizations should cooperate. Their cooperation can be represented by exchanges of information and expertise, legislative compliance, common activities for the monitoring and investigation of economic crimes and frauds across borders. Moreover, the analysis of the current economic crisis emphasizes major flaws of monitoring in the financial sector, both in individual cases and within the overall system, as it is shown in

preamble 1 of Directive 2010/78/EU. National monitoring models have not succeeded in keeping up with financial globalization of the reality of European financial markets based on integration and interconnection within which numerous financial institutions perform cross-border activities. Directive 2010/78/EU entails several amendments to Directive 2003/6/ regarding market abuses, namely it grants certain rights to the European Supervisory Authority (European Securities and Markets Authority) (hereinafter referred to as ESMA) set up by (EC) Regulation no.1095/2010 of the European Parliament and Council, regarding the drawing up of technical standard projects referring to allowed market practices, the supply of uniform circumstances to apply the Commission’s acts. In addition, there is the obligation of supervisory authorities to collaborate and timely provide the ESMA with all the necessary information to help it fulfil its tasks.

In Romania, market abuses are incriminated by Law 297/2004 concerning capital market, with subsequent amendments and annexes. The set of crimes generically called market abuses is made up of market manipulation and use of confidential information.

Manipulation as a component of market abuses is defined by Article 244, fifth indent as being:

a) transactions and transaction orders:

1. which raise or might raise false questions that mislead one in relation with the demand, supply or prices of financial instruments;

2. which, by the action of one or several people together, maintain the price of one or several financial instruments at an abnormal or unreal level;

b) transactions or transaction orders which involve fictitious procedures or any other form of fraudulence;

c) dissemination of information by means of the mass-media, Internet, or any other way, showing false signals that mislead one about financial instruments, including the dissemination of misleading rumours and false news when the disseminating person knows or should know that a piece of information is untrue or deceptive. As far as journalists doing their jobs are concerned,

information dissemination is taken into account in conformity with the rules governing their performance, except for the people who use such information in order to directly or indirectly gain some advantages or profits.

What is also noteworthy is law makers' intention to exemplify various operations which can be regarded as market manipulatory by Article 244, sixth indent.

Since the performance of capital market can also be influenced by certain people's use of information that the others cannot access, the category of crimes aiming at capital market also includes initiates' offence meaning the use of privileged information.

Privileged information is defined as precise and never made public, directly or indirectly referring to one or several issuers, or one or several financial tools and, if made public, it could have a significant impact upon the prices of such tools or upon the prices of derivatives it is connected with (Law 297/2004, Article 244, first indent). Since the transaction activity on capital market envisages derivatives for commodities, too, then "privileged information" is concerned with precise information which has not been made public and directly or indirectly refers to derivatives, whereas it is expected by the players on the markets where the respective derivatives are transacted, in compliance with accepted market practices (Law 297/2004, Article 244, second indent).

## Conclusions

Market criminality trend is highly important due to the effects it generates both at microeconomic level (the control over certain companies taken by certain groups, or the raising of huge profits), and at macroeconomic level in a context where prices' decrease can lead to financial markets' collapse, there is investors' reticence of participating on the market, and the relocation of funds towards other financial markets thought to be more stable, and even worse, keeping funds to one's own interests and emergence of crises whose consequences cannot be estimated from the beginning.

The major economic change for the integration in the global economic system

and for the liberalization of trade and investment has made Romania face a substantial increase of world trade and capital flows.

The world economic crisis has entailed increasing criminal deeds especially in organized ways and economic criminality means a threat to a state's economic and social stability.

Once information technology has progressed, the criminal networks of cross-border organizations have been internationalized as well.

Cross-border organized criminality has diversified its operations and it aims at: drug trafficking, gun trafficking, human smuggling, trading of smuggled goods, fraudulent commercial practice, informatics criminality, counterfeiting, stealing, money laundering.

Criminal organizations have acquired great financial powers which allow them to get involved in human and capital resources, to access privileged information, influence political and economic decisions in order to get revenues by means of their own activities, money laundering and speculations of the legal framework's flaws.

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## IMF Role in the Context of the Romanian Financial Law

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### Abstract

*Today, as we know, credit takes the form of a loan of money to be returned in a future period established in the loan agreement, which is a document under private signature. Credit operation is also considered to be the operation we take into possession resource using as payment a sum of money called interest.*

*Lending operation necessarily refers at two parts; one part receives money while the other borrows money. Lending can occur in various forms, among individuals in the form of simple personal agreements, but also using the form of lease transactions involving complex credit contracts. Parties involved, tools used by parties, the guarantee used for credit, the terms of restitution and interest, are often very different.*

*Financial credit as an institution is essential for good working of economy, but also means taking a risk by providing money from banks or financial institution. For this reason, the bank must act as a financial analyst or "loan officer" in order to ensure its future. Financial resources must be directed towards the most efficient investments. With each loan, banks face a number of risks: default risk, illiquidity risk, interest rate change market risk, capital risk etc.*

**Key words:** Financial Law, Credit, Crisis, IMF, Depression;

**JEL Classification:** Law and Economics General; K 30

### 1. Romanian Financial Law, the Credit and IMF.

Credit appeared thousands of years ago with the general using of the money as a medium of exchange of the merchandise. The

credit had a constant evolution. Today the credit has a crucial role in global economical development and trade mechanisms. Taking in account the world economy, there were different stages in the development of credit. At beginning, the majority of the members of the society produced goods and services for their own consumption. Today the world economy has reached a place where trade is carried out using bank transfers and "electronic money"(Ion Turcu, Mădălina Stan - "Current issues in banking law"). If initially, national banks were important, today an increasing role is played by international banks.

International banks are banks that have headquarters in one country and branches in many others. The main banking operations carried out by them are: banking for transnational corporations, loans to companies in other countries, the preferential trade credit and other foreign currencies.

Among these international banks, the International Monetary Fund plays a key role due to its huge financial force and international representation.

With its near-global membership of 188 countries, the IMF is permanently helping member states and governments around the globe. This organization is observing all the time global economic trends and performance, showing its member states the main problems and difficulties, providing a non-political platform for financial and economical dialogue. From the very beginning, IMF was preoccupied by the ways to identify the main financial problems and to show to its member states the ways to pass the crisis and "stop over" moments.

Globalization from the perspective of economical integration and financial crisis might be the general terms used to describe the worldwide situation. The actual globalization brought a plenty of benefits, has increased international trade and cultural

exchanges, removing political and economic obstacles. Increasing interdependence in international relations, besides positive aspects undoubtedly brought some negative aspects related to economy, financial market, labor market, commerce and tax policies. The present economical and financial crisis has emphasized this huge interconnection between the member states of the world. The IMF is the “financial angels” of the world permanently helping the states facing difficulties and giving specialized advices in this regard. Another important role of IMF is the financial support provided to the members and also the economical advices for developing nations in order to help them to achieve macroeconomic stability and reduce the level of the poverty and to create a better environmental conditions for economy, financial market and life in general (Florica Iordache – „*The environment – a must be protected resource*”).

## 2. The international crisis and IMF.

The IMF, as international financial organization is permanently supporting its member countries trying to offer:

- assistance and programs for training to support member states to improve the management and development of their economies.
- financial, economical and administrative advices for banks, financial institutions, Ministers and governments based on studies and analysis taking in account economic trends and tendencies.
- financial credits to help states facing economical and financial difficulties and crises;
- statistics, forecasts, studies and analysis based on tendencies of global, zonal, and individual economies and financial markets.
- long time financial credits to help fight poverty in developing countries.

The IMF has been on the first place lending money to different states to help boost the global economy as it suffers from a deep crisis and economical convulses. The beginning of the 21st

century, allowed the international financial credits to help the globalization and economical development that enabled many countries to pay back the credits from the IMF and other international banks. Moreover, these credits have been transformed in economical opportunities causing the accumulation of financial reserves, on national level, to protect the natural resources and to use in efficient way the current opportunities (Anechitoae Constantin – „*The geopolitics of the maritime systems*”). The present global economic and financial crisis began in 2007 with the collapse of mortgage lending in the United States, and due to globalization spread around the world. The crisis was possible, as well, because of huge imbalances in global financial credits. The private financial credits would never have again the crucial role they had in the nineteenth and early twentieth centuries, and the IMF had traditionally offered credits to members facing economical and financial difficulties.

## 3. Conclusions.

The present global crisis revealed the instability of financial markets that soon led to the worst global depression ever. The IMF has been assaulted with requests for stand-by arrangements, financial requests and other forms of financial and support. The IMF's lending capacity increased in 4 years with 300%, reaching the record level - \$750 billion. In order to manage this huge amount of money, IMF should create new flexible mechanisms and new accreditation rules offering a modern financial policy for its clients.

The global economy was forced to admit, after decades, that the IMF's financial resources were the main “financial protector” of the nations and a reliable engine in the fight against this great depression.

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## Tax Havens and the Financial Law

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### Abstract

*After the beginning of the financial crisis, the topic of tax havens has been emphasized as priority and put back in financial and economical debate. The participating countries requested update of the "black list of tax havens" in Europe, some voices calling for the addition of Switzerland. Previous list contained only three countries, namely Monaco, Andorra and Liechtenstein*

*Tax havens are using easily convertible national currency and fiscal and financial control is dedicated only for the residents. The effect of tax havens in the context of current economical crisis requires more points of view. In the analysis, should be considered, also, the off shore territories, due to the fact that, in the current globalization, tax havens have become a part of the global economy*

*According to some views tax havens, primarily generates and encourages tax evasion in off shore territories. Permanent fight to reduce taxes, avoiding taxes is not all the time tax evasion. It is obvious that, essentially, evasion is an unlawful act, in all tax systems, assuming a tax fraud for the financial system.*

**Key words:** Financial Law, Tax havens, Crisis, Tax evasion, Off shore companies;

**JEL Classification:** Law and Economics General; K 30

### 1. Tax havens and off shore companies versus financial law.

Theoretically, should be admitted that, can be tax evasion through legal means, i.e. using the vulnerabilities and gaps of the law. In terms of legal doctrine, a company could get more income by paying lower taxes,

respecting the law, not committing a fraudulent act. For this, the administrator should be an excellent book-keeper person having good knowledge of financial and tax law.

When taxpayers, respecting the law, placing their business in tax havens using off shore centers, to pay less taxes, they do nothing then exercising a right. This right is the right to establish the company wherever business pays lower taxes. In these circumstances, exercise a legal right is not "tax evasion", because distort the notion of "tax evasion" and distort the exercise of rights itself

The disadvantages of the existence of tax havens, with global impact include - increase tax evasion, increasing corruption and organized crime (including money laundering), creating preconditions of the financial crises, the emergence of imbalances in operating systems markets. There are other significant side effects - tax losses of the world, marketing illegal or prohibited products, the illegal placing of capital etc

The existence of these areas enables financing of illegal activities or terrorist acts, which, due to banking secrecy are almost impossible to prevent and detect them. The current financial crisis highlighted the importance of supervision to maintain the functionality of financial systems. Wealth tax havens adversely affect the budget revenues of countries with high taxation - especially in the context of the economic crisis.

Due to the internationalization of off shore funds, appeared disadvantages and difficulties in applying national monetary policies

The tax cut is the main advantage of being tax havens because it is done by optimizing fiscal and financial systems worldwide, off shore territories contributing to capital mobility.

Status of an off shore company offers benefits to investors and the state where there are such companies. Investors bring tax advantages, minimal accounting formalities, avoidance of double taxation, privacy, anonymity of ownership, reduced risks, flexibility and efficiency in company registration without rigorous controls.

States of the world where there are such companies have several advantages: receiving registration fees, taxes operation, taxes for licensing, increasing the level of employment, use of the local economic potential, eliminate poverty, etc.

The main advantages of tax havens are:

- Developed infrastructure. They hold advanced telecommunications, developed and stable banking system;
- Low bureaucracy. Off shore companies are exempt from the obligation to keep accounts or to sign the balance sheet, or all of these are formal;
- Reduced taxation. In all tax havens, the law tax regime is guaranteed by law. Taxation is zero or near zero;
- Protection of property rights. Income and assets offshore company can be used anytime after the free will of the beneficiary company.
- Anonymity. Identification of shareholders and directors is not allowed;

Among other advantages are: increasing foreign revenue, accelerating economic development, increase employment and income levels of the population etc.

Organization for Economic Cooperation and Development has identified some key factors that are precise criteria for determining and defining those territories practicing a favorable tax system.

First, the OECD established that the level set for any taxes is much reduced or is totally missing. Level of business transparency is very low. OECD has established as a tax haven is characterized by the existence of a legal vacuum in the area of finance and taxes. This organization has determined that another feature of tax havens is the secrecy of financial operations. There is always a reluctance of companies to provide financial information about their activities, confidentiality being protected by law in this respect. From this perspective, the OECD urged countries of the world to adopt laws allowing the exchange of information in legal

interest to be facilitated. Thus, the OECD has issued “white”, “gray” and “black” lists for different countries, depending on their willingness to collaborate.

## 2. Conclusions.

The debates on the positive or negative effects of tax havens may continue. Beyond these arguments, the question remains whether the phenomenon of tax havens should be encouraged or denied and if the world needs to react in favor of these territories?

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## Globalization in the Field of Legal Language: the European Legislation and the Strive towards a Pan-European Legal Taxonomy

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### Abstract

*Generally speaking, translation plays a fundamental role in the interaction between law and other domains, between different peoples and cultures. Given its important role in the intellectual and institutional development in EU countries and its pragmatic importance in the economic field, legal translation deserves close analysis. The present paper attempts contribute to the investigation of this field since its main purpose is studying legal translation as both an intellectual pursuit and a profession in our increasingly globalized world.*

**Key words:** multilingualism, legal translation, source language, target language, aquis

**J.E.L classification:** Z00

### 1. Introduction

Multilingualism and linguistic equality among European Union (EU) Member States has been one of the underpinning values and practices since the foundation of the EU. Linguistic and cultural variety is what gives the EU its specific personality (Wilson 2003: 20). As legislating body, the European Parliament promulgates laws that turn into national laws and have direct binding force on the citizens of the Member States. To this end, EU laws are translated and published in its Member States' official languages and, thus, translation is essential for the functioning of the European Parliament. At another level, the demand for legal translation is on the increase around the world due to globalization and the increased connection and exchange between peoples and states. Therefore, it should be pointed out that EU laws are inconceivable without

translation (cf. Correia 2003: 40) since, at present, not only does the EU have twenty official languages, but also the demand for translation in the EU is growing with the addition of new Member State (see Wagner et al. 2002: 78).

Obviously, translation plays an integral part in the interaction between law and other spheres, between different peoples and cultures. Given its important role in the intellectual and institutional development in different countries and its pragmatic importance in the economic field, legal translation deserves close analysis. These pages attempt contribute to the investigation of this field precisely since its main purpose is studying legal translation as both an intellectual pursuit and a profession in our increasingly globalized world.

It is commonly accepted that legal translation is intricate, and it requires special skills, knowledge and experience on the part of the translator to produce such translation. As we are going to see, daring claims have been made about legal translation (Harvey 2002: 177). It has been described as a category in its own right, and as 'the ultimate linguistic challenge', combining the inventiveness of literary translation with the terminological precision of technical translation (Cairns and McKeon 1995, Gémar 1995, Pelage 2000, cited in Harvey 2002: 154). Indeed, as already mentioned, the translation of law has played a very important part in the contact between different peoples and different cultures in history, and it is playing an even more important role in today's globalized world. One major problem with the existing classifications of legal translation is that they are based on the function or use of the original legal texts in the source language (SL), without due regard to the various target language (TL) factors, such as the functions or status of the translated texts. Legal

translation can be classified according to different criteria, such as the subject matter of the SL texts. First, these can be: (1) private legal documents; (2) domestic statutes and international treaties; (3) legal scholarly works; and (4) case law. Second, legal translation can also be divided according to the status of the original text: (a) translating enforceable law, e.g. statutes; and (b) translating non-enforceable law, e.g. legal scholarly works. Moreover, according to Sarcevic (1997), legal translation can be classified according to the functions of the legal texts in the SL into the following categories: (A) primarily prescriptive, e.g. laws, regulations, codes, contracts, treaties and conventions—these are regulatory instruments containing rules of conduct or norms and therefore represent normative texts; (B) primarily descriptive and also prescriptive, e.g. judicial decisions and legal instruments that are used to carry on judicial and administrative proceedings such as actions, pleadings, briefs, appeals, requests, petitions etc.; and (C) purely descriptive, e.g. scholarly works written by legal scholars such as legal opinions, law textbooks, articles etc. However, as stated by Roberts (1992), there is a need to distinguish the functions of the SL text from those of the TL text and it is necessary to consider the TL variables, in addition to those of the SL. Another problem of the existing taxonomies is that many documents such as documents used in court proceedings that are used in the legal process and translated as such are excluded from the classifications. A third key problem is that some of the classifications such as Sarcevic’s exclude communications between lawyers and non-lawyers (clients). The restriction in Sarcevic’s ‘legal texts for specialists only’ excludes some text types that account for a big part of the legal translator’s workload in his/her daily activity: private agreements and correspondence between lawyers and clients, for instance (see Harvey 2000).

## 2. Strategies in translating legal texts

Due to the nature and function of law, legal language has acquired particular linguistic features—lexical, syntactical and pragmatic—in order to fulfill the demands of the law and accommodate the idiosyncrasies of law and its applications. Such linguistic

characteristics of legal language have profound repercussions for legal translation. If we examine legal language as a whole, common and singular linguistic characteristics can be recognized across different legal languages, traits which become manifest from the point of view of the vocabulary, syntax, pragmatics, and style.

### 2.1 Lexicon

In terms of legal vocabulary, a distinctive feature of legal language is the complex and unique legal lexicon found in different legal languages. This is a universal feature of legal language but different legal languages have their own unique legal vocabulary. This can be considered as the most visible and striking linguistic feature of legal language as a technical language used for specific purposes.

The legal vocabulary in each language is often extensive as it results from and reflects the law of the particular legal system concerned. Because of the differences in legal systems, in translation, many of the legal terms in one language do not correspond to terms in another a fact that gives way to the issue of non-equivalence, a major source of difficulty in translation. Furthermore, within each legal lexicon, there are also peculiarities which do not always match in different legal languages.

For instance, studies have identified specific linguistic characteristics of the English legal language. The English legal lexicon is full of archaic words, formal and ritualistic usage, word strings, common words with uncommon meanings and words of over-precision, among others (see Mellinkoff 1963, Danet 1980, Bowers 1989), Tiersma 1999). On the other hand, in legal German, the terminology is often highly abstract, with a high frequency of the use of nouns (Smith 1995).

### 2.2. Syntax

When analyzing legal language, a common feature of its syntax is represented by the formal and impersonal written style coupled with considerable complexity and length. As noticed by Salmi-Tolonen (2004: 1173), in general, sentences in legal texts are longer than in other text types, and they may serve various purposes. For example, in statutes, often long and complex sentences are required due to the complexity of the subject matters and the prospective nature of

legislative law. Using conditions, qualifications and exceptions extensively are the additional linguistic features of legislative language, commonly employed to express complex contingencies. According to Bhatia (1997), these peculiar linguistic features, often create barriers to the effective understanding of such writing for ordinary people, translators included. Thus, in order to understand and translate legislative provisions, one is required to take into account the typical difficulties imposed by some of these factors (Bhatia 1997: 208).

Apart from long and complex sentence structures found in most legal languages, there are also syntactical peculiarities to each legal language. In legal English, complex structures, passive voice, multiple negations, and prepositional phrases are used at length.

### 2.3. Pragmatics

As stated earlier, law depends upon the performative nature of language. Legal utterances perform acts and generate facts, rights and institutions. Typically, legislation is a prime example of ‘saying as doing’. Statutes, contracts and wills are other examples of legal speech acts in action. For instance, a statute is a master speech act with each provision constituting individual speech acts. It should be pointed out therefore that ‘performativity and modality are the linguistic means which express the institutional ideology of the role relationships involved in legislative rule-making’ (Maley 1994: 21).

Words in legal language differ in meaning, their importance and effect depend on the person who utters them, on where and when (Hart 1950). Of these speech acts, a prominent linguistic feature is the frequent use of performative markers. For instance, in English legal documents, ‘may’ and ‘shall’ are extensively employed. Performative verbs such as ‘declare’, ‘announce’, ‘promise’, ‘undertake’, ‘enact’, ‘confer’ and ‘amend’ are also common. Another pragmatic consideration in legal texts is ambiguity, vagueness and other uncertainties found in statutes and contracts, which are often points of legal contention. The courts often have to deal with such linguistic problems in their search for uniform interpretation and legal certainty.

### 2.4. Style

Legal style refers to the linguistic aspects

of the written legal language and also the way in which legal problems are approached, managed and solved (Smith 1995: 190). Legal style results from legal traditions, thought and culture (Smith 1995). As already mentioned, legal writing is characterized by an impersonal style, with its extensive use of declarative sentences pronouncing rights and obligations.

To sum up, the abovementioned description of legal language is a general account of the linguistic markers believed to be common in most if not all legal languages in varying degrees. Nevertheless, it is important to take into account that major differences also exist in different legal languages and such differences represent a source of difficulty in legal translation.

### 3. Striving for a pan-European legal language

As far as private law is concerned, the link between language, law and cultural identity is considered to be strong. It is not therefore surprising that the greatest resistance to the harmonization of European law has been in core areas of private law relating to contract law.

This section examines basic terminological problems in the present acquis and the new approach to language in the ‘academic’ DCFR, which was published in 2008 as a model for a ‘political’ Common Frame of Reference (CFR) to be completed by the Commissions and adopted during 2016. Although it remains to be seen whether and to what extent the CFR will be used in future EU legislation, Professor Christian von Bar, chairman of the Study Group on a European Civil Code is optimistic that it will eventually lead to the creation of a new *ius commune europaeum* (von Bar 2005:17 on the *ius commune*- debate see Smith 2007: 219-230). This reference to the common law of continental Europe formed by the reception of Roman law in the 17th and 18th centuries raises questions as to the feasibility of such an ambitious project under the present conditions. Namely, at that time lawyers in large parts of continental Europe were all part of one unified culture and used the same language, i.e. Latin.

Today the common drafting language is English; however the new pan-European

legal language is not intended to be a process of ‘Anglification’. Therefore, the project can be successful only if the EU policy of multilingualism is upheld and to that end high quality translations are required.

Specialists such as Van Hoecke/Warrington (1998:525) regard the development of some conceptual legal meta-language as “a necessary condition for a real development of comparative law”. A linguist, Anne Lise Kjær, joined the debate on the possibility or desirability of developing a common European legal language. Discussing the topic outside the framework of a European private law, she rejects the creation of a meta-language, calling instead for a European legal discourse across languages as a means of promoting a “common understanding” between lawyers of different legal systems (2004:396; cf. 2008: 153-156).

Multiple references occur especially when EU legislators do not succeed in defining the specific meaning and scope of application of a EU term or provide unclear, vague or inconsistent definitions, “forcing” national judges to interpret the notion in accordance with their national law, a practice which unavoidably leads to different results in the Member States. Deeply rooted in the legal culture and history of each state, private law terminology has different meanings and different usage and it is sometimes classified differently in different national legal systems (cf. Pozzo 2003:756-763; 2006: 7-12). This is also true in regard to legal terms belonging to the common core of all legal systems, such as contract, consumer and damage. For instance, a type of damage which qualifies for compensation in one national legal system is not necessarily as such in another, although the legal systems are closely related and even the same language is spoken as in Austria and Germany (Heutger 2003:7; 2008:12). As for the EU law, the term ‘damage’ is defined differently in the defective products Directive (85/374/EEC). More recently, the environmental liability Directive (2004/35/EC) provides a non-technical definition of ‘damage’ which fails to specify clear criteria for its usage (Pozzo 2006:14), thus enabling the national courts to term in accordance with their national law, at least until the European Court of Justice

(hereinafter: the ECJ) provides a clear definition for the purpose of the Directive.

Later the Commission changed its strategy and introduced the first detailed directive requiring maximum harmonization in consumer protection. Nevertheless, Directive 2005/29/EC on unfair commercial practices also contains general clauses drawing on a „code of conduct” based on „honest market practices” and/or “the general practice of good faith”. In an attempt to achieve maximum harmonization, national legislators are required to faithfully reproduce the words of the detailed provisions as closely as possible when transposing such directives and incorporate word-for-word the long back (=binding) list of aggressive and misleading commercial practices which are deemed unfair in all circumstances. As stated in the Unfair Commercial Practices Directive, the objective is to remove internal market barriers by replacing Member States` divergent general clauses, thus putting pressure on the ECJ to introduce an autonomous interpretation of good faith that would eventually lead to a consistently applicable criterion for determining which commercial practices qualify as aggressive and misleading for the purpose of the Directive. Whether this is possible and desirable has recently been challenged by cultural experts who stress the need to take account of variations of consumer culture in Europe (Wilhelmsson 2007:265-268).

Another shortcoming of the *acquis* is the EU legislator`s use of different terms to express the same concept within the same directive and in other directives. Terminological inconsistency on the part of the EU legislator results in multiple references causing incoherency leading to legal uncertainty and inevitable linguistic diversity in the translations (Šarčević 2006:128). For example, Art.4 of the Doorstep Selling Directive (85/577/EEC) governs the right of cancellation whereby the consumer is released from all his obligations; however, the term ‘right of renunciation’ is used in Article 7 to express the same concept, although the term ‘renounce’ has a special usage indicating the possibility of renouncing a right or interest, for instance, when someone renounces an inheritance (Black`s Law Dictionary 2000:1041). In Article 5 of Timeshare Directive 94/47/EC, the verbs

*withdraw* and *cancel* are used as synonyms in tandem with right to withdraw and right to cancellation. The EU term right to withdrawal finally appears by itself in Article 4 of the Distance Selling Directive 97/7/EC and has been used consistently thereafter by EU drafters (Šarčević/Čikara 2009: 204-206), although the time period allowed for withdrawal differs in almost every directive on consumer protection.

Another flagrant inconsistency is the use of different terms and definitions in respect of the parties to a consumer contract. Although one party is always a consumer, the term is defined differently for the purpose of each directive (see Denkinger 2007:261), causing confusion and encouraging litigation. In fact, one party is always a professional; however, instead of using the generic term professional in the English texts of the directives, as in some French texts, more specific terms are used, such as ‘trader’, ‘seller’, ‘supplier’, ‘vendor’ and ‘retailer’, thus resulting in considerable terminological diversity in the various language versions of the relevant directives.

It shouldn't be overlooked that legal concepts are abstraction of the generic legal thoughts and rules within a legal system. With Weisflog, legal concepts are the “authoritative categories to which types or classes of transactions, cases, or situations are refereed, in consequences of which a series of principles, rules and standards become applicable” (1987:207). Therefore, they play an important role in delineating each branch of the law. For our purpose, as legal translation involves specialized or technical language, the technical nature of legal language stems largely from the extensive use of concepts (cf. Weisflog 1987: 207). Consequently, a frequently encountered challenge in legal translation is the translation of legal concepts because they are often legal system-bound. Take for instance, as cited in Weisflog (1987), the concept of ‘theft’ in English law and its equivalent ‘Diebstahl’ in German law. There are considerable differences in the respective laws as to what constitutes ‘theft’. As Weisflog explains, in English law, ‘theft’ is the ‘dishonest appropriation of property belonging to someone else with the intention of keeping it permanently’ under the English Theft Act 1968. Under the German law, a

person is guilty of ‘Diebstahl’ (theft) if he or she takes away movable property belonging to another with the intention of appropriating it unlawfully. Furthermore, how the two legal systems define ‘property’ and other concepts contained in the definitions also differs (see Weisflog 1987: 210–211).

The problem of translating legal concepts is not new and efforts have been made to find possible solutions.

Recently, various terminological databases have been developed with CAT technology, for instance, Eurodicautom of the EU, but they remain at the terminological, not conceptual level. However, we are reminded that legal translation is not the automatic transposition of a concept from one language into another, but rather it requires thorough knowledge of the two legal systems that interface with one another as well as a comparative analysis of the text and the terms to be translated (2001).

It can be suggested that a legal concept is three dimensional (Cao 2001) based on Peirce's semiotics, meaning that it has linguistic, referential and conceptual dimensions.

To ascertain whether a concept in one language can be translated as a concept in another language, we need to consider whether they are equivalent or similar in these three dimensions. However, in translation, words from different languages are rarely the exact equivalent in all three dimensions. There are two major scenarios in translation here: firstly, when there are no existing equivalent concepts and words in the TL, that is, they are linguistically or conceptually absent, new words must be created or new meanings introduced; and secondly, when there are existing words in the TL that are linguistic equivalent to the SL, these words in the two languages may only carry partially equivalent meanings in law or sometimes may not be functionally equivalent in law at all. This can be seen in terms of the conceptual dimension of a term and its referential dimension, that is, how it is realized in the legal system and how it is understood by the users of the language (see Cao 2004).

The lesson here is that when trying to identify and ascertain the meaning of a particular word with both ordinary and legal meanings or a word with several legal

meanings, one can make use of the context in which the word occurs. This includes both the wider legal context, such as a particular area of law, and the immediate linguistic context such as the sentence, the paragraph and the entire text in which the word is used. A legal dictionary will also be of great help. However, if one is not aware of the additional legal meaning that a simple everyday word may have, and assumes, wrongly, that it is the ordinary usage, one may not enlist the help of the dictionary or reference materials in the first place. So, in translating legal texts in general, the translator, especially those who do not have legal training, should not readily assume that ordinary and common words are always used in the ordinary way. To conclude, general reading of and cross-reference to the relevant existing laws and other legal texts and their translations are always recommended.

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# The Impact of Cultural Events on Tourism Development: Sibiu - The European Cultural Capital

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## Abstract

*This study reviews the findings of longitudinal field research in Sibiu on the cultural profile of tourists during and after the European Cultural Capital Programme (ECOC) and the effects of the event on local tourism. The impact of the event can be gauged through the growth of tourism stimulated by infrastructure improvements and product development, not only in terms of increasing tourist numbers but also by the increase of local income from tourism and related sectors. The ECOC has turned into a model followed by many European cities seeking tourism growth and image change. The ten years of research conducted in Sibiu have highlighted the variety of long term effects that can result from such a complex development model, including tourism growth, changes in tourist profile, image improvement and increased social cohesion.*

**Keywords:** cultural events, European Cultural Capital, impact on tourism, Sibiu ECO.

**J.E.L. classification:** L83, O17

## 1. Introduction

The literature encompasses many explanations for the rise of culture as a force for local development. In Europe, one particularly prominent model of cultural event-led regeneration has been the European Capital of Culture (ECOC), a year-long celebration of civic and European culture which rotates between the member states of the EU. This model has been seen as particularly successful in delivering a range

of benefits, which has led to interest in, and competition for, the ECOC growing markedly [6]

This paper reports on a long-term monitoring project for the Romanian city of Sibiu, which was ECOC in 2007. This case study is of particular interest as the first city in Central and Eastern Europe to host the ECOC, the co-occurrence of the event with the entry of Romania into the European Union (EU) and the development of a growth coalition related to a specific cultural group in the region. The paper aims to evaluate the impacts of the ECOC relative to the aims set for it by local stakeholders and to assess the success of the event and the overall strategy in regenerating the city over the past decade.

The literature on ECOC and its follow-up on local economies and EU as a funder are wide and sometimes controversial. All the ECOC organisers have provided reports and conclusions to the European Commission by the end of the project and some of these reports were used for theoretical and field researches

The Palmer report [6] which evaluated the ECOC from 1995 to 2004 saw the event as one of the most successful EU programmes of all time, delivering huge benefits against a minimal investment from Brussels. The ECOC in Luxemburg in 2007 commissioned an extensive programme of research, which included monitoring of resident and visitor attitudes before and during the event [4]. Stavanger [8] undertook extensive research with local residents before, during and after the event [9]. In Liverpool a major research programme was set up to monitor the long term impacts of the event, with baseline measurements before the event, stakeholder studies during the event and monitoring after the event.

The ECOC has not been without its critics, who have argued that the event tends to cater to well-off, frequent cultural consumers rather than the whole population [1, 5]. The event arguably also has shifted from cultural motives to economic ones. The recent evaluation of Stavanger [9] complained that the European Commission is no longer interested in the cultural content of the event, but would rather hear about success stories in urban regeneration.

What is lacking in much previous ECOC-related research is a link with the broader development of the host city. This paper reports on longitudinal research undertaken in the Romanian city of Sibiu, host to the ECOC in 2007, over a ten year period from 2001-2010. This is the first study to be undertaken of a city hosting the ECOC in Central and Eastern Europe, the period of the research therefore also covers a period of considerable structural change in Romania as a whole and Sibiu in particular.

## **2. Methods**

It is not enough to use official statistics to measure the impact of a major event in tourism development of a city. The statistical data series that intend to figure the evolution of the tourism were examined for their accuracy and checked by several sources. There are some significant limitations with the use of official statistics on economic impact in Romania, the most important of which is under-reporting in order to limit tax liability. For example, Ivan-Ungureanu [2] assumes that for hotels the number of non-registered tourists is about one third of the total.

In addition to measuring different aspects of the relationship between a city and its event(s), there is also a need to develop a longitudinal component to research using field interview. In order to investigate the more qualitative aspects of the effects of the ECOC we have used questionnaires for by passing people downtown and deep interviews among the main stakeholders. The monitoring has started in 2001 as a project for the cultural profile of the tourist of EU covering. After Sibiu was nominated as ECOC organiser with Luxembourg for 2007 the investigations were enlarged and focused on the effects, and long time effects later of

the cultural event in this tourism destination. The research was extended to cover a greater range of stakeholders, and measures were made of the image of the city in other parts of Europe comparing with data from the regular surveys carried out by ATLAS

In this paper we look back over ten years of data collection and analysis to assess the effectiveness of Sibiu’s cultural and tourism development strategy

## **3. Results**

Our annual reports have tried to evaluate the extent to which the city has met its specific aims, which in the case of the ECOC were: raising the international profile of Sibiu, long term cultural development, attracting international visitors, enhancing feelings of pride and self-confidence, growing and expanding the local audience for culture, improving social cohesion and creating an economic downstream, improving cultural and non cultural infrastructure, developing relationships with other European cities/regions and promoting European cultural cooperation, promoting creativity and innovation.

The city therefore had a mix of economic, image, cultural, social and physical regeneration goals. In this paper we look back over ten years of data collection and analysis to assess the effectiveness of Sibiu’s cultural and tourism development strategy. In this work in progress we highlight some of the major impacts of the ECOC cultural event in Sibiu tourism development.

### **3.1 Impact on local population and major stakeholders**

The major impact might be considered the influence the ECOC had on the local community as reflected in the opinions of major stakeholders and residents during the depth interviews. A total of 170 interviews were completed yearly between 2007 and 2011 with stakeholders, the vast majority in Sibiu and the surrounding region and a few number in the rest of Romania. The main interview groups were: cultural operators, travel agents and tour operators, banking and insurance, media, hotels and restaurants, businesses and tourism organizations. Some ideas were found each year that underline the

power of the impact. A short selection of major themes from the data base of ATLAS and Lucian Blaga University of Sibiu as reflected in the annual rounds of data collection [7, 8] include:

*Pride in the city:* Being from Sibiu was suddenly something to take pride in, especially as the city was recognized not just as national, but also European level. “I developed a special sensitivity for everything you call “my city”. The fact that Sibiu was named European Cultural Capital together with Luxembourg is a proud moment. Also, the image to make a potential cue ball in Romania” or “I gained a sense of pride, a kind of: here as you can, you can do something good, something of quality, here we are appreciated”.

*Transformation:* “This programme helped the evolution of the organization of events and highlighted the organizational capabilities of companies in this area”; “My personal life has changed in the sense that in my spare time walking on downtown Sibiu noticed different people from different corners of the world”; “Sibiu has changed a lot lately, mostly due to the great event held in 2007”

*Image of Sibiu:* There was a widespread feeling that the ECOC had put Sibiu on the map not just nationally but internationally as well. Typical remarks were: “Another positive aspect resulting from Sibiu European Cultural Capital Sibiu in 2007 is to increase visibility both nationally and internationally through cultural events of the highest class”. The image impacts were not just external, but internal as well: “Of course Sibiu has a good image because of its history and medieval atmosphere that persist through the beauty of places, the hosts, etc., which has aroused the curiosity of many Europeans, bringing them here in 2007. I think this programme has been exploited bringing many benefits to residents of the town. I am from Sibiu and attended many events held in 2007 in Sibiu and I was pleasantly surprised by the seriousness and extraordinary ideas”.

*Cultural and social impacts:* Many interviewees emphasized that the impacts of the ECOC were wider than just economic: “Sibiu-European Cultural Capital in 2007 was designed so as to provide opportunities for issues of inclusion and social cohesion, education, heritage tourism and urban

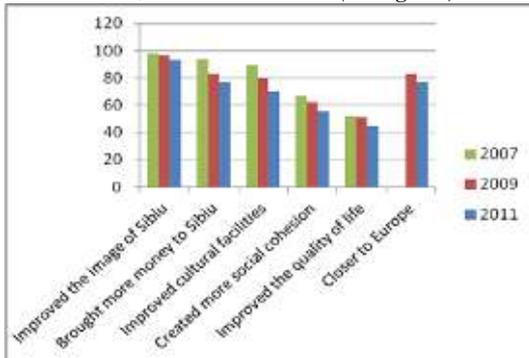
regeneration at all levels. The programme puts culture at the heart of city life and looking into her inspiration for driving community forward” or “The ECOC in 2007 as well as 2008 both gave the opportunity for me and other one thousand inhabitants of the town to watch shows and events culture that otherwise would not have been present in Sibiu (i.g. the Vienna Philharmonic)”

*Renovation:* One of the crucial elements in improving the image of the city was the renovation of the old town. “Very visible in the eyes of the people was the renovation historical centre which otherwise would not have happened very quickly. Both the historical centre and the renovation of an impressive number of monuments and cultural organization of the various events had a favorable effect on the town”; “After renovations are completed, Sibiu has restored life ... or so it seems to me”; “large investments in conservation, renovation and highlighting the historical centre, has attracted a number of investments that have led to the development of tourism, both in Sibiu and its surroundings”

*Role of the Local Authority:* Many stakeholders emphasized the important role that the civic administration had played in the development and the success of the ECOC. “Locally, in my view local authorities were very much involved, have managed to attract funds and manage them as effectively all in the interests of the community and the city that was very visible in the eyes of the people was the renovation of the historical centre”.

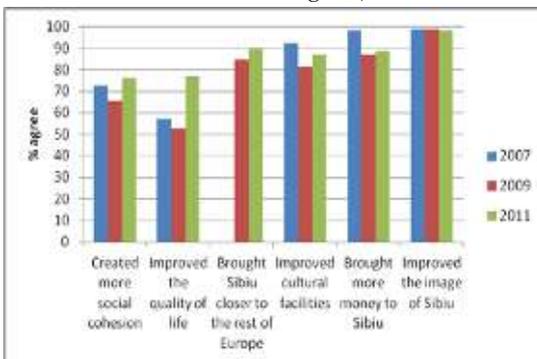
The feeling that the ECOC has had a positive and determinant impact is still high even after five years. Interestingly, there was also an increase in the quality of life and social cohesion benefits of the ECOC among residents in 2011 compared to 2009.

1. Statements about the impact on Sibiu 2007, 2009 and 2011 (% agree)



Source: (Richards & Rotariu 2011) page 41

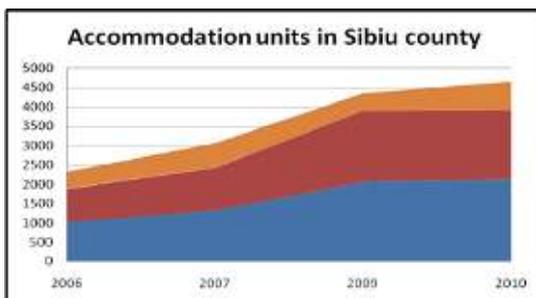
2. Statements about the impact on Sibiu 2007, 2009 and 2011 (residents only, % agree)



Source: (Richards & Rotariu 2011) page 41

3.2 Tourism Development Effects

The impact of the ECOC on the general growth in tourism supply before, but mainly after the event focused on hotels and other accommodation facilities in terms of number of hotels' beds but also in terms of the standard of the accommodation establishments. Since 2001 the number of hotels has more than doubled and the total registered accommodation units have grown by 40% to fit the increased demand.



Source: (Richards & Rotariu 2011) page 39

All figures show the same major trends: increase of capacity; increase of high level of comfort units; a faster increase of investments in neighborhoods of Sibiu comparing to the town; a trend of enlargement and development and improve of comfort of existing capacities; a relatively slow increase in 2010. Specially notable is the operating of global hotel brands in the city: Hilton, Ramada, Golden Tulip, Best Western, Ibis and national brand Continental.

The growth of hotel accommodation in Sibiu itself also had a strong impact on the surrounding region. Growth in the regions close to Sibiu was just as strong as in the city itself. The Sibiu neighbourhoods (up to 25 km radius) has achieved the same capacity as the town itself, but the accommodation is mainly guest houses and pensions that offer much lower rates, offering both green holidays and easy access to the intense cultural life of the town.

3.3 Tourism economic impact

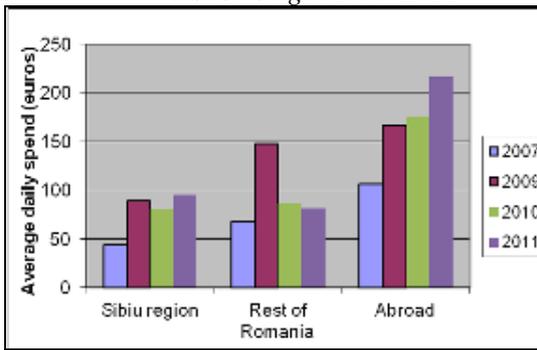
All major events are supposed to boost the tourists' arrivals and increase the income of the organizing area. All ECOC have had this result. Statistical data and field research have shown that Sibiu has enjoyed significant outcomes in spite of the effect of the global crises. And the effect is still visible even after five years. The tourists' arrivals reached a pick in 2007 as a result of the large number of events organized. Figures on average visitor spending show that spend levels increased particularly sharply during the ECOC in 2007, largely because of the influx of high spending foreign visitors

2. Spend by hotel guests in Euros

	Travel spend	Admission	Food and drink	Shopping	Accommodation
2007	212.1	21.53	126.2	87.9	250.2
2009	157.7	62.44	145.3	277.9	269.4
2010	249.5	82.67	187.5	167.9	310.0
2011	227.3	47.95	157.1	147.2	310.5

Source: (Richards & Rotariu 2011) page 32

3. Average spend per day (Euros) by visitor origin 2007-2011



Source: (Richards & Rotariu 2011) page 31

Taking the figures for tourists staying in Sibiu and their average spend, we can estimate total tourism spending at €26 million in 2010, which is actually higher than 2007, the ECOC year. This indicates that the ECOC had a strong and stable positive impact on local tourism development over the longer term (Richards & Rotariu 2011 pag 36)

We have also to point out that the field research has clearly shown that almost one third of the visitors stay with friends and relatives. This allows us to estimate the total tourist expenditure at almost €50 Million, which is 40% more than in 2007, in spite of the global economic crisis

3.4 Visitor behavior, quality of the visits experiences

Sibiu was known as a medieval city. Classic tours included a walk downtown and a visit to Bruckenthal Museum. The ECOC changed the cultural consumption of cultural attractions. Previously the town have hosted a couple of traditional events: Theater Festival, Jazz Festival, Potters Faire etc. After 2007 the cultural agenda has become more organised all year round and has become more related with the tourism seasons. Since 2007, it is clear that visitors to the city have been visiting an even wider range of attractions. In particular, visits to ASTRA Museum, the Lower Town and the Fortifications have increased, reflecting the investment in these areas, but also the Orthodox and Evangelic Cathedrals.

4. Sites visited in and around Sibiu (% of visitors)

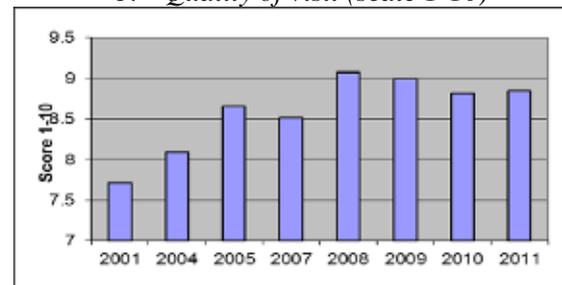
	2007	2008	2009	2010	2011
Bruckenthal Museum	27	71	61	57	62
Orthodox Church	27	40	46		39
Evangelic Church	25	60	46	39	41
The Lower Town	25	35	52	47	51
ASTRA Museum	20	58	58	54	57
The fortification	19	25	38	33	32
Fortified Churches around Sibiu	12	24	24	19	22
Street animation		50	42	43	43
None of these	36	4	7	4	4

Multiple responses allowed; Source: (Richards & Rotariu 2011) page 27

As a result of the modernization of the museum offer, the number of visitors – locals and tourists – has constantly increased: the National Bruckenthal Museum had almost 3000,000 visitors (one of the most frequently visited museums in the country) and ASTRA Museum had 250,000 visitors.

The number of visitors coming especially for events has steadily increased, and most of the shows sold out all their tickets, which has led to a diversification of booking systems. The experience acquired for and after ECOC has developed more expertise in the local administration and created strong collaboration with stakeholders involved directly in tourism activities. This has led to a higher quality of tourism experiences.

5. Quality of visit (scale 1-10)



Source: (Richards & Rotariu 2011) page 28

The new expertise and the ability to work in the community has encouraged the local authorities to launch a new major event for 2012; the “Sibiu Baroque Update”, which is addressed to the national market that supplies the majority of the tourists (around two thirds of total visitors).

#### 4. Conclusion

Our research indicates that the Sibiu ECOC in 2007 and the programme of cultural development leading up to it had substantial impacts on the city both in the short and longer term. In the short term there was a significant economic boost from tourism and an improvement in the external image of the city. Levels of social cohesion rose and feelings of local pride increased and cultural activity in the city reached record levels. Over the longer term there has been increased cultural, hotel and infrastructure investment and a qualitative change in tourism flows towards cultural visitors with higher spending power.

The Sibiu experience emphasises the importance of creating internal and external networks. Sibiu has made good use of its links to rest of Europe, helped by its cultural ties with Luxemburg and the linguistic links with Germany. This situation may seem extraordinary in Romania, but it does to some extent mirror the experience of cities elsewhere.

This seems to confirm an important conclusion of the Palmer Report (2004) evaluation of the ECOC, namely that political stability and commitment are vital to the success of the programme.

In the case of Sibiu this seems to have delivered an event which is perceived to have a tangible legacy, and which has not been quickly forgotten by residents or external observers. This is an important factor in the current adverse economic climate, which in many other cases might lead to the ECOC being associated with the economic slump that followed it.

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## The Monetary Policy of China- An Econometric Model

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### Abstract

*An economy like that of China started out a lot of controversies and a lot of analysis. Recently, the monetary policy led by China gave birth to a series of disturbing questions, as follows: for how long can the fixed exchange rate be sustained? what will be the consequences of the continuous increase in foreign exchange reserves? is the expansionary monetary policy reliable? will the inflation bubble explode? In this article we apply an econometric model using the Eviews software in order to illustrate that the increase in money supply will eventually lead to inflation. This analysis is the basis to be followed up in the future if this co-dependence relationship between money supply and inflation continues. It would mean the end of the economic stability and growth of China. On the long run this model could prove that the Chinese economy is in fact a bubble ready to explode.*

**Key words:** monetary policy, money supply, inflation, econometric model, expansionary monetary policy.

**J.E.L. classification:** E27, E47, E51

### Introduction

A country such as China that relies on strength, on stability, on exports, on supremacy to evolve and especially a country that uses every mean necessary to develop usually hides a lot of problems. A lot of times it has been said that an economy like that of China will „explode” because the economic growth is not sustainable on the long run and

the attitude of great power is premature. In this article we focus on the monetary policy and we will show that the expansionary monetary policy that China adopted in the last years would eventually lead to the beginning of the destruction of the „bubble” often associated to this economy. We will focus on the relationship between the increase in money supply and inflation to sustain a model that could enforce this idea.

We sustain the idea that the unjustified growth of the monetary mass will in the end lead to high and uncontrollable inflation and the price stability would be history.

### Literature review

Across the economic history, there were a lot of definitions for inflation, and even more theories stating the connection between inflation and the monetary mass. Even since 1752 David Hume stated that, when there is an increase in the money, then in time we will automatically witness an increase in the prices. Furthermore, the supportive theory developed from the quantitative theory of money to the theory of the purchasing power of Irving Fisher. According to this theory, the increase in the money supply will be automatically transposed in an increase in the prices, inflation being a monetary phenomenon. From Keynes on other elements were discussed, like the theory that the increase in the monetary mass will not exclusively reflect itself in the prices, and will have effects both upon income and upon the interest rate [1]. After that, the neo-monetary theories stated that the economic development can only happen if there is a stable evolution of the monetary mass, and that a non-justified increase in this mass will

generate inflation and will threaten the economic stability.

### Research methodology

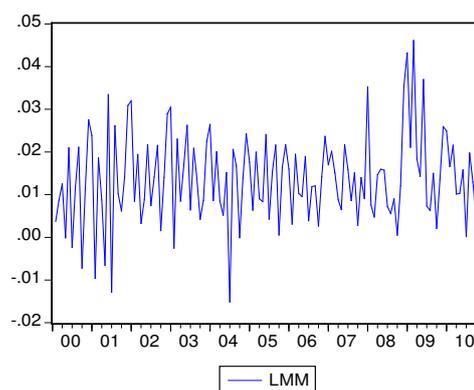
There are a lot of factors that contribute to inflation like the interest rates, the costs with labor and the exchange rates. Moreover, the effect of an unjustified increase in the monetary mass in stimulating inflation is a little more subtle. In an economy like that of China, this connection is difficult to be observed due to the constant intervention of the authorities in order to maintain stability of prices. In the short run, the solution to use the monetary mass as an instrument could prove to be effective. This was the case here. The problem was the abuse of this temporary solution. But, in the long run, a constant increase in the monetary mass correlated with the fix exchange rate could threaten the economic stability of the country and even generate inflation. China proves instead that it does not obey to the classical rules of the economy because China does not have a free market economy, as the communist party and the state intervention through the monetary policy have always been active.

Without an econometric analysis this connection is difficult to be observed, and that is why we propose a model in order to see if this connection exists and what are the potential consequences of it. The real economic climate of China showed that, whenever the economy had signs of stagnation or decline, the authorities reacted through open market operations and by authorizing unlimited bank loans. The monetary policy that China adopted was an expansionary one, by increasing its money supply. According to Keynes, every increase in the money supply moves the LM curve to the right, the interest rate drops, the investments will increase, and through the multiplier effect, it will lead to an increase of the income, and therefore consumption. This solution is only a temporary one, and in the long run it is a damaging one.

All the interventions in the monetary policy of China have been targeted towards sustaining an economic rise of 10% every year. During the economic crisis, the authorities increased the monetary mass monthly in order to encourage consumption, and the rate of growth was significant,

especially in 2009 when the turbulences on the partners' markets caused a decrease in exports. According to the People Bank of China, M1 and M2 had an ascending trend; the tip of the iceberg was during the crisis as we can see below. The main reason was the reluctance of the people to consume. Normally, the people of China are used to save money and nowadays China has the highest savings rate in the world: 56%. Adding this to the crisis in all the countries, the consumption dropped significantly. As we can see, in 2000 and 2001 (the highest economic growth) when the authorities did not had to intervene to encourage consumption, the monetary mass had diminished, as well as in 2011, when the exports regained their force.

*Figure 1 Evolution of the monetary mass in China*



Source: Authors' processing using Eviews based on the data from PBC

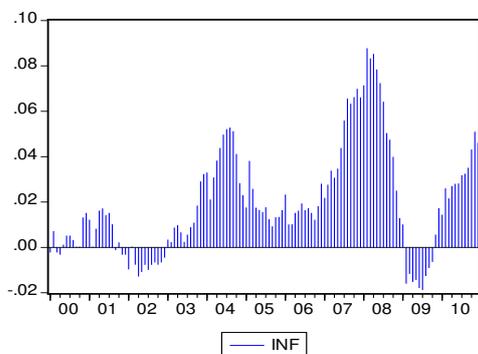
And this is not the only problem of China. There is still the exchange rate policy. Whenever a stabilization of the Yuan was necessary, the authorities intervened by purchasing dollars. This caused a massive accumulation of foreign capital, mainly dollars. In the last trimester of 2011, the foreign exchange reserves of China reached 2.85 trillion dollars. As the mission of maintaining the fixed exchange rate become more and more expensive, China had to print more and more national currency in order to buy these dollars. In reality this means that, the constant increase of these reserves with the undervaluation of the national currency will be a threat to the independence of their monetary policy. A fixed exchange rate, according to the economists Goldstein and Lardy would put pressure upon the monetary

policy due to the variation between the internal interest rate and the external interest rate which would destabilize the capital flows. They argue that, if the control mechanisms prove efficient in limiting capital inflows and outflows, a country with an under-evaluated national currency like the Chinese Yuan) faces two problems. First, it would have an increase in the domestic money supply due to the high acquisitions of foreign currency (because of the lower internal interest rate the investors sell local currency and buy foreign currency). Secondly, that massive sale of local currency without an efficient control will lead to an increase of the liquidity in the banking and financial system that in the end will cause inflation and the appreciation of the exchange rate [2].

**Results and comments**

The first signs of an increase in inflation have been obvious in the last three years, starting with 2009 when there was an obvious increase in the prices. It is interesting that, during the economic turbulences in the partner countries, there was a decrease in the prices, especially for the real estates, fuel and consumption goods. But still, in order to maintain a high targeted economic growth of almost 10%, another boost was needed. The answer was, of course, an increase in the money supply, except for 2011. More accurate, the authorities adopted a stimulus package of 586 million dollars, with a lot of side effects. As we can see below, the most important side effect was an increase in inflation.

*Figure no. 2 Evolution of inflation in China*

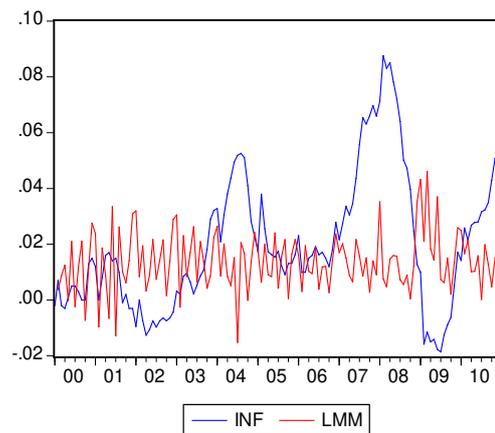


*Source: Authors’ processing using Eviews based on the data from PBC*

As we can see, the data are very contradictory. For several times, People Bank of China was accused that the statistic data do not accurately reflect the economical reality. We based our analysis on the data provided by the PBC. As we stated above, the connection between the money supply and inflation in China is not obvious to the naked eye. That is why we propose an econometric model to prove this connection. The data used are provided by the National Bank of China and represents monthly values for the 2000-2010 period. The variables are  $Y = mm$  (monetary mass) and  $X = inf$  (inflation rate).

We start our analysis from the premises that inflation is influenced by a series of variables, among which the monetary mass (Lmm). So, in the figure below, we can analyze how exactly this variables evolved during the analyzed period.

*Figure no. 3 Evolution of inflation and monetary mass in China*



*Source: Authors’ processing using Eviews based on the data from PBC*

As we can see, the two variables seem to „evolve together”, meaning they have a common similar tendency. So, it may be possible for a cointegration relation to exist between them, which means that these two variables involved in the regression equation move together, so they do not drift apart during time.

All this is the result of the expansionary monetary policy and in the end it could threaten the monetary and economic stability of China. We have to apply a cointegration test, in order to avoid false regressions. In 1987 Engle and Granger proved that a linear

combination of two or three nonstationary series can be stationary. The relation of co-dependence between them is stable. Next, we will test the nature of casualty between the two variables. Two series,  $Y_t, X_t$  integrated of the same order  $I(d)$  are co integrated by the order  $CI(d,b)$  if there is a linear combination  $Z_t = aY_t + bX_t$  which has a smaller integration order.  $I(d-b)$  [3]. In order to verify that there is a cointegration relation between monetary mass and inflation, we will take three steps.

The first step checks to see if the both variables are co integrated. We will use ADF test. Then, we will estimate the simple regression in order to obtain the estimation of the co integrated relation. The existence of such a relation will be shown by MMP. The third step is to see that the residues are stationary. If the hypothesis of the unit root in the series of the residues is rejected, then, between the monetary mass and inflation there is a co integration relation. After estimating the coefficient regression relations and the residues, we apply the ADF test with another type of unit root in order to detect the nonstationary residues. In this order, we will check if the variables are stationary applying Unit root test/ Adf (trend and intercept):

Null Hypothesis: INF has a unit root  
Exogenous: Constant, Linear Trend  
Lag Length: 12 (Automatic based on SIC, MAXLAG=12)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-2.281770	0.4402
Test critical values:		
1% level	-4.036983	
5% level	-3.448021	
10% level	-3.149135	

\*MacKinnon (1996) one-sided p-values.

The result, a probability of  $0.44 > 5\%$  denotes that INF has unit root (stochastic tendency)

Null Hypothesis: LMM has a unit root  
Exogenous: Constant, Linear Trend  
Lag Length: 11 (Automatic based on SIC, MAXLAG=12)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-2.118659	0.5298
Test critical values:		
1% level	-4.036983	
5% level	-3.448021	
10% level	-3.149135	

\*MacKinnon (1996) one-sided p-values.

Probability  $0.5298 > 5\%$  illustrates that LMM has unit root (stochastic tendency).

Next, applying the test has several aspects. We differentiate the series one time and they become stationary, as we can see from ADF. For dlmm we have  $t=9.74$ , none, for dlnf,  $t=-5.42$ . dlmm( differential equation).

Pairwise Granger Causality Tests  
Date: 02/07/12 Time: 13:25  
Sample: 2000M01 2010M12  
Lags: 2

Null Hypothesis:	Obs	F-Statistic	Probability
DLMM does not Granger Cause DINF	128	0.61858	0.54038
DINF does not Granger Cause DLMM		0.34997	0.70541

1.  $H_0$ : DLMM does not Granger Cause DINF, probability=  $0.54 > 0.05$ . The null hypothesis is accepted, therefore, monetary mass is Granger cause for inflation. The decision upon this hypothesis is maintained also for lags equal 3 or 4.

2.  $H_0$ : DINF does not Granger Cause DLMM, probability= $0,7 > 0,05$ , null hypothesis is accepted, therefore, inflation is not Granger cause for monetary mass. This hypothesis is accepted even if we increase lags to 3 or 4.

Next, we will determine the integration order of the two series. We estimate MMP between the variables observed.  $INF = a + bLMM + \epsilon$  where  $\epsilon$  is the residue. So, the „ce” equation is:

Dependent Variable: INF  
Method: Least Squares  
Date: 02/07/12 Time: 18:12  
Sample (adjusted): 2000M02 2010M12  
Included observations: 131 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LMM	-0.263359	0.201895	-1.304435	0.1944
C	0.023780	0.003491	6.811885	0.0000

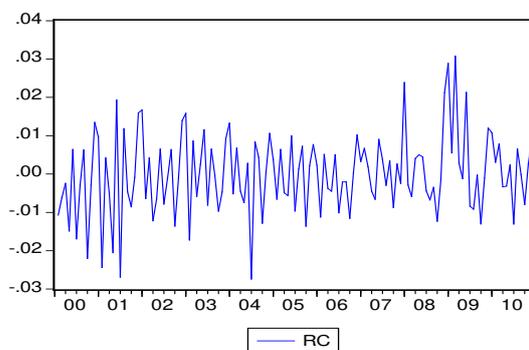
ADF test on residue shows that prob=0.05=5%, further indicating that the residue from the regression is stationery.

Null Hypothesis: RC has a unit root( RC being the critical region-if the numerical value of the test does not fall in the critical region, then the null hypothesis is accepted.

Null Hypothesis: RC has a unit root  
Exogenous: None  
Lag Length: 11 (Automatic based on SIC, MAXLAG=12)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-1.923597	0.0523
Test critical values:		
1% level	-2.584539	
5% level	-1.943540	
10% level	-1.614941	

Figure no. 4 Cointegration relation



Source: Authors' processing using Eviews

After this analysis, we can state that between these two variables there is a cointegration relation, meaning there is a codependence relation. MMP identified one cointegration relation:  $INF=0.023-0.26LMM$ .

This analysis on the economic model of China proves that, in the long run, this permanent increase in the money supply will lead to an evolution in the same way of inflation.

## Conclusions

In the end, the biggest problem of China is that it relies exclusively on economic growth using every means necessary. There are a lot of problems that China needs to address before aspiring to the status of a great economic power and leader. The economic growth of almost 10% each year is not enough. Our analysis proves that China needs a stable and confident monetary policy. Assuring growth by pumping money into the economy is not a solution. The result of our analysis that there is a codependence relation between this two variables in the long run could prove that, without an intervention of the monetary authorities to stop this trend of permanent increasing money supply, will in the end lead to a fall out of the entire system.

It is clear that this country has a lot of problems to address; we would like to state here an important one correlated with everything in regards to our paper: capital account liberalization. Capital flows liberalization is an image of a modern country with a stable and clean monetary policy. In regards to the monetary policy, a lot of arguments state that China will never have a complete liberalization of the capital account. One reason could be the banking system. As the vice-president of the administration board of PBC, Xiao Gang stated: “the growth policy by using every mean is the best way for the Chinese banks to make a lot of money in the current economic conditions. This model of growth, however, does not assure long term sustainability, and does not fulfill the needs for a balanced economic and social structure”. One solution could be the relaxation of the control mechanism for the interest rate [4].

Another reason is the entire financial system of China, that is highly under evaluated. Roubini states that, by 2013, 30% of the loans given by the Chinese banks will be nonperforming loans. Another motive is obviously the highly under-evaluated Chinese renminbi. A liberalization of the capital account without an appreciation of the currency could lead to speculative attacks by massive capital inflow, which would lead to the impossibility of maintaining price stability. As we can see, there is a vicious circle in the monetary policy of China. They cannot have a liberalization of the capital

account without a relaxation of the fixed exchange rate and allowing the Chinese Yuan to appreciate. And they cannot let the exchange rate fix without sacrificing price stability and endangering the precious 10% economic growth. China wants to prove that great accomplishments in an economy can be made without sacrifice. This article states that in the end China could sacrifice its entire stability and existence.

All in all the monetary policy of China in the third millennium reflects a sick system and a dangerous one in the end for the whole world. An economy that in the end, will not full anyone anymore and the great power attitude will be just an unsustainable attitude.

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## The Degree of Regional Specialization of Imports in Romania

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### Abstract

*In analyzing the evolution of the degree of specialization of regional imports in Romania in the period of time 2000-2010, we started from the study of the modifications made in the structure of the sections included in the CR for regional imports. In order to quantify the degree of regional specialization, we determined Onicescu's informational energy, and in order to offer a synthetic view of the dynamic of regional import specialization, we calculated the Balassa indexes for each section.*

**Keywords:** Balassa indexes of specialization for imports, Onicescu's informational energy – corrected formula, sections of the Combined Register.

**J.E.L. Classification:** F14, R11.

### 1. Introduction

The assessment of the regional inter-industrial specialization processes from the point of view of import distribution on the sections listed in the Combined Register is necessary in order to know and to diagnose a regional economy (such as the Romanian one) which is going through an intense modernization and development process due to the integration into the economical and institutional structures of the European Union, as well as due to the more intense involvement into the international trade flow.

### 2. Evolution of the structure for each section of the Combined Register for regional imports

During the last years, in the *structure of the imports on sections listed in the*

*Combined Register (CR)*, the highest percentage, over 25,0%, was that of the section „Machines, devices and electrical equipment; machines for recording sound and picture and reader machines”, and the regions with great contribution to the imports in this section are the North-West, West and South Muntenia areas.

This aspect proves the existence of a certain degree of specialization in the import of such goods in the areas mentioned above, since this section also has a great percentage in the regional imports. According to figure 1, almost 50% of the imports in the North-West region since 2010 consist in products included in this section. We should mention that the region increased its imports of electrical machines and devices, especially during the last 5 years, since at the beginning of the period subjected to this analysis the section we are talking about had a low percentage in the regional imports (for example: 18,5% in 2000).

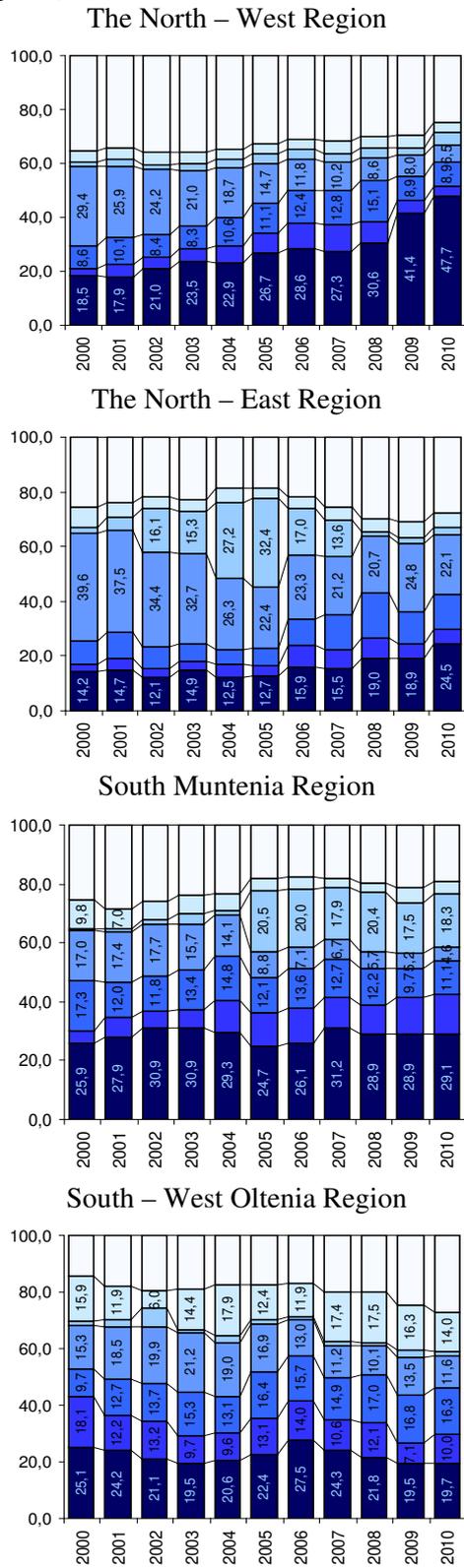
The same phenomenon happened in the South Muntenia region, as in 2000 the percentage of such goods in the regional imports was of 25,9%, while in 2010 in increased up to 29,1%. On the other hand, in the West area, the imports of such goods are a tradition of this economy, since during the whole period subjected to the analysis the percentage of this section in the regional imports was over 30%, reaching even 50,5% in 2000.

Other sections with great percentage in the total imports registered in Romania are:

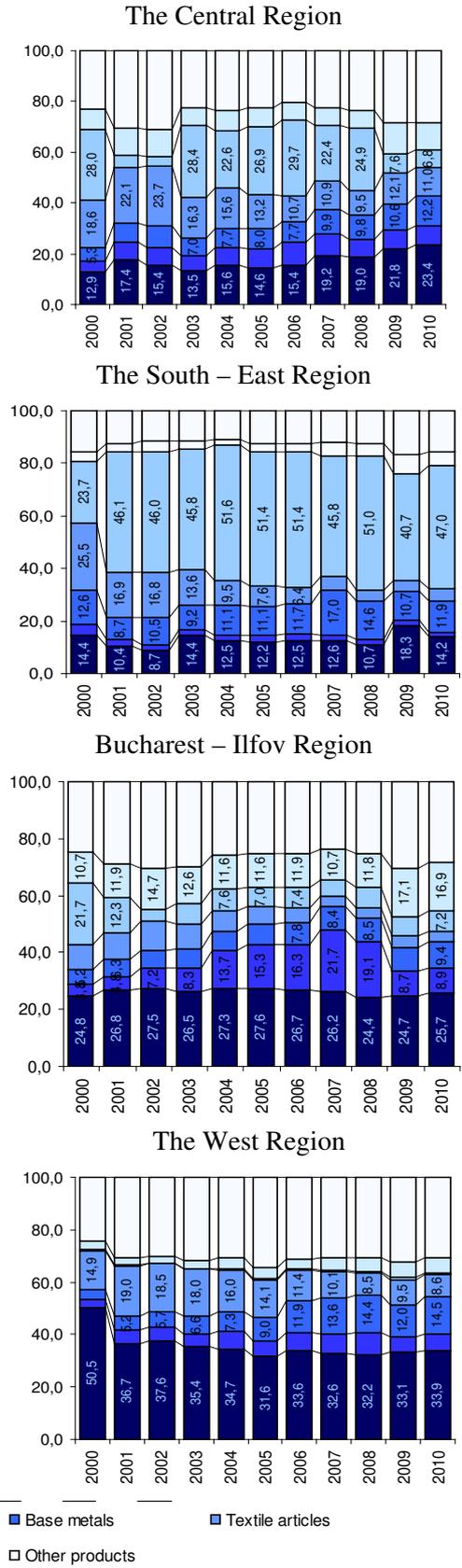
- „Common metals and articles made of these metals” are over 15% of the total imports, especially during the first years. Contributions of about 15% of the total regional imports are registered in the South-East and the West. In the South-East and in South Muntenia regions, the

imports of metal products are a tradition, since percentages of about 15% in the regional import are registered in these areas during the whole period.

Figure 1. Evolution of the percentage of the main sections in the CR in the regional import (%)



■ Electrical equipment    ■ Transport equipment  
■ Mineral products    □ Chemical products



Source: personal processing of NIS data

- „*Mineral products*” are over 10% of the total imports, during the whole period of time subjected to this analysis. The regions with great contributions to the imports in this section are the South-East (47,0% of the regional imports for 2010 are mineral products) and South Muntenia (18,3%) regions.
- The “*Means of transport*” are about 10% of the total imports, especially during the last few years. The regions with great contributions to the imports in this section are South Muntenia (13,6% of the regional imports in 2010 are means of transport), Bucharest Ilfov (8,9%) and South-West Oltenia (10,0%).
- The „*Textile fabrics and textile products*” registered great percentages at the beginning of the period analyzed - over 15% - and the regions which still have great contributions to the imports in this section are the North-East (22,1%), Central (11,0%) and South-West Oltenia (11,6%) regions.

### 3. Assessment of the degree of specialization of regional imports for each section in the Combined Register

In order to express in numbers the *degree of specialization of the imports for each section included in the Combined Register* we calculated, for each region, the **Balassa index of specialization** [1] **Iapadre P.L.** [2] – *believes that this index can also be applied to imports*. It is determined by reporting the import percentage for that product within the total imports in the region to the import percentage of the product within the total imports in Romania. When the index has positive values, the region has a *high degree of specialization in the import of a certain product*; when the index is higher than 1, the *degree of specialization in manufacturing that product is low*.

As we showed in the first part of this analysis, the section „*Machines, devices and electrical equipment; machines for recording sound and picture and reader machines*” has a high percentage in most regional imports; consequently, we can suppose that the regions did not specialize in manufacturing such products, and by calculating the Balassa index we can establish the degree of specialization in each region. As we can see

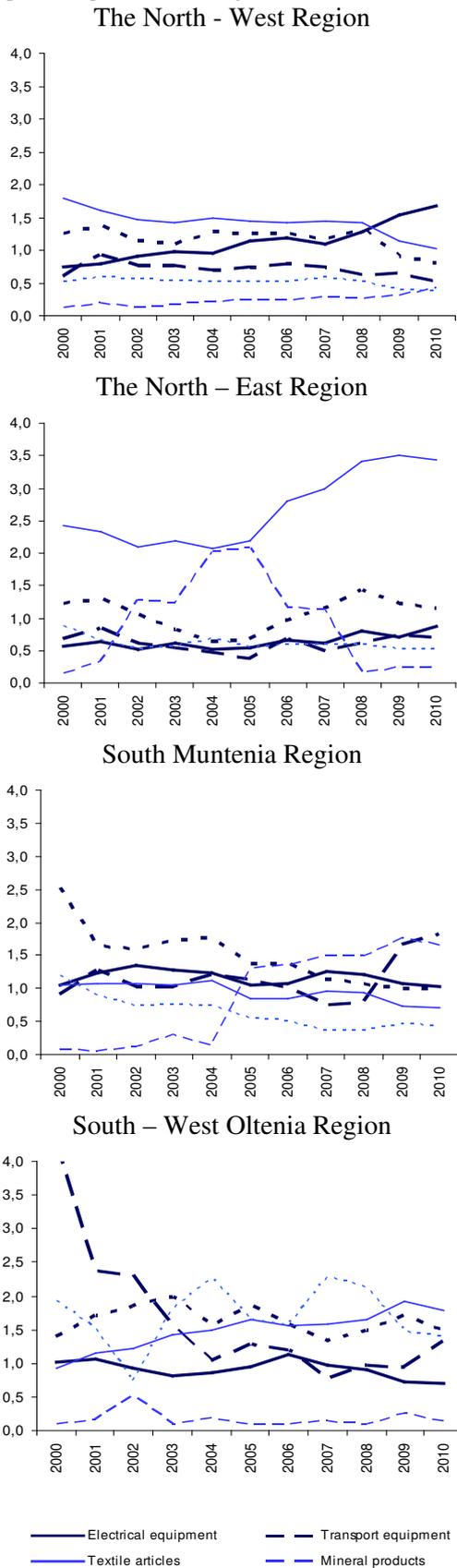
inn figure 2, *the highest degree of specialization in the import of electrical machines and devices*, during almost the whole period subjected to the analysis, is recorded only in the North-West and West regions, the other regions having a higher degree of specialization in other products.

Another section with high percentage in the structure of regional imports is the section „*Mineral products*”. *The continuous specialization of the South-East region* in the import of such products is obvious. A high degree of specialization is also registered at present in South Muntenia region (the specialization of imports increased starting in 2005), while in the North-East and the Central regions there was a high degree of regional specialization in the period of time 2002-2007 and 2003-2008 respectively. As to the section “*Textile materials and textile products*”, it has the highest degree of specialization for imports, during the whole period analyzed, only in the North-East region, the other regions having a low degree of specialization.

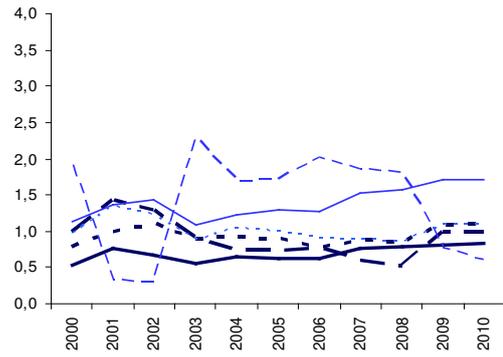
*The main trends, on regional level, in the evolution of the degree of specialization of imports for each section in the CR, are:*

- *in most regions there is an increase or a stagnancy of the degree of specialization for the import of **electrical machines and devices** (except for the South-West Oltenia and the West regions, where the degree of specialization is highly reduced). The highest increase of specialization for the import of such products is registered in the North-West (from 0,75 in 2000 to 1,68 in 2010) and Central (from 0,52 in 2000 to 0,82 in 2010) regions. Great decrease in the degree of specialization is registered in South Oltenia (from 1,01 in 2000 to 0,69 in 2010) and in the West region (from 2,04 to 1,19).*
- *in most regions there is an increase or a stagnancy of the degree of specialization for the import of **mineral products** (except for the Central, the North-East and Bucharest-Ilfov regions, where the degree of specialization oscillates). The highest increase of specialization for the import of such products is in the South-East (from 1,63 in 2000 to 4,21 in 2010) and South Muntenia (from 0,06 to 1,64).*

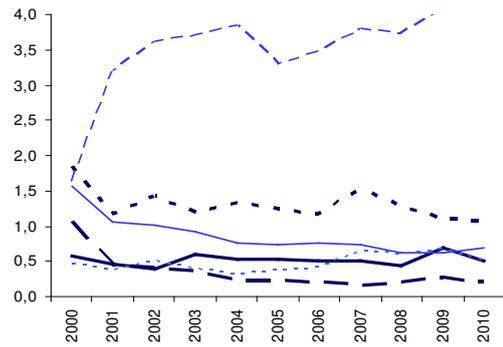
Figure 2. Evolution of the Balassa indexes of regional specialization for each section



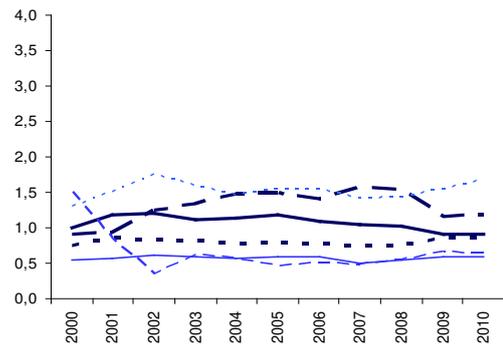
The Central Region



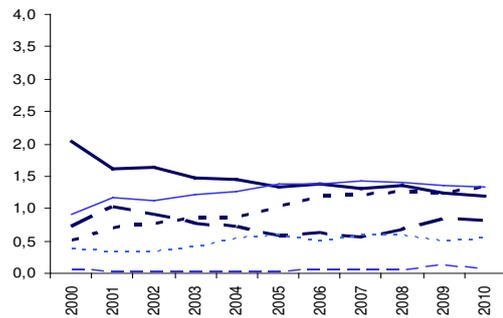
The South - East Region



Bucharest - Ilfov Region



The West Region



Legend:

- Base metals (dashed dark blue line)
- Chemical products (dashed light blue line)

Source: personal processing of the data offered by the NIS

- *in most of the regions there is a decrease of the degree of specialization for the import of **means of transport**. The largest decrease was noticed in the South-East (from 1,06 in 2000 to 0,21 in 2010) and South-West Oltenia (from 4,27 in 2000 to 1,34 in 2010) regions, and increase is registered in South Muntenia (from 0,91 in 2000 to 1,82 in 2010) and Bucharest Ilfov (from 0,91 in 2000 to 1,19 in 2010) regions.*
- *in all the regions there is a slight increase of the degree of specialization for the import of **textile products** (except for the South-East and South Muntenia regions, where the degree of specialization decreased). The largest increase of specialization for the import of such products is registered in the North-East (from 2,42 in 2000 to 3,44 in 2010) and South-West Oltenia (from 0,93 in 2000 to 1,80 in 2010) regions, while in the other regions the specialization increased only slightly or remained relatively constant during the whole period of time.*

#### 4. Analysis of the degree of specialization of the regional import from the point of view of the value of Onicescu's informational energy - the corrected formula

Elaborating the analysis of the regional imports in Romania and starting from the previous conclusions, we can notice that the first 5 sections with the highest percentage cumulate about 75,0% of the whole value of imports; consequently, we can ask the question if there is *a specialization of the regional imports*, and respectively a concentration of the imports of a certain region. In order to express this phenomenon in numbers, we calculated for each region *the value of Onicescu's informational energy [3] of the distribution on each of the sections listed in the CR, applying the corrected formula.*

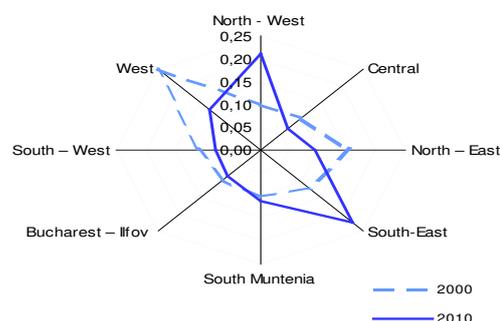
The index calculated on regional level measures the degree of specialization for each region according to the percentage of imports of each of the sections listed in the CR within the total regional import. Consequently, the index calculated for a region is not influenced by the type of specialization pertaining to Romania.

The index oscillates on the interval (0,1); a *concentration of the import* of a certain region on a small number of sections included in the Combined register makes the *value of Onicescu's informational energy to tend to 1*. According to figure 3, the *North-West* (47,7% of the total imports in the region in 2010 are goods from the section „Machines, devices and electrical equipment; machines for recording sound and picture and reader machines”) and the *South-East* (47,0% of the total regional imports in 2010 was included in the section „Mineral products”) regions were in this situation in 2010.

On the opposite pole, with a decreased degree of specialization (concentration) and a *value of Onicescu's informational energy which tends to 0* – due to the dispersal of regional imports on a large number of sections included in the CR –, are *Bucharest-Ilfov* and the *Central* regions.

In 2000, unlike during the last year of the period analyzed, there was a *high degree of specialization (concentration)* of the import in the *North-East* (39,6% of the total imports of this region in 2000 were from the section “Textile fabrics and textile products”) and *West* (50,5% of the total imports of this region in 2000 were from the section “Machines, devices and electrical equipment; machines for recording sound and picture and reader machines” and 14,9% from “Textile fabrics and textile products”) regions.

Figure 3. Evolution of Onicescu index of specialization on each region



Source: personal processing of the data offered by the INS

The classification of the degree of regional specialization (concentration) of imports on 4 categories according to the values of the quartiles – low degree of specialization (values between minimum and Q1), medium-low (values between Q1 and Q2), medium-

high (values between Q2 and Q3) and high (values between Q3 and maximum) – offer a synthetic image of the dynamic of regional import specialization.

Making a comparison between 2000 and 2010, the evolution of the degree of import specialization is as follows:

- in *only one region the degree of import specialization (concentration) does not change* ( a low level is registered in the Central region).
- in *4 regions* - the North-West, the South-East, South-Muntenia and Bucharest Ilfov regions – *the degree of import specialization (concentration) increases*.
- in *3 regions* - the North-East, South-West Oltenia and the West regions - *the degree of import specialization (concentration) decreases from a high level to a medium-high or a medium-low one*.

According to figure 3, **the main conclusions** concerning the regional specialization **from the point of view of Onicescu specialization (concentration) indexes pertaining to regional imports**, are the following:

- *the classification of the regions according to the degree of specialization (concentration) of imports changes. Thus, in 2010, the most specialized regions were the North-West and the South-East, while, at the beginning of the period analyzed, the most specialized regions were the North-East and the West.*
- *in most regions, the degree of specialization (concentration) of imports decreases or remains constant during the period of time analyzed, except for the North-West, South-East and South-Muntenia regions, where there is an increase of the degree of specialization.*
- *the region with the highest degree of specialization (concentration) of imports during the whole period of time 2000-2010 is the South-East, and the trend is towards an increase in the specialization of imports. The regions South-Muntenia, the North-East, the North-West and South-West Oltenia, have close values of the average specialization indexes, but their evolution is different: the North-West and South-Muntenia specialized, while in South-West Oltenia, the West and the North-East there is a rather high*

*despecialization of imports. The lowest values of the degree of specialization (concentration) of imports are registered in the Central and Bucharest-Ilfov regions, and their trend is towards a continuous decrease.*

## 5. Conclusions

Such an evolution of the degree of regional specialization of imports, meaning an increase of specialization for the imports of goods with low or medium-low technological level and a slight increase or stagnation in the case of goods with medium-high or high technological level is not beneficial for the regional economy, since the increase in the market share of „foreign” human-capital-intensive and high-technology goods are not premises for increasing the level of economical development.

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## Using Business Simulation as a Complementary Educational Method in Universities

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### Abstract

*As the global economic environment is permanently changing and evolving, the educational system must prepare young people to face the challenges of a real job.*

*The traditional approaches for teaching international business in universities is focused on sharing knowledge and as far as creating student competencies, the educational method is mainly static. The purpose of this article is to analyze a relative new learning method, which can be applied in the area of international economic environment and consists of using business simulation as a dynamic component of the educational process.*

*We aim to present our researches regarding the use of this method in universities and focus on a case study of how this method was implemented in The Bucharest Academy of Economic Studies.*

*Using the data collected from participants in an internship project, which was based on business simulation in virtual enterprises, we will decide upon the benefits of applying this educational method in universities.*

**Key words:** international business, educational process, business simulation, teaching methods

**J.E.L. classification:** A23, F23.

### 1. Introduction

The learning system in Romania is considered by specialists rather static, from the point of view of the educational methods that are used. Social studies have identified a problem which affects both graduates and employers: the students have theoretical knowledge that they have learned in the university, but their practical skills are lacking. This problem has led to the situation when over 35% of university graduates are unemployed in an year after graduation.

The European Commission has set up a human resources development funding program, part of the European Social Fund, known as POSDRU.

Since 2008, Romania has received from the European Commission only 200 million Euros for projects implemented within the human resources program, out of total sums available of 3.47 billion Euros.

Obviously, the poor attraction of funds for projects for this area is also considered a problem in Romania. So let's take the two problems that we encountered so far and see what possible solutions we can identify: lack of practical skills on university graduates and poor absorbing of funds for human resources development program.

A possible solution seems to be the use of business simulation in the educational process from universities, as a complementary method of teaching, financed by applying to the funding from the

European Social Fund.

Several consortiums of universities have already identified this solution, and projects for students internships in virtual or real enterprises have been financed and implemented starting with last year.

## **2. Research methodology**

First, the stage of documentation and literature review consists of researching the data bases for articles that addressed the topic of business simulation.

We will present the manner of implementation of a project financed by European Funds, that uses business simulation as a method for developing skills in international business area for students or master students.

In order to analyze some results of this teaching method we will focus on a case study about the implementation of a student internship program, that uses business simulation in virtual created enterprises.

Based on the answers that participant students gave in questionnaires, we will collect and analyze data that can show how efficient is this learning method, from the perspective of its results.

## **3. Literature review**

The main data base used to research the papers that make references to the business simulation method and other teaching methods in international business, was JSTOR and also ANELiS.

Traditionally, the first dimension in education for international business has been the textbook-lecture-discussion approach. (Dowd, L.P., 1973).

The second dimension in education for business is the use of case-studies in which students are given actual, or hypothetical, business examples and are asked to make decisions. This is an evolution in international business education, as it forces the application of economic principles into business situations. (Herreid, C. F., 1994).

The main weaknesses of case studies are: the historical nature of most cases that leads to freezing of environment conditions, though they are continuous changing, the information is limited and this tends to rigidify the thinking process of students.

The third dimension is the use of management simulation games, which introduces dynamic developments into decision making processes. The most important improvement in this teaching method is the introduction of planning-decision making for the future and not for the past. (Jain, L. C et al., 2002).

The fourth dimension that has been described consists of involving students in dynamic day-to-day management decision making and providing them with the experience of working as a "team". This would be very close to the concept of internship in a real company.

We shall canalize our attention on the third dimension of education for international business, as identified in the literature review. The main challenge is to identify and describe the actual methods used for implementing the business simulation as a teaching method in universities.

In most cases, students are assigned to teams and each team represents a virtual enterprise, with a predefined object of activity, social capital and an economic environment with certain characteristics.

The main activities for students in an international business game are tasks as: forecast sales, perform cash flow analysis, and develop operating strategies based on relevant operational concepts. The student team must consider factors as: political stability in forecasting, possible exchange gains and losses in cash flow analysis.

The material basis on which the activity of enterprises is sustained, consists of an informatics program, that creates a virtual economic environment, with defined economic, social and political factors. Depending on the decisions that students make for the enterprises they manage, the result is different. The interaction between the virtual enterprises must also be taken into consideration, as the firms may be cooperative, competing or complementary as economic actors.

## **4. Is business simulation an effective method to prepare students for their future jobs?**

As Ronald D. Klein (1984) states in his article, there is widespread controversy over the effectiveness of using business simulation

games as a learning medium. Games are recognized as excellent motivators and as providers of valid decision-making experiences, but the accumulated evidence concerning their learning effectiveness is inconclusive and divided.

We will try to answer this question, by bringing new data on the matter. This data was collected from applying a questionnaire to students and master students that have participated to a program of internships in virtual enterprises. This project is implemented in the Bucharest Academy of Economic Studies (and also other universities) and is financed by the European Social Fund through the Sectoral Operational Programme Human Resources Development 2007-2013, Priority Axis 2 "Linking lifelong learning to the labor market necessities", Key area of intervention 2.1 "Transition from school to active life". The title of the project is "REAL ACCESS TO LABOUR MARKET BY SIMULATED ENTREPRISE", Contract no. POSDRU/90/2.1/S/63442, and the university that coordinates the implementation of the project is Ovidius University from Constanta.

The questionnaire we applied contains 13 questions, 9 of them are YES/NO answer, 2 are multiple choice ones, 1 is likert scale type and one is with open answer.

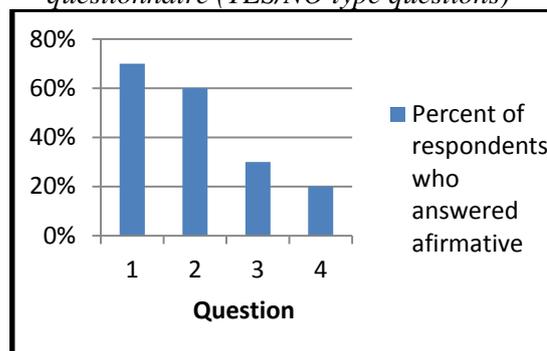
The target group was formed of 200 students, who completed the questionnaire. From the 200 questionnaires, 161 were valid completed, and used for further analyze.

We synthesized the answers and analyzed the information that was relevant for the main question addressed in the subtitle: *Is business simulation an effective method to prepare students for their future jobs?*

The results indicated that over 70% of the participant students considered that the information received in this internship would be useful at their future jobs (question 1). Over 60% thinks that the guidance received from their tutors, regarding the way an enterprise functions, helped them in the decision-making process and will continue to be useful when they will work in a real company (question 2).

Still, only 30% of the respondents think that they have become more of a entrepreneur (question 3), and only 20% say that they want to start their own business (question 4).

Figure 1: The percent of affirmative answers to questions 1,2,3,4 from the questionnaire (YES/NO type questions)



Source: by the authors

From the information gathered using the questionnaire, we can conclude that the business simulation method definitively brings an improvement in the understanding of economic principles by students. The dynamic interaction with an enterprise functions, even if they are virtual, gives students more confidence about their knowledge and as far as their perception goes, this experience will help them find a job and perform at it.

Of course, the main deficiency of this questionnaire is that it only addresses the perception of students on how effective the internship program is, and it cannot predict their future evolution on the labor market.

This problem shall be addressed in a future article, based on an already existing questionnaire, regarding the future insertion on the labor market of present participants at the internship. Of course, this questionnaire cannot be applied until the students have graduated from the university and go out on the labor market, looking for a job.

Then we can find out whether the participants in this program have more chances at receiving a job, and if it is better paid than for the graduates who haven't benefit from this type of complementary business education.

As for the possibilities of improving the manner of implementation, we centralized the answers to the questions that targeted the qualitative elements, in the table below.

*Table 1: The average level of importance granted by students to the following rules applied to the activity of virtual enterprises*

Rule	Average score
Assigning a team leader for the entire period of business simulation	3
Assigning a team leader for each period of business simulation	2
Everybody works in the same time and for the same objective	4
Everybody works in the same time but for different objectives	2
Each person works with the purpose of optimizing the collective result	3
Each person works with the purpose of optimizing his own result	5
The responsibilities are assigned inside the team using each one preferences as criteria	5
The responsibilities are assigned within the team using each ones abilities as criteria	2
The desired result is established from the beginning by the team	5
The means that are to be used for achieving the result are established from the beginning by the team	5
The person considered to be the best one in the team must be rewarded	4
The person considered to be most incompetent in the team should be lectured	1
Each document from the activity of the virtual enterprise should be carefully and correctly noted	5

Source: by the authors

The scores interpretation is:

- 5: most important
- 4: important
- 3: indifferent
- 2: less important
- 1: not important

If we take into consideration the average scores, we can conclude that students prefer to have a leader from the beginning, they wish to be a part of the decision making process and the criteria for assigning responsibilities should be individual

preferences. Also, they would like to be rewarded if they are the best, but do not consider appropriate to be penalized if they prove to be incompetent. Most students agree on the importance of completing documents carefully and correctly.

## 5. Conclusions

The research we conducted on the subject of effectiveness of business simulation as an educational method, indicates that students who benefited from an internship in a virtual enterprise, found this experience enriching to their theoretical and practical knowledge. Also, it made them more self confident that they will find their place on the labor market and that they are well prepared for their future job.

We consider that the varieties of business situations that can be simulated, as well as the similarity to real world companies, are positive points in favor of using this teaching method, complementary to the traditional ones. The simulation games can play a supportive role adding decision-making relevance to the lectures and text.

The conclusion is that business simulation is a value-adding learning method that helps students gain self-confidence and have a better understanding of enterprise functions and correlations between them.

Whatsoever, more insight is needed on this issue, so we propose, as further research, the analyze of data regarding the insertion of internship participants on the labor market. Obviously this information will only be available after a period of time, and maybe aggregating data from more universities may share light over the issue of the success at the employment process, for students who were part of teams that worked in virtual enterprises.

## 6. Acknowledgment

The research and publishing of this article has been financially supported from the project "REAL ACCESS TO LABOUR MARKET BY SIMULATED ENTREPRISE", Contract no. POSDRU/90/2.1/S/63442, that is coordinated by the Ovidius University from Constanta and financed by the European Social Fund through the Sectoral Operational

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# A Comparative Analysis of Informatics Solutions Used for Business Simulation in Educational Systems

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## Abstract

*In order to keep up with the changing economic environment, graduates from business schools must be prepared to face different challenges.*

*In fact, it is the educational system that must be configured properly, so it can create student competencies in a dynamic way. A research has already been conducted on the subject of dimensions in education for international business, and identified the most important ones (Tartavulea et al, 2012).*

*The purpose of this article is to analyze some of the informatics solutions for business simulation and compare their mechanisms and results in terms of student satisfaction regarding the preparation for the labor market.*

*As the economic environment is becoming more complicated in terms of financial markets and products diversification, the new comers in the labor field must have the knowledge to understand the mechanisms of the market and the skills necessary to keep businesses on top of the wave.*

**Key words:** international business, comparative analysis, business simulation, informatics solution

**J.E.L. classification:** A23, F23.

## 1. Introduction

Business simulation, as an educational method, permits the creation of relevant market conditions, although artificially imposed to a virtual enterprise. It can be focused on a single discipline or with a variety of disciplines.

Griffin and Williams (1964) identified three conditions that must be fulfilled in order to consider the business simulation an effective pedagogical method:

- it requires the presence of one or more sensitive problems which are meaningful to the student
- it requires the assembly and assimilation of all information that may be usefully brought to bear upon each specific problem's solution
- It assumes the existence of an integrating methodology for logically ordering and analyzing these data in the decision process.

The scope of business simulation is to help students achieve and consolidate technical skills and prepare them for a real decision-making process.

Specialists in educational methods believe that relating various disciplines and considering their corporate effects and complementation gives value to the pedagogic experience. The complementary character of several related elements from management, marketing, statistics, finance, macroeconomics, etc. represent important

landmarks that should be used in the process of finding a solution to complex business problems.

The purpose of this article is to find relevant informatics solutions that can be used in the process of business simulation and conduct a comparative analysis between them.

## 2. Research methodology

First, the stage of documentation and literature review consists of researching the data bases for articles that addressed the topic of informatics solutions used for business simulation, as well as further understanding of the concept and its applicability in the educational process.

As we stated in a previous research, the main challenge is to identify and describe the actual methods used for implementing the business simulation as a teaching method in universities. In order to achieve this goal, we must identify the most notorious informatics solutions that are being used in the process of business simulation in universities. Also, we will present short descriptions of the manner that the software can be implemented in the educational process, in order to generate positive effects on the learning system and to create and develop practical skills for students.

In order to analyze some results of the implementation of informatics solution for this teaching method, we will focus on a case study about the development of a student internship program that uses business simulation in virtual created enterprises.

The data collected from questionnaires applied to participant students will be analyzed, in order to find out how effective was the informatics solution in the process of acquiring skills and knowledge through business simulation. Also, based on the literature review regarding the most common used informatics solutions for business simulation, we can carry out a comparative analysis between these programs and the one that has been used in the project "REAL ACCESS TO LABOUR MARKET BY SIMULATED ENTREPRISE", Contract no. POSDRU/90/2.1/S/63442 that is coordinated by the Ovidius University from Constanta, and implemented also in The Bucharest Academy of Economic Studies.

## 3. Literature review

We researched mainly the databases JSTOR and also ANELiS for papers that make references to the business simulation method and the informatics solutions used in business schools over the world. Other sources were also consulted as listed in the bibliography section.

As the preliminary research has shown, the business simulation is not a very new concept, as it appears in the topics since the 1960. Still, it generates new research directions, as the evolution of information technology has given innovative solutions for creating virtual enterprises that can run on multiple economic scenarios. This has led to a whole new dynamic dimension of business simulation that can work in favor of students, helping them to prepare for the demands of a changing economic environment.

Interactive computer applications and simulation exercises are used to supplement the traditional case study preparation (Leider, D.E. and Jarvenpaa, S.L., 1995).

According to Jain, L. C et al., (2002) management simulation games introduces dynamic developments into decision making processes. The most important improvement in this teaching method is the introduction of planning-decision making for the future and not for the past.

Software used in IESEG School of Management and MIT Sloan School of Management for business simulation is SIMUL8. Teachers that used it consider its graphical interface is intuitive and its animation capabilities are very useful to develop intuition.

From the point of view of students, the expected results of the program are the development of their critical thinking about business processes, retaining the ability to create complex models in a short time in class. The use of this software in their education system enriches their competence as future managers.

From the teachers point of view the benefits of this program are learning to ask the right questions, verifying the rigor of simulation models and appreciating their importance in a modern business environment.

Another informatics solution for business simulation is proposed by Harvard Business

School and it allows students to play the role of a business unit manager at a company who faces the dilemma of balancing a portfolio of investment strategies across products.

The student must decide which market opportunities to pursue, each of which offers the student varying levels of short- and long-term profit prospects. Students manage the investment portfolios over eight simulated years. Throughout the simulation the student is forced to address a number of challenges including timing and level of investment across both mature and new businesses, choices regarding market opportunities and inherent product performance characteristics, requirements to meet constraining financial objectives and constant trade-offs between investment options, all in the context of uncertain market information [6].

The company BTS declares to be the world leader in customized business simulations and discovery of learning solutions. They developed several informatics solutions for business simulation.

Board simulations are board games that represent a company's operations and simulate its business. During simulation rounds, participants literally pick up and move money (chips) through the different areas of their company. This hands-on approach allows participants to visualize the cash-flow cycle in action.

Scenario simulations, sometimes called "best-practice" simulations, are used to build leadership, project management, and sales capabilities. These simulations leverage decision tree structures in realistic story lines, enhanced with text, audio, still photography, and video. As participants read and observe real-world business situations, they have the opportunity to react to the issues presented. When participants choose a course of action, the simulation immediately presents the impact of their decisions on the ultimate goal.

Web-based business and scenario simulations engage participants in highly interactive learning. In these competitive, game-style programs, students and master students participate as teams or individually. As participants and teams set their own pace throughout the simulations, they receive feedback on their performance and experience the impacts of their decisions on leadership, operational, and financial performance. [5]

Another company is Innovative Learning Solutions Inc., which provides state-of-the-art learning tools for business schools and business professionals, called Marketplace.

Marketplace® simulations are a family of business simulations for undergraduate, graduate and executive level business courses. Used by over 300 business schools and 180 corporations in 35 countries worldwide, Marketplace simulations deliver a realistic hands-on learning experience. The simulations are designed to fit both the distance learning and the classroom format. Marketplace simulations are fully web-based, so there is no software to install and no hassles to administer it. The company located their Processing Center in the premier data center facility in the area, Digital Crossing (Tennessee, USA). [7]

An impressive number of informatics solutions have been developed for the purpose of business simulation. Some of them are oriented towards the companies that want to improve their processes or make well-founded decisions and others are directed to the educational system.

#### **4. The selection process of an informatics solution for business simulation**

The process of selection for simulation software can be defined by a sequence of steps (adaptation after [8]):

1. Clearly state the problem that needs to be addressed

It is important that we establish the scope that should be achieved by using the simulation software, because this will help narrow the search to a certain type of informatics solution, which is the role of the next step.

2. Determine the general type of simulation tool required

Because simulation is such a powerful tool to assist in understanding complex systems and to support decision-making, a wide variety of approaches and tools exist.

The general purpose tools can be categorized as follows:

- Discrete Event Simulators: are generally designed for simulating processes such as call centers, factory operations, and shipping facilities in which the material or information that is being simulated can be described as moving in discrete steps

- Agent-Based Simulators: agents have both attributes and methods (e.g., rules for interacting with other agents). An agent-based model could, for example, simulate the behavior of a population of animals that are moving around and interacting with each other.
- Continuous Simulators: Although these tools usually have some mechanism to represent discrete events, they are most appropriate if the material or information that is being simulated can be described as evolving or moving smoothly and continuously, rather than in infrequent discrete steps or packets.
- Hybrid Simulators: These tools combine the features of continuous simulators and discrete simulators. That is, they solve differential equations, but can superimpose discrete events on the continuously varying system.

3. Carry out an initial survey of potential solutions

Identifying the potential software that can serve the purpose that has been established in step no. 1 can prove to be a difficult task. Before starting analyzing, a list of possibilities must be completed. In order to help the ones who are at this stage we offer some recommendations of places to start from.

The Institute for Operations Research and the Management Sciences ([www.informs.org](http://www.informs.org)) publishes an online Resource Directory that includes most simulation software vendors. Another good resource is a list of simulation tools assembled and maintained by Andrea Emilio Rizzoli, a research scientist affiliated with IDSIA in Switzerland (<http://www.idsia.ch/~andrea/simtools.html>).

4. Develop a list of functional requirements

A functional requirement is a necessary feature or attribute of the simulation software solution that is necessary for the fulfillment of the purpose it is being used for.

5. Make a selection of informatics solutions that appear to best meet the functional requirements

Using the list created at the previous step, a verification of each tools feature must be made, followed by a comparison with the requirements defined in step 4.

6. Carry out a detailed evaluation of the screened tools

The final step in the process involves carrying out a detailed evaluation of the tools screened in step 5 and selecting the most appropriate tool.

This is actually the most difficult part, as the “Selecting Simulation Software” paper [8], doesn’t give much information about the way that the evaluation should be conducted. There are other papers that address this topic and propose criteria that can be used in the process of selection.

We propose a new evaluation framework, which is easy to complete. For each of the products that are on the narrowed list from step 5, we must complete a table that will help establish the most suitable informatics solution, based on the highest score.

For each criterion, a score between 1 and 5 should be assigned. Basically, a likert scale is used to measure the fulfillment of the criteria proposed for evaluation. The scale is defined as follows: 5- very well accomplished; 4- well accomplished; 3- accomplished; 2- poorly accomplished; 1: not accomplished.

Table 1: Framework for evaluation simulation solutions

Nr	Criteria	Score
1	Input capability and flexibility	
2	Data analysis capabilities	
3	Standard statistics generation	
4	Interactive debugger for error checking	
5	Support provided by the supplier	
6	Low cost of simulation software	
7	Ease of model editing	
8	Simulation speed	
9	Graphical display of input and output	
10	Interfacing the simulation package with external systems	
11	Friendly user interface	
12	Software compatibility with operating systems	
	TOTAL	

Source: by the author

This table should be included in a

questionnaire that must be completed by the potential users of the software for each software included on the narrowed list from step 5, before deciding which one to acquire. After synthesizing the results, the medium score can be calculated for each possible informatics solution and the higher score will indicate the most appropriate one to fulfill the needs defined in step 1.

**5. Comparative analysis of Topsim software and other informatics solutions available for business simulation**

The research question could be defined as: is Topsim the most appropriate informatics solution for the process of business simulation conducted by the Bucharest Academy of Economic Studies, through the project "Real access to labor market by simulated enterprise"?

We conducted a comparative analysis between the following informatics solutions: Topsim (1), SIMUL8 (2), Strategic Innovation Simulation (3), BTS (4), Marketplace (5).

We will follow the steps defined in section 4 of this article. First, we must define the purpose that needs to be fulfilled: students should acquire competences and skills in the area of international business by facing simulated economic scenarios that challenges them to make decisions, regarding the activity of virtual enterprises, in certain market conditions. After consulting the general types of informatics solutions, we decided that the one we need is from the Discrete Event Simulators category.

The initial survey on possible solutions has already been conducted in the previous section of this paper.

Next we must put together a list of functional requirements:

- the possibility of creating a virtual enterprise
- input data about the general market should be edited by the trainer
- students must be involved in decision-making processes, based on various economic factors
- the software should offer data analysis capabilities
- output data should be presented graphically and with the possibility of

standard statistics generation

- software compatibility with operating systems
- support provided by the supplier

The selection of informatics solutions that fulfill the functional requirements mentioned above include: Topsim, SIMUL8, Strategic Innovation Simulation, BTS, Marketplace.

For each of these we will complete table 1.

Using the total scores obtained by the software we can decide upon the most appropriate one to fulfill the requirements of the human resources development project.

As the project "REAL ACCESS TO LABOUR MARKET BY SIMULATED ENTREPRISE", is financed by the European Social Fund through the Sectoral Operational Programme Human Resources Development 2007-2013, Priority Axis 2 "Linking lifelong learning to the labor market necessities", Key area of intervention 2.1 "Transition from school to active life", there is a contract (POSDRU/90/2.1/S/63442) that requires that all expenses to comply with the budget. Because of this constraint, we have decided to give different importance on the criteria. The importance of criteria is defined by a percent, written in the last column of the table.

*Table 2: Comparative analysis of selected informatics solutions for business simulation in the educational system*

Criteria No.	1	2	3	4	5	Percent
1	3	3	5	4	4	8%
2	4	4	5	4	4	8%
3	4	3	5	4	4	8%
4	3	5	5	3	3	8%
5	3	4	3	4	5	8%
6	5	1	2	3	4	12%
7	4	4	5	2	2	8%
8	5	4	5	3	3	8%
9	4	5	2	5	3	8%
10	4	3	4	3	4	8%
11	4	5	2	5	5	8%
12	5	4	4	5	5	8%
Average SCORE	4	3.7	3.9	3.7	3.8	
Weighted SCORE	4.0	3.6	3.8	3.7	3.8	

Source: by the author

## 6. Acknowledgment

The research and publishing of this article has been financially supported from the project "REAL ACCESS TO LABOUR MARKET BY SIMULATED ENTREPRISE", Contract no. POSDRU/90/2.1/S/63442, that is coordinated by the Ovidius University from Constanta and financed by the European Social Fund through the Sectoral Operational Programmed Human Resources Development 2007-2013, Priority Axis 2 "Linking lifelong learning to the labor market necessities", Key area of intervention 2.1 "Transition from school to active life".

## 7. Conclusions

The comparative analysis conducted on five informatics solutions, selected based on functional requirements from a larger list, has proven the choice of Topsim software for the process of business simulation for students, to be correct.

We can observe that the competition was very tight, as all software scored between 3.6 – 4. Still, we must mention that there was a slight distortion of competition because we attributed a higher importance to the price criteria (12%) in comparison with the others (8%). This decision was made based on constrains from the project's budget.

The evaluation of projects was made by the authors, based on the analysis of data available on the software official web sites. A better understanding of each software's functionality could be achieved if students were given access to free trials and a future analysis can be conducted based on answers on questionnaires.

As the research has demonstrated, simulation games can play a supportive role in the educational system, adding value to the theoretical knowledge for students.

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# Foreign Direct Investments. Does the Form of Entry Matters? Evidence from Central and Eastern Europe.

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## Abstract

*If most of the literature regarding foreign direct investments (FDI) investigates the trend of FDI, the motives and their effects on development, little has been analyzed regarding the composition of FDI and the influence it has on the evolution of FDI's trend. The current paper tries to analyze this issue in the case of Central and Eastern Europe Countries between 2000 and 2010. Equity capital proves to be the most stable form of capital, feature evident even during the financial crisis, where the drastic reduction of FDI in the region was determined most by fluctuations in the other two forms of FDI (meaning reinvested earning and inter-company loans)*

**Keywords:** Foreign direct investments, Central and Eastern Europe, equity capital, reinvested earnings

**J.E.L. Classification:** F21, F23

## 1. Introduction

Countries of Central and Eastern Europe have certain characteristics that have had an impact on the type of FDI received and the time they occurred. (Sels, 2006). The status of "countries in transition" implies a distinction from other states, meaning that they are in the process of transforming their economy from the centrally-planned one to the market economy. In order to accomplish this goal, these states would first need capital. The domestic capital was extremely low so that foreign capital was the most viable solution.

The main advantages of the CEE in attracting investors were cheap labor and privatization of the state companies. With the rapid development of some countries and

their classification among middle or high income countries, FDI have been attracted by other features: investment environment, high profitability and various incentives offered to investors. (Suder and Sohn, 2006) FDI has three main forms: equity capital, reinvested earnings and inter-company loan (other forms of capital). The market entry form is particularly important in analyzing FDI, as they can explain a series of fluctuations from one year to another. In recent years, FDI have changed the structure and the share of the various forms of FDI in total FDI. The different composition of FDI depends on several factors related to the host country or country of origin among which we have: the taxes, the control level, regulations on investment, exchange the or macroeconomic situation (WB, 2004).

The literature is little on this issue, especially taking into account that the booking of the three forms of investments in the balance of payments is not made in all states and thus we do not have very accurate data, creating difficulties in their analysis.

This paper presents an analysis of FDI's composition during the period 2000-2010 in the states of Central and Eastern Europe, with focus on the new member states of the European Union. The article is structured as follows: the first chapter presents an overview of the evolution of FDI in the region, while the second chapter analyzes the composition of FDI and the motivations of the investors in choosing one form or another.

## 2. How important is FDI to the region?

Despite official assistance provided by international organizations, the main source of capital for Central and Eastern Europe came in the form of foreign direct investment. But not all countries have

proved to be as attractive to foreign investors and in the first 10 years of transition the gap between countries grew. Natural resource endowments, the proximity of the European Union or cheap labor, these are some of the reasons why countries have attracted FDI differently. (UNECE, 2001)

Most investments were directed to a small group of countries and this trend has been preserved in the second part of the transition, although the level was lower, and new countries have entered into the category of most attractive countries.

Following the global trend, also the Central and Eastern Europe region booked a new record in 2000, FDI heading, as in the past, especially towards two countries, which absorb half of all FDI: Poland and the Czech Republic. Poland proved to be extremely attractive to foreign investors since the early years of transition, being along with the Czech Republic and Hungary the performers of the region and since 1996 it took over the leadership of FDI inflows (WIR 1997). Among the Visegrad countries, Poland was the first to pass over the shock of transition, and recorded both economic growth and a significant increase in FDI (WIR 1996). Romania, along with the rest of Southeastern Europe is one of the states for which FDI were absolutely poor in the first half of the transition.

The uneven distribution of FDI depends on some factors among which: the transition to market economy, the speed at which this occurs, the privatization, investment climate and current negotiations on EU accession and harmonization of policies. The Visegrad countries were those that met most of these criteria and this was noticed also in the level of the FDI inflows (WIR, 1995)

Between 2000-2008, CEE experienced a period of real progress in attracting FDI. Although initially the received values were modest, recording even a decline in 2003, between 2004 and 2007 the region saw a real boom in FDI, which increased three times.

Although the regional evolution of FDI is somewhat stable between 2000-2003, Poland registered a period of decline in foreign direct investments since 2001. This was a result of unfavorable current global conditions and probably due to privatization coming to an end and the macroeconomic problems it was facing. (UNCTAD, 2002).

From a 34% share in total FDI in 2000, Poland attracted only 13.50% in 2002, the year in which the leading position of FDI inflows in CEE is taken by Czech. Given the fluctuations between states and the same state during years, we see that the changes from one year to another are given mainly by the levels of mergers (in this case privatization). A major privatization in one year may explain a peak in that year and may be higher than many low privatizations carried out before. (Estrin et al, 2000) The decline of FDI inflows on 2003 in CEE region is due to the end of privatization in the Czech Republic and Slovakia ( UNCTAD, 2004) and the new values attracted by the two countries in 2003 are just normal (peak reached in 2002, is uncommon).

The domination of the Czech Republic, Hungary, and Poland began to reduce, other countries coming back strong. (UNCTAD, 2003). Since 2004, FDI have begun an increasing trend, in conformity with the trend recorded worldwide. Although some of the countries of the region have become European Union (EU) members, they continue to have high risks that influence negatively foreign investors. The competitiveness of these states is threatened by corruption, poor infrastructure or loss of benefits of cheap labor and the costs for solving all these problems are high. The new EU regulations regarding taxes and costs of labor force can also erode the competitiveness of these countries and directing investors to other countries, also from CEE that are not yet EU members.(UNCTAD, 2005)

All states have received record levels of FDI between 2004-2007. The new 10 countries which joined the EU during 2004-2007, the in two waves of accession, continue to be the main recipients of FDI, but their share is declining from 90% in 2004 to about 82% in 2007. Romania, has become the second most attractive country after Poland since 2006 Poland and joins the group of the best performers in attracting FDI. So does Bulgaria, which evolution is similar to Romania's one. CEE countries recorded a peak in FDI inflows in 2007, up by 13%, from the previous year, while for Romania the peak will be reached next year, in 2008.

The financial crisis erupted in developed countries is felt in the CEE through a reduction in FDI, as a result of the reduced profitability of the companies. Although in 2008, the decline of FDI in the region accounts for only 14%, in 2009 the region records a drastic decrease of 52%. In 2010, there is a modest growth in FDI inflows, with different developments at individual level, the Czech Republic being the one that recorded the best performance.

### 3. The composition of FDI in Central and Eastern Europe

Foreign direct investments are preferable to other forms of investment, because on long term they are much more stable. But, FDI have different forms and this may affect in various ways the level of the investments placed. The question now we ask is which is the composition of FDI in different countries? Which of these forms is the most stable?

All three forms under which foreign direct investment take place are important. If equity capital has always been the predominant form in which company realize FDI, reinvested earnings and intra company loans have increased their importance in the recent years. This has a direct impact on the balance of payments, which in the majority of cases is a negative one.

Generally, privatization related FDI and greenfield investments are realized through *equity capital* (Hunya, 2004.) Investments in equity capital seem to be most stable and secure form that can be achieved through FDI. They require a long time horizon and acquiring of foreign assets in the host country. And, in general, this form of investment is also associated with technology transfer, job creation and increased productivity.

Until 2000, the largest share in total FDI in CEE was held by equity capital, with percentages above 80%. The share of FDI in the form of equity in CEE has been decreasing in the second decade of transition, having values between 45 and 60% of total FDI. In the 90s, in the first years of transition, most of the FDI inflows were related to privatization. As already mentioned above they were achieved as equities. The coming to the end of privatizations in the

main host countries: Hungary, Poland, Czech Republic and Slovakia led to a reduction in this type of investment in the following years. For example in 2000, when the largest acquisition and privatization of the region was made in Poland and was represented by the acquiring of Telekomunikacja Polska by France Telecom (UNCTAD, 2001), the equity share in total FDI of Poland was 94%. The same is noticed in 2002 in the Czech Republic and Slovakia, where high values of FDI due to privatization have led to 74% and 98% of total FDI to be realized as equities. In 2003, when FDI returned to "normal values" for the two countries, equities fell sharply, in the Czech Republic having even negative values.

During the boom in FDI, equity level was relatively stable, even if their share in total FDI was declining. Basically, the increases registered by the region in terms of FDI inflows is due to other forms of capital: reinvested earnings and inter-company loans (see figure 1).

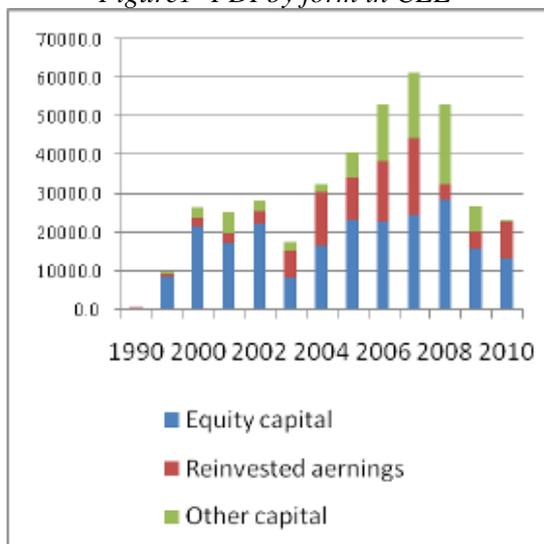
Foreign direct investments affect directly the balance of payments. The inflows produce a unidirectional effect and then there is a "funding out" through the repatriation of profits, the interest payments or the return of the loans received. Reinvested profits are not found among the initial forms of investment (Hunya, 2004). These take place only after the foreign subsidiaries became profitable, meaning, after passing a few years from the investment.

*Profits* of foreign affiliates in host countries lead to different choices: the company either pays dividends to the mother company or reinvests in the host country. Until 2000, the share of profits reinvested in the region amounted to about 10%. During this time the largest share of reinvested profits was held in Hungary, with 35% of total investments. This is explained by the fact that Hungary was first to complete privatization and received large sums of foreign direct investment since the beginning of transition, those investments showing in this period "its fruits". Since 2003, the share of profits reinvested in the region reaches 30%, with different percentages at individual level. Basically, during the boom of FDI 2003-2007, the corporate profits increased and a good proportion is reinvested in the host countries. Strategies, generally involve

transnational companies receiving dividends from subsidiaries always, while reinvested earnings fluctuate depending on the income of foreign subsidiaries (WB, 2004) Usually, when mother companies have financial problems there could be an increase of repatriation of profits (Hunya, 2004).

In 2008, with the outbreak of the crisis, the value of reinvested profits accounted for only 8% which means that either the share of repatriated profits increased significantly, or the profitability of foreign affiliates was extremely low.

Figure1- FDI by form in CEE



Source: created by author (wiiw database)

Lundan (2006) identifies five factors that determine the reinvestment of profits in the host country:

- investment opportunities which are considered the most important factor in determining the investment decision and are determined by the growth rate of host country or the growth differential between the two countries: home and host (if the best investment conditions are found in the host country, profit can be reinvested here, otherwise the repatriation of profits and investment to the country of origin or third countries may be more viable options)
- the profitability of foreign subsidiaries, a factor which is determined by the characteristics of the firms, (such as productivity) and high profitability encourages new investments. An important element in determining profitability are transfer pricing, that may influence investment decisions of the company.

Internalization and conducting of research and development activities involve the use of current transfer prices between different branches of transnational companies and the impact on company profitability can be significant.

- exchange rate: exchange rate depreciation may lead to the reinvestment of profits, because his return would be inappropriate at this time. On the other hand, as we talk about long-term investment, currency depreciation may influence the time the return is taking place and not the "quantity" to be distributed as dividends. (Dunning, 1993 in Laudan, 2006)

- corporate governance: companies that are interested in short-term financial gain lead to repatriation of profits, while the option of reinvesting is a feature in a coordinated market system and not in a liberal one.

- Tax on foreign subsidiary income: income tax system has a great influence on the repatriation or reinvestment and in determining the form of the repatriation: dividends, interest or royalties. On the other hand, the host country taxes can influence both achievement of foreign direct investment and their level. Companies seek to reduce costs of taxes on profits and reinvest trying to benefit from the deferral option. (WB, 2004) Dividends are those kind of capital transfers that are state-controlled, especially by currency convertibility (WB, 2004)

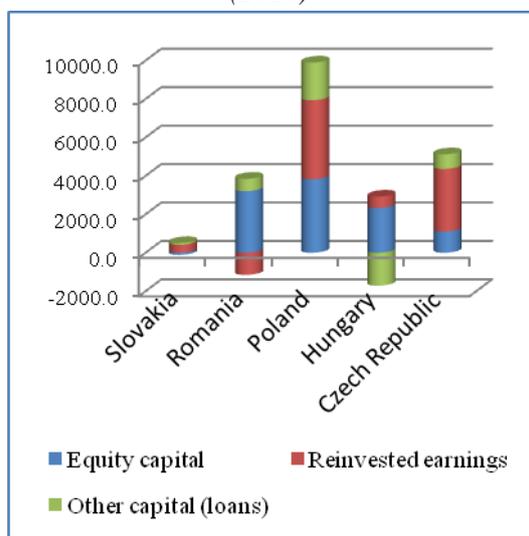
Laudan's research (2006) suggests that subsidiaries of European companies, unlike the U.S. ones, use profits for new investments only in a certain period of time, then they are repatriated.

*Other capital form:* the existence of restrictions on capital, may encourage loans to equity. (Extractive industry is the best example, as being a key industry, host countries try to limit foreign capital) (WB, 2004). In general, inter-company loans are extremely volatile. Companies can add capital to the subsidiary, but also this can be removed easily. (Hunya, 2004). As seen in figure 1, the share of inter-company loans increased sharply after 2005 in the CEE, during boom of FDI. But high levels in one year may be followed by massive withdrawals next year. This is seen in 2008-2009, when once the crisis hit, lending weight decreased significantly from

39% to 25% of total FDI, in 2010 represented only 2%.

At individual level we can see a different composition of the three forms of FDI (see Figure 2). Poland recorded a steady decrease in equity from 99% in 2003 to only 23% in 2010, while reinvested profits presents fluctuations between -7% and 48%, having in 2010 a share of 70% of total FDI. The composition recorded in 2010 by Poland, is also found in the case the Czech Republic or Slovakia. For the Czech Republic, 2010 is both a revival of the total flows, and of the levels of reinvested profits. These features are found in mature countries, where FDI are considered less risky for investors, in normal economic conditions. (Hunya, 2011)

Figure 2 - FDI by form in selected countries (2010)



Source: created by author (wiiw database)

Slovakia and Slovenia in 2009 recorded negative values of FDI received as a result of massive withdrawal of intercompany loans, but in 2010 managed to return to a positive trend due to increased of reinvested profits. After reaching in 2009 a record of reinvested profits Hungary accounts in 2010 a sharply decrease, these values reaching to be negative.

If Poland and the Czech Republic attracted FDI in the form of loans and reinvested profits, reflecting favorable investment conditions, Hungary and Romania have been preferred for new investment, an effect that is observed by the high share of equity capital. (Hunya, 2011).

#### 4. Conclusions

Equity capital are characterized by being a stable form of capital and investors are expecting to obtain profit. The decision regarding the reinvesting of profits shows the confidence in the host economy for short term of the foreign investors, along with the capital needs of the parent company. Other forms of capital (inter- company loans) reflect short-term decisions and varies strongly from year to year. (Hunya 2011)

If CEE boom in FDI during 2004-2007 was due to a significant increase of the last two form of capital, they are also the "guilty" part for the FDI decline during the crisis. Although mature states, are characterized by a significant share of profits reinvested, the stability offered by equity capital is preferable, especially for the CEE region.

#### 5. Acknowledgments

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**Section I**  
**International Affairs and European Integration**

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**Subsection 2**  
**European Integration**

# The Freedom of Movement in the European Space

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## Abstract

*The question one should ponder on is to know how to keep what Monnet proposed and realized in the last 50 years, as current economic and political situations require. The European Union is the laboratory of successful experiences regarding unification. It started from a collaboration between two competing countries and went to today's 27 accessions and perhaps many more in the near future. Jean Monnet himself concluded that from an economic union, states will want to switch to a political union. History has proved that the union of peoples will remain strong just based on common values. The current European Union was a product of a conspiracy of the elite, with good intentions and remarkable results.*

**Keywords:** Freedom, community law, european union

**J.E.L. Classification:** K 32

## 1. Introduction

During this study we tried to emphasize issues related to free movement of goods, persons, services and capital and that led to these conclusions:

- The studying of the evolution, of the concepts, of the Community institutions in the context of globalization is most present, it results from the socio-political situation of today, it does not need be directly proven, it is notorious.
- Schengen area should not be confused with the European Union and the reasons as we are to find out in the study.
- Public opinion believes that although Romania was integrated on 1 January 2007 it still has a long way ahead to adhere de facto to the principles of

community, according to a study conducted in due.

## 2. Content

The evolution of the European Union today is interesting, but more interesting to know is what freedom of movement of goods, persons, services and capital really mean. The growth registered in the EU concerns regarding finding the most effective approaches in both the legislative and social, practical problems faced by European citizens is remarkable. News of the chosen subject lies not only in the fact that it evokes the title of the first four chapters of the *acquis communautaire*, but also in the fact that free movement issue is on the agenda of European officials.

The importance of free movement within the European Union is still a natural given, established in rules, but to maintain this right one must fight. Violation of the meaning of EU legislation means restricting the free movement proportional to the infringed rule.

The phenomenon is of pressing current and the resulting conclusion is that the existing legal and institutional will be in a continuous improvement.

The situation of migrants, the unemployed, asylum seekers, students, employees and employers in general and in particular, has not remained unanswered, on the contrary, the analysis is supported by practical support Diversification of social services favours competition, it is how we analyzed the relationship between free movement of services with free movement of capital. It is also interesting to study the free movement of criminals correlated with the attitude of the authorities to prevent and combat criminal behaviors.

The study would not be complete without a qualified approach in the field, that is why we consulted official documents, opinions of experts drawn from conferences, debates on

European issues. The research is based on case study findings, designed to draw attention to public perception about the current situation of Romania in the European context of globalization.

Although we can travel anywhere in the Community, we can not travel freely. Airport rules are required in order to ensure citizen safety against terrorism and other criminogenic factors.

We know that Romania liberalized access to foreign citizens, but we don't know what countries impose travel restrictions, why and until when. Writing about Europe and European Union from its origins to the present, about the viability of institutions that handle all the strings of an international theater is a distraction that requires information, inspiration, analysis and objectivity. The research covers different historical places, so we made a retrospective and current insight. We invite the reader into a success story where the height is given by the free circulation within the Union and the outcome is open, allowing the shaping of their opinions.

### 3. Conclusions

The conclusions we stopped at are but a few, as the topic causes new debates and thinking subjects, so I will conclude asking the following questions:

Where can we travel? What papers do we need when crossing the border? What services may we provide inside the EU? Are we allowed to start a company in the EU?

We hope that this study brings a modest contribution to the dissemination of community law among those interested in this important area. Given the contents recorded in the study and the findings above, these recommendations are required *de lege ferenda*: to clarify the meaning of the concepts of freedom of movement not only through rules but also by implementing it the mind of citizens, to develop a strategy of bringing to the attention of the EU citizens of their rights and freedoms in a more practical and easy manner such as information through the media.

It is true that the treaties, conventions and many other regulations provide legal freedoms to citizens of Europe but many people do not know how to apply them. It is

a wide range of people who either do not have access to the media or are disinterested.

I propose that the *theme of free movement of goods, persons, services and capital* be no longer on the table of officials, but be carefully debated by citizens.

And this will happen when the *kings* of today will facilitate access to information to deprived areas, where in fact the situation is worrisome. Lack of information on the other hand leads to criminal. To inform the public on free movement in particular is not only sufficient but also necessary in a democratic society. Do you want to know the European Union? It is an open invitation to all who wish to move freely in the European spirit. That is why, at least for these benefits, we should thank the founders of the yesterday Europe for the Europe today.

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## Some Critical Aspects on Monetary Maastricht Convergence Criteria

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### Abstract

*So far, we can say that although the euro area has resisted even more than some of its critics believed, this does not make it invulnerable. In the context of current major macroeconomic imbalances, nominal convergence problem has received many analyzes and reflections. Insufficiency of the Maastricht criteria to reflect the ability of European Union Member States in achieving the economic development required by the EMU integration and also in compliance with strict fiscal and monetary policy governing its operation, is the primary consideration of the intention to highlight some of their critical aspects.*

**Key words:** nominal convergence criteria, price stability, inflation rate, long term interest rate, exchange rate

**J.E.L. Classification:** E31, E43, F15

### 1. Introduction

While the exchange rate criterion and fiscal criteria (government deficit and gross debt) require a fixed reference value, the inflation and long-term interest rate reference values are defined in relation to the average of the three best-performing EU Member States in terms of price stability.

A notable feature of the last two aforementioned criteria is related to the change above their reference value in the context of EU enlargement. Accession of a new Member State may reduce the reference value (if it has a sufficiently low inflation rate in the reference group), but never

increase it. EU enlargement from 15 to 27 Member States has led, on average, to a lower reference value. The importance of this effect was emphasized in May 2006, when two states outside the euro area, Sweden and Poland, were included in the reference group for reference value calculation, below which Lithuania amounted to 0.1 percentage points [6]. If the reference group was limited to the 15 states of EU or EMU members, Lithuania would be located within the reference value.

### 2. HICP inflation – a real challenge for the New Member States of the European Union

Meeting the inflation criterion is a real challenge for new EU countries from Central and Eastern Europe for the following reasons: on one hand, price convergence exerts pressure on inflation, especially in countries with fixed parity against the euro [1], and on the other hand secondly, the EU enlargement process gradually reduced inflation criterion reference value. A lower benchmark assumes that its fulfillment by the EU Member States to become increasingly more difficult.

Using available data on annual inflation rate in the 27 EU Member States we intend to realize, taking into account the last two waves of enlargement, a comparative analysis of the evolution of inflation during three time periods: 1999-2011, 2004-2011 and 2007-2011.

In this respect, we determine the average annual inflation rates (measured by HICP) and the dispersion of inflation to the average value for each Member State in each calculation period.

Tabel 1. Statistical calculations on the HICP inflation rate in EU-27 during 1999 and 2011 (%)

	1999-2011		2004-2011		2007-2011	
	Average	Standard deviation	Average	Standard deviation	Average	Standard deviation
Belgium	2.16	1.10	2.35	1.31	2.42	1.71
France	1.79	0.77	1.88	0.88	1.78	1.13
Germany	1.60	0.74	1.81	0.82	1.80	1.08
Italy	2.27	0.67	2.19	0.81	2.16	1.06
Luxembourg	2.70	1.17	2.91	1.28	2.66	1.60
Netherlands	2.18	1.17	1.60	0.55	1.64	0.71
Ireland	2.43	2.12	1.39	1.96	0.78	2.34
Denmark	2.10	0.70	1.98	0.87	2.26	0.96
United Kingdom	2.12	1.10	2.70	1.02	3.18	0.96
Greece	3.24	0.87	3.26	1.00	3.26	1.31
Portugal	2.55	1.30	2.10	1.37	1.84	1.72
Spain	2.85	1.08	2.74	1.34	2.36	1.62
Austria	1.90	0.89	2.11	0.98	2.22	1.27
Finland	1.88	1.06	1.79	1.25	2.42	1.10
Sweden	1.71	0.77	1.69	0.76	2.04	0.73
Slovenia	4.61	2.64	2.89	1.40	2.88	1.79
Cyprus	2.60	1.32	2.38	1.23	2.58	1.58
Malta	2.44	0.89	2.43	1.12	2.32	1.47
Slovakia	5.22	3.62	3.26	2.22	2.30	1.62
Estonia	4.18	2.57	4.60	3.08	5.06	3.96
Latvia	4.88	4.24	6.43	4.86	6.34	6.42
Lithuania	2.88	3.10	4.26	3.17	5.28	3.65
Poland	3.82	2.56	3.06	1.03	3.48	0.77
Czech Republic	2.38	1.72	2.44	1.74	2.64	2.24
Hungary	6.14	2.39	5.10	1.61	5.30	1.68
Bulgaria	5.88	3.08	6.00	3.13	5.70	4.07
Romania	17.05	15.25	7.24	2.32	6.06	1.12
<b>EU-15 average</b>	<b>2.23</b>	<b>1.03</b>	<b>2.17</b>	<b>1.08</b>	<b>2.19</b>	<b>1.29</b>
<b>EU-10+2 average</b>	<b>5.17</b>	<b>3.61</b>	<b>4.17</b>	<b>2.24</b>	<b>4.16</b>	<b>2.53</b>
<b>EU-27 average</b>	<b>3.54</b>	<b>2.18</b>	<b>3.06</b>	<b>1.60</b>	<b>3.07</b>	<b>1.84</b>

Source: Own calculations, based on data available on Eurostat

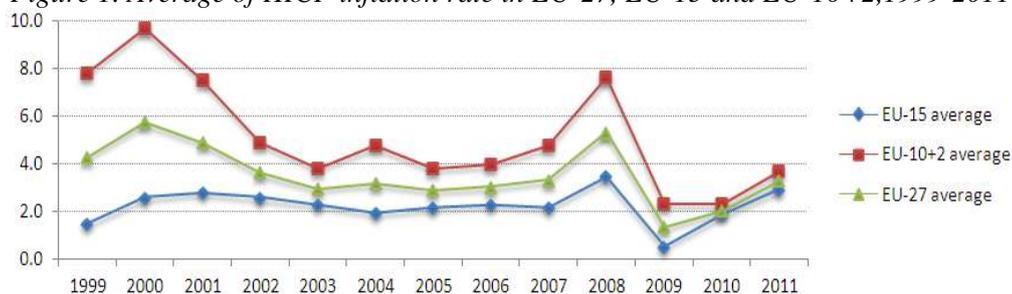
Firstly, these results show that the average HICP inflation rate in the 27 EU Member States is relatively stable over time. Also, average inflation in the EU-10+2, except Romania, has a certain relative stability during analyzed periods.

Secondly, average inflation in the EU-15 is below EU-10+2 average and also the EU-

15 average inflation is lower than EU-27 average, difference that diminishes over time due mainly to the reducing of the inflation rate in Romania.

Thirdly, dispersion of inflation rates in the EU-10+2 is higher than in the EU-15 and also standard deviation in the EU-27 is higher than in EU-15.

Figure 1. Average of HICP inflation rate in EU-27, EU-15 and EU-10+2, 1999-2011



Source: Own calculations, based on data available on Eurostat

EU enlargement has brought countries with high levels of inflation, but with greater variability, which allows us to appreciate the

low possibility that a new Member State is one of the three best-performing countries in terms of price stability.

Table 2. Average of HICP inflation rate in the best-performing EU-15 and EU-27 Member States in terms of price stability during 1999 and 2011 (%)

	Average inflation rate in the best-performing EU-15 countries (%)	Average inflation rate in the best-performing EU-27 countries (%)	Average inflation rate difference between the EU-27 and EU-15 (%)
1999	0.5	0.5	0.0
2000	1.1	1.0	-0.1
2001	1.6	1.5	-0.1
2002	1.4	0.8	-0.6
2003	1.2	1.0	-0.2
2004	0.4	0.4	0.0
2005	1.0	1.0	0.0
2006	1.5	1.5	0.0
2007	1.6	1.2	-0.4
2008	2.6	2.6	0.0
2009	0.0	0.0	0.0
2010	1.2	0.9	-0.3
2011	1.6	1.6	0.0

Note: Member States with negative inflation were excluded from analysis.

Source: Own calculations, based on data available on Eurostat

The impact of EU enlargement in terms of inflation rate criterion can be expressed, on one hand, by substantial changes in average inflation rates of the three best-performing countries, in the EU-15 and EU-27, between 0.0% and 2.6%, so that setting a fixed reference value would be appropriate. Triandafil (2011) believes that it would be appropriate to establish the reference value for the inflation rate criterion as a specific range of variation for the, mainly envisaging mainly extending the corridor by about 3 percentage points, except the case when inflation spikes could occur, which would cause the exceedance of the reference [5].

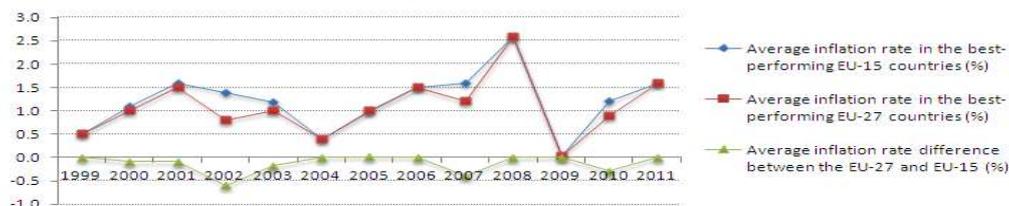
Moreover, Jonas (2006) emphasizes that the existence of a unique benchmark for EU-27 is not appropriate and considers to be more relevant the establishment of two reference values, depending on the stage of the business cycle, a benchmark for countries experiencing an overheating of the economy and another benchmark for other countries

passing through the descending phase of the economic cycle [2].

On the other hand, the difference between average inflation rates of the three best-performing Member States in the EU-27 and EU-15 in terms of price stability varies significantly during 1999 and 2011, between -0.6% and 0.0%.

Graphical representation of the results shows that average inflation rate in the EU-27 is lower than in the EU-15 or at most its maximum level. This situation confirms the previous statement, that the probability that a New Member State, especially from the EU-10+2, to be one of the three best-performing countries in terms of inflation is lower. Average values for EU-15 and EU-27 are identical in 1999, 2004-2006, 2008-2009 and 2011, and the negative values of the difference indicate us an unfavorable aspect on inflationary phenomenon in the context of EU enlargement.

Figure 2. Average inflation rate in the best-performing EU-15 and EU-27 Member States in terms of price stability, 1999-2011 (%)



Note: Member States with negative inflation were excluded from analysis.

Source: Own calculations, based on data available on Eurostat

Countries in the last wave of enlargement, Bulgaria and Romania, have a notable change in the inflation rate and also a high average. Therefore, it is obvious that none of these two countries has been found in the three best-performing countries group during 1999 and 2011.

A quantitative more complex estimate of the EU enlargement impact on inflation rate reference value is made by Lewis and Staehr (2007) using Monte Carlo simulations. Experiments undertaken in their study showed that in EU-27 instead of EU-15 the reference value for price stability criterion was significantly lower during 1999 and 2004 and since mid 2006. Monte Carlo simulations indicated that the expected reference value decreased by 0.15-0.2 percentage points due to EU enlargement from 15 to 27 countries, with the likelihood of significant reductions [4].

Another feature on monetary convergence criteria related to the stringency of control over inflation, which typically involves an increase in interest rates and an appreciating exchange rate, thereby causing a violation of the nominal convergence criteria, while interest rate creates long-term inflationary pressures. Lewis (2007) highlights some natural tension between nominal convergence process and simultaneous fulfillment of exchange rate criterion and the inflation rate. Authorities can use monetary policy to meet one of the target-criteria either inflation or

exchange rate so that later will subsequently “hope” to fulfill another criterion [3].

### 3. Long-term interest rate in the enlarged European Union

Meeting long-term interest rates criterion in the frame of EU enlargement also raises challenges for the New Member States.

An issue for long-term interest rate criterion is using long-term government securities or other comparable securities since there are no bonds with maturity close to 10 years in all Member States. Therefore, different securities with various maturities are compared, which implies a high degree of flow.

Also, in the absence of a mature bonds market denominated in Estonian crowns and reflecting low public debt, harmonized long-term interest rates for Estonia are not available, making it difficult to assess the sustainability of convergence process prior to the moment of entry into EMU.

Given the available data on long-term interest rates in the EU-27 and taking in consideration the last two waves of enlargement, we analyze in a comparative manner the evolution of the indicator during the same three time periods: 1999-2011, 2004-2011, 2007-2011, by setting the average of long-term interest rates and the dispersion to the average value for each Member State in each calculation period.

Table 3. Statistical calculation on long-term interest rate in EU-27 during 1999 and 2011 (%)

	1999-2011		2004-2011		2007-2011	
	Average	Standard deviation	Average	Standard deviation	Average	Standard deviation
Belgium	4.34	0.62	3.97	0.38	4.07	0.39
France	4.14	0.66	3.74	0.44	3.72	0.53
Germany	3.95	0.77	3.49	0.61	3.35	0.72
Italy	4.58	0.57	4.35	0.55	4.59	0.52
Luxembourg	3.92	0.93	3.49	0.83	3.88	0.78
Netherlands	4.11	0.72	3.68	0.52	3.64	0.64
Ireland	5.00	1.49	5.07	1.99	5.88	2.15
Denmark	4.18	0.83	3.67	0.62	3.56	0.73
United Kingdom	4.46	0.71	4.14	0.77	3.87	0.87
Greece	6.02	3.11	6.40	4.14	7.86	4.79
Portugal	5.00	1.62	5.04	2.18	5.76	2.55
Spain	4.47	0.62	4.20	0.59	4.47	0.56
Austria	4.22	0.68	3.81	0.45	3.83	0.53
Finland	4.15	0.74	3.70	0.53	3.67	0.64
Sweden	4.13	0.89	3.54	0.62	3.36	0.66
Slovenia	4.98	1.44	4.33	0.45	4.46	0.42
Cyprus	5.20	0.94	4.90	0.62	4.81	0.55
Malta	4.85	0.59	4.54	0.21	4.55	0.24
Slovakia	5.02	1.26	4.40	0.49	4.45	0.35
Estonia	:	:	:	:	:	:
Latvia	6.46	2.54	6.65	3.07	8.06	3.11

Lithuania	6.06	2.75	5.90	3.34	6.98	3.95
Poland	6.42	1.48	5.85	0.56	5.88	0.26
Czech Republic	4.44	0.75	4.19	0.52	4.27	0.48
Hungary	7.53	0.74	7.62	0.86	7.80	0.92
Bulgaria	5.37	1.02	5.24	1.07	5.70	1.00
Romania	7.73	0.89	7.73	0.98	7.83	1.06
<b>EU-15 average</b>	<b>4.44</b>	<b>1.00</b>	<b>4.15</b>	<b>1.01</b>	<b>4.37</b>	<b>1.14</b>
<b>EU-10+2 average</b>	<b>5.82</b>	<b>1.31</b>	<b>5.58</b>	<b>1.11</b>	<b>5.89</b>	<b>1.12</b>
<b>EU-27 average</b>	<b>5.03</b>	<b>1.13</b>	<b>4.75</b>	<b>1.05</b>	<b>5.01</b>	<b>1.13</b>

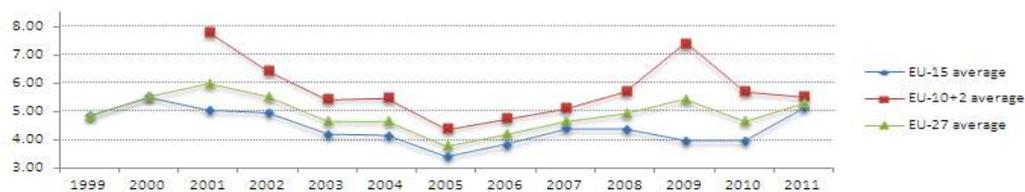
Note: : – data not available

Source: Own calculations, based on data available on Eurostat

Our results firstly indicate a relatively stable average of long-term interest rates over time for all Member States and in the EU-27, EU-15 and EU-10+2, in the context of a downward trend. Also, the average of long-term interest rates in the EU-15 is below the average in EU-10+2, difference that reduced slightly over time. Secondly, the dispersion

of long-term interest rates appears relatively stable with a slight decreasing trend during the three periods of calculation. Deviation from the average value is higher in EU-10+2 than the EU-15 and also in EU-27 standard deviation is stronger than in EU-15, with a downward tendency for all groups.

Figure 3. Average of long-term interest rates in EU-27, EU-15 and EU-10+2, 1999-2011 (%)



Source: Own calculations, based on data available on Eurostat

Limiting the interest rates corresponding to long-term securities involves a high opportunity cost by sacrificing the opportunities to valorize the short-term interest differentials [5], reason for which we

aim to identify taking into account short-term interest rates the potential Member States on their way to EMU to fulfill a high degree of convergence.

Table 4. Short-term interest rate (one month) in EU-27 and EA during 1999 and 2011 (%)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Bulgaria	4.03	4.14	5.01	4.32	3.14	3.11	2.71	3.09	4.61	6.71	4.50	2.41	2.08
Latvia	7.07	4.65	6.58	3.93	3.54	4.07	2.95	3.89	7.21	6.32	9.19	1.22	0.60
Lithuania	11.72	7.53	5.27	3.25	2.56	2.20	2.26	2.99	4.90	5.26	3.70	1.00	1.36
Hungary	15.21	11.44	11.09	9.12	8.42	11.48	7.38	6.96	7.86	8.97	8.90	5.26	6.31
Poland	14.57	18.49	16.49	9.22	5.74	6.03	5.36	4.17	4.64	6.11	3.88	3.61	4.37
Czech Republic	6.84	5.31	5.15	3.58	2.30	2.26	1.97	2.22	2.97	3.81	1.92	1.08	0.97
Romania	82.65	49.70	40.53	26.95	18.20	19.18	7.96	8.11	7.25	12.23	11.32	5.68	5.02
Sweden	3.21	3.90	4.10	4.21	3.28	2.30	1.86	2.43	3.75	4.52	0.78	0.72	2.16
Denmark	3.32	4.75	4.76	3.52	2.45	2.18	2.20	3.09	4.31	4.86	2.12	0.98	1.19
United Kingdom	5.43	6.05	5.07	3.99	3.71	4.52	4.74	4.79	5.86	5.18	0.82	0.56	0.65
<b>EU-27</b>	<b>:</b>	<b>:</b>	<b>4.81</b>	<b>3.85</b>	<b>2.87</b>	<b>2.82</b>	<b>2.75</b>	<b>3.35</b>	<b>4.44</b>	<b>4.61</b>	<b>1.21</b>	<b>0.78</b>	<b>:</b>
<b>Euro Area</b>	<b>2.86</b>	<b>4.24</b>	<b>4.33</b>	<b>3.30</b>	<b>2.35</b>	<b>2.08</b>	<b>2.14</b>	<b>2.94</b>	<b>4.09</b>	<b>4.27</b>	<b>0.89</b>	<b>0.57</b>	<b>1.18</b>

Note: – data not available, Euro Area: EA11-2000, EA12-2006, EA13-2007, EA15-2008, EA16-2010, EA17-2011

Source: Eurostat

Except for Hungary, Poland and Romania, whose annual short-term interest rate levels are more distant from the EU-27 average and the Euro Area, all other Member States

indicate a high degree of convergence, the size indicator tends to average level so that the potential for interest rate harmonization can increase by taking into account short-

term indicator, unlike the classic indicator of nominal convergence.

#### 4. Exchange rate stability criterion

In order to achieve the exchange rate stability criterion, as a consequence of sustainability of monetary and also fiscal indicators, it is necessary the correlation with the other indicators. However, an excessive tendency to stabilize the exchange rate may result in removal of the economy from the natural steady-state, jeopardizing its self-regulating capacity. Also, a reduction in inflation leads to an increase in real interest rates which determine the attraction of foreign capital in the context of currency appreciation, but with negative effects on net exports.

Possible adjustments [5] to the exchange rate criterion could be an increased flexibility, by maintaining the system of managed floating and coexistence of trend appreciation in real terms with the variability of quotations on short term. Thus, it provides a high degree of independence of monetary policy, with increased effectiveness in controlling inflation phenomenon. Also the managed float exchange rate regime is consistent with choosing the nominal anchor, which allows a flexible response to unforeseen external and domestic shocks that may occur.

Reducing the gap between the economy of financial flows and real economy indicates that the state has the ability to achieve real convergence criteria, so that cost-benefit ratio should favor the euro adoption.

#### 5. Conclusions

Consequently, due to current financial crisis, euro area countries experience different problematic situations generated by a brisk increase in the share of government deficit and public debt in GDP and by the economic downturn that *limited character of the nominal convergence monetary criteria*.

Also, Member States wishing to join the Euro Area should be aware of the importance of dynamic criteria, not just their level during the evaluation.

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## Health Satellite Accounts and Indicators for Ageing Populations in EU and Romania Statistics

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### Abstract

*Active ageing policies, together with health-related technological advances and improving living conditions have led to increased life expectancy for the EU's elderly population.*

*Furthermore, there is a great deal of variation in the way that healthcare services are provided and funded across the Member States.*

*An ageing population is expected to result in additional demands for a range of health and health-related products and services.*

*With no change in the overall health status of the EU population and without any future reform of social security systems and labour markets to promote healthy and active ageing, demographic developments will likely result in increased pressure on public budgets for health and long-term care.*

*In the case of Romania, "The 2008-2010 multi-annual national statistics program" includes nothing about healthcare satellite accounts or indicators for ageing population.*

**Key words:** health satellite accounts, healthcare indicators, EU, Romania.

**J.E.L. Classification:** A10; H50; H51; H53; H75; I1; I13; I18.

### 1. Introduction

For the EU Member States, EAS is the standard for submitting national accounts data to international bodies. The EAS concepts are focused on describing the economic process in easily observable monetary terms.

On the other hand, for some specific needs

in terms of data, the best solution is to have separate satellite accounts. These needs relate to data requirements for: the analysis of the role the tourism plays in the national economy, the analysis of the cost and financing of the health care, the analysis of the importance of the research and development (R&D) and the human resources for the national economy, the analysis of revenue and expenditure for households taking into account the microeconomic concepts of income and expenditure, the analysis of the interaction between the economy and the environment, the analysis of the production within households, the analysis of the changes in citizens' welfare, the analysis of the differences between the national accounts and the business accounts and their influence on stock and exchange markets, the estimation of tax revenues. Besides, there has been recently introduced the satellite account for the social economy. [1]

Article 152 of the Treaty establishing the European Community states that „a high level of human health protection shall be ensured in the definition and implementation of all Community policies and activities”, thus acknowledging that public health is heavily dependent on policies in many other areas, including environment, agriculture, industry, trade, and social and economic policy. [2]

The current version of the EU health strategy [3] presents three strategic themes intended to meet the major challenges facing health in the EU. The first theme focuses on the promotion of healthy lifestyles to improve healthy ageing. The second, concerned with the protection from health threats, is an explicit objective in the

Sustainable Development Strategy (EU SDS) and covers related subjects such as food security and environmental pollution. The third looks at the sustainability of health systems and the role of technological development in improving their efficiency.

Active ageing policies, together with health-related technological advances and improving living conditions have led to increased life expectancy for the EU's elderly population.

There is no doubt that poor health is perceived as a key driver of early retirement. As such, maintaining the autonomy and independence of the elderly generations has become a goal for some policymakers, as better health has the potential to: improve the well-being of individuals; extend their working lives – providing a stimulus for economic growth; reduce the overall strain on health and social care systems.

The EU supports healthy ageing as part of its health strategy ‘Together for health: a strategic approach for the EU, 2008-13’ and through the open method of coordination on social protection and social inclusion. Healthy ageing is based on a two-fold approach: the promotion of health over the whole of an individual's life, aiming to prevent health problems and disabilities from an early age (promoting a healthy lifestyle through actions that seek to increase levels of physical activity, encourage the adoption of a healthy diet, or reduce individual's dependence on the use of tobacco, alcohol or illicit substances); a commitment to tackle health inequalities that are linked to social, economic and environmental factors.

An ageing population is expected to result in additional demands for a range of health and health-related products and services. For example, as people live longer, a larger number will become very old (aged 80 or over) and therefore it is likely that many will become frail and require more social care services in the form of support at home or in long-term residential centres. This development is likely to be intensified in the future, with a higher proportion of very old persons projected to live alone, reflecting the break-up of family units and a reduction in the willingness/possibility for family members to provide care to their older relatives. With no change in the overall health status of the EU population and

without any future reform of social security systems and labour markets to promote healthy and active ageing, demographic developments will likely result in increased pressure on public budgets for health and long-term care. [4]

## **2. Healthcare satellite accounts and indicators in EU statistics**

Health is an important priority for Europeans, who expect to be protected against illness and disease at home, in the workplace and when travelling. Health issues cut across a range of topics-including consumer safety, health and safety at the workplace, environmental and social policies. [5]

Information about healthcare systems and, ultimately, about the health of a population is a prerequisite for monitoring the performance of health policy. The regional indicators currently available for health provide an insight into similarities, particularities and contrasts across regions in Europe. There can be big differences between regions in the same country, while regions in different countries may be very similar. Thorough analysis of trends and variations in health indicators at regional level is therefore indispensable for planning and monitoring action and programmes, formulating new policies, developing new strategies and, all in all, contributing to ‘evidence-based health policy’. Eurostat's work on health statistics is focusing mainly on further improvements in the quality, comparability and completeness of the data and further extension of the regional coverage. [6]

Eurostat statistics is including in „Population and social conditions” chapter some health indicators for public health. [7]

Public health is providing as structural indicators: healthy life years in absolute value at birth-females; healthy life years at birth in percentage of the total life expectancy-females; life expectancy in absolute value at birth-females; healthy life years in absolute value at birth-males; healthy life years at birth in percentage of the total life expectancy-males; life expectancy in absolute value at birth-males; healthy life years in absolute value at 65-females; healthy life years at 65 in percentage of the total life expectancy-females; life expectancy in

absolute value at 65-females; healthy life years in absolute value at 65-males; healthy life years at 65 in percentage of the total life expectancy-males; life expectancy in absolute value at 65-males.

The above ones are completed by causes of death: causes of death-absolute number (annual data); causes of death-standardised death rate (per 100,000 inhabitants) (annual data); causes of death by region-crude death rate (per 100,000 inhabitants) (annual data); causes of death by region-standardised death rate (per 100,000 inhabitants-3 years average); causes of death by region-crude death rate (per 100,000 inhabitants-3 years average)-females; causes of death by region-crude death rate (per 100,000 inhabitants-3 years average)-males; causes of death by region-crude death rate (per 100,000 inhabitants-3 years average)-total; causes of death by region-absolute number (3 years average)-females; causes of death by region-absolute number (3 years average)-males; causes of death by region-absolute number (3 years average)-total.

Health care expenditure is including as first mention the health care expenditure-summary tables: health care expenditure by provider; health care expenditure by function; health care expenditure by financing agent; health care expenditure on long term care. Expenditure of selected health care functions by providers of health care, expenditure of selected health care functions by financing agents in health care and expenditure of providers of health care by financing agents in health care are provided in millions, in percentage and per inhabitant.

Determinants of health are incorporating: body mass index (BMI) by sex, age and educational level (%); body mass index (BMI) by sex, age and income quintile (%); daily smokers by sex, age and educational level (%); daily smokers by sex, age and income quintile (%); smokers by number of cigarettes by sex, age and educational level (%); alcohol consumption by sex, age and educational level (%); consumption of fruits by sex, age and educational level (%); consumption of vegetables by sex, age and educational level (%); practice of daily physical activity by sex, age and educational level (%).

Health care is including: vaccination

against influenza during the past 12 months by sex, age and educational level (%); breast examination by X-ray by educational level among women 50-69 (%); cervical smear test by educational level among women 20-69 (%); colorectal cancer screening test by sex, age and educational level among people aged 50-74 (%); consultation of a medical professional during the last 4 weeks by sex, age and educational level (%); consultation of a psychologist during the last year by sex, age and educational level (%); use of medicines during the past 2 weeks by sex, age and educational level (%).

### **3. Healthcare satellite accounts and indicators for ageing populations in EU statistics**

The prevalence of physical health problems is higher among older people. Many of the illnesses that cause poor health (and in some cases death) are preventable, for example, cardiovascular disease or type II diabetes. Many of the conditions leading to death are the outcome of risk factors accumulated over a lifetime.

Even in old age it is possible for individuals to achieve health gains-for example, through taking up a physical activity. The share of the population aged 55 to 64 that undertook exercise on a regular basis was often slightly higher than the average for the whole of the population aged 15 or more. However, from the age of 65 onwards, there was a marked reduction in the share of the population undertaking regular physical activity.

Although life expectancy is increasing and most Europeans may realistically hope to live longer than previous generations, it is perhaps more important from an active ageing perspective and from the perspective of most individuals to consider the years of retirement that can be experienced in good health.

The consumption of various medical goods and services is expected to rise as the EU's population ages in the coming decades. Whether this is financed privately or from the public purse, the expanding number of older persons in the population may have significant consequences on the number of healthcare professionals that are required to care for the elderly - and this during a period

when the overall size of the EU's workforce is expected to contract.

One measure of the supply of healthcare services is the number of practising physicians or doctors per 100 000 inhabitants, which generally ranged from 270 to 380 in the majority of the Member States. Information on the number of nursing and caring professionals per 100 000 inhabitants is available for a smaller number of countries, with a much wider variation in staff numbers.

Out-patient healthcare services may be analysed from the demand side through the use of an indicator on the proportion of the population that had consulted a general practitioner (GP) or medical specialist. A higher proportion of the older population tended to visit a doctor more frequently, with almost half (48.2 %) of the population aged 65 or above having visited a doctor at least six times in 2009.

The number of hospital discharges per 100 000 inhabitants is a commonly used measure for the utilisation of hospital services, reflecting the demand for in-patient care and services. Discharge statistics do not provide a measure of the success of an intervention or cure, as discharges may result from treatment being finalised, but also when a patient signs out against medical advice, if a patient is transferred to another institution, or if a patient dies.

Furthermore, there is a great deal of variation in the way that healthcare services are provided and funded across the Member States. As such, while it may be commonplace to treat a particular illness as an in-patient in a general hospital in one country, such a procedure might be provided through a specialised out-patient facility in another. The number of in-patient hospital discharges generally rises as a function of age in most countries, to such a degree that by the age of 95 there are some countries where on average each person visits hospital more than once a year.

Healthcare spending is linked to technological progress, as new methods of diagnosis and treatment impact on expenditure, in some cases introducing cheaper, simpler, quicker, more effective, less invasive techniques, in others introducing new technologies with a very high capital expenditure. Expenditure on

healthcare needs to be considered in the context of long-term savings that may be associated with a healthier population. Healthcare expenditure (current and capital spending) ranged from 5.7 % of GDP in Romania to 12.0 % of GDP in the Netherlands in 2009. Care for the elderly - based on information relating to social protection expenditure devoted to old age care (which includes expenditure to cover care allowances, accommodation and assistance in carrying out daily tasks) - accounted for 0.4 % of GDP in the EU-27 in 2008, peaking at 2.3 % in Sweden; the only other Member States where care for the elderly accounted for at least 1 % of GDP were Denmark and Austria.

Care for the frail and old is often provided on an informal basis - by spouses, relatives or friends. However, changes in family structures, higher labour force participation (especially among women), and increased geographical mobility, may reduce the provision of informal care in the coming years. As such, the ageing population may require additional formal care provisions and providers of these services. Increasing care facilities for the old within the community and making greater use of information technologies may encourage older people to remain within their established community.

Healthcare expenditure can also be analysed according to purpose - for example, health promotion activities, curing illnesses, or long-term care.

The final section presents the results of a survey conducted in March 2009 concerning intergenerational solidarity and more specifically opinions relating to the provision of pensions and care for the elderly. Some 58.5 % of people aged 15 or more in the EU-27 agreed that governments would no longer be able to pay for pensions and care for the elderly in the coming decades. Despite this, 83.6 % of those surveyed agreed that governments should provide much more money for pensions and care for the elderly; it is interesting to note that the highest proportion in agreement with this proposition was recorded among those close to retirement (persons aged 55 to 64 years, 86.0 %). The same survey indicates that just over one third (34.3 %) of the EU-27 population aged 15 or more agreed that there were sufficient social services to support frail older people so that

they could stay in their own home; it is interesting to note that the age group that had the highest proportion agreeing that there were sufficient social services for this purpose was those aged 65 or more. A far higher percentage (84.5 %) agreed that frail, elderly people could not live autonomously because their homes were not adapted to their needs.

A survey conducted in September and October 2011 provides details of how Europeans think governments should help people care for older family members. Of the solutions proposed, the highest proportion (44 %) of persons aged 15 and over thought that providing some form of financial remuneration to those providing care would be the most useful thing that governments could do. [4]

#### 4. Conclusions

For Romania, "The 2008-2010 multi-annual national statistics program" includes some extremely shy actions on health satellite accounts for 2008 (implementation of data collection on health expenditure, harmonized with OECD methodology and with the most recent methodological recommendations of EUROSTAT), yearly (for the collection of health expenditure of the three areas: funding sources, health functions and services, health service providers; an additional field is the collection of expenditure on health human resources in the standardized format), for 2009 (review the national methodology of the System of Health Accounts, following the preparation and publication of the second edition of the OECD-EUROSTAT-WHO methodology) and for 2010 (dissemination of statistics on health expenditure).

There's nothing about healthcare indicators or satellite accounts for ageing population in Romania.

#### 5. Acknowledgements

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## A Critical Analysis Regarding the Euro Area Governance

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### Abstract

*The history of the European monetary integration process reveals the fragile foundation for constructing such a union in terms of economic and political vulnerabilities, which have accumulated over time. In this paper, we mention some of the problems concerning the governance in the euro area, based on the principles underlying its performance, to highlight the risks that enhance the split euro area.*

*Reconsidering the European integration as a political project, with huge responsibilities arising from this, represent a solution to maintain the euro area on a sustainable path, at least in the medium term.*

**Keywords:** Eurozone, governance, single monetary policy, budgetary deficit, public debt.

**JEL Classification:** E61, F36.

### 1. Introduction

The principles underlying the functioning of the euro area are included in two European treaties – one is the Maastricht Treaty, whereby the countries entering into the third stage of economic and monetary union (i.e. adopting the common currency, the euro) is conditioned by the achieving a *sustainable* nominal convergence in the candidate countries, and the Amsterdam Treaty, which established "The Stability and Growth Pact", represented by a set of detailed rules and procedures to ensure budgetary discipline of the euro area countries.

During negotiations on the Maastricht Treaty, Germany, the main catalyst of European integration, insisted on the establishment of rules - as conditions for

joining the euro area, in return for giving up their own currency. These rules have resulted in:

- assurance of the European Central Bank independence, meaning its separation from the political pressure;
- establishing a low inflation target (2%);
- designing budgetary rules, which were originally part of the whole set of nominal convergence criteria for the euro, and afterwards were included in "The Stability and Growth Pact".

In the economic literature, the terms *governance* and *good governance* received a special attention in the last years. Very often, *bad governance* is perceived as a reason for all problems in the modern society. Furthermore, the lending decisions of the international financial institutions are increasingly based on conditions that ensure good governance practices. Nevertheless, it is worth to mention that even the *good governance* become imperative, it is an ideal difficult to achieve it, entirely.

The economic governance has been progressively put in place in the European Union and it is a system that has distinctive characteristics. According to Begg (2008) these can partly be explained by the manner in which integration has evolved, partly by reference to the experience gained as the European Union has evolved from the customs union to European Monetary Union, partly by the manner in which ideas about economic policy-making have changed, and partly by how policy actors have *learned-by doing*. From their perspective, six facets of governance can be distinguished in a framework for appraising the system as a whole [1].

In order to sew up the functioning of Monetary Union, the undertaken policies

should consider both, the national and the area level. After the last events, appeared the recognized need to reinforce the economic governance within the euro area.

## **2. The Ground Rules for Eurozone Performance**

The euro area is characterized by a high level of monetary authority, represented by the European Central Bank, and by the lack of fiscal authorities. In such conditions, there is no coordination between fiscal and monetary policies, the monetary authority being still more important, by the fact that the interest rates are set and modified to compensate for the lack of a common fiscal policy. The independence of the European Central Bank and of the national central banks largely limits a possible coordination between macroeconomic policies in the euro area.

However, there is a coordination of the national fiscal policies through The Stability and Growth Pact, which makes up for the lack of a single tax policy in the euro area and through the meeting of the Economics and Finance Ministers of the Member States (Ecofin Council). Such coordination concerns however the budgets' "control" in order to obtain an average balance or a surplus, and not to manage the problems of inflation and unemployment in the monetary area through coordinated corrective measures of these indicators. National budgetary policies should support the stability-oriented monetary policy.

The single monetary policy, attributed to the European Central Bank, as a supranational authority, has a complex framework of objectives, instruments and procedures for decisions making. According to the Maastricht Treaty, the primary objective of the single monetary policy is the price stability in the euro area. Governing Council should support the economic growth and the employment, without affecting its primary objective, as outlined in the second paragraph of the Maastricht Treaty. In reality, it is reinterpreted in a general way, that monetary policy's objective of maintaining price stability contributes to the meeting of the community's objective [4].

However, the European Central Bank has no specific features of a genuine central

bank. For example, the European Central Bank may not issue banknotes denominated in euro (as shown in its balance sheet), but they are issued by a national central bank, and some of these bills are "statistically allocated" to the European Central Bank. The European Central Bank does not have public or private debt instruments to the active side, which could be used for open market interventions, and cannot act in the position of a lender of last resort for commercial banks. Moreover, the monetary policy is the responsibility of the Governing Council and is implemented by national central banks, and not by the European Central Bank.

## **3. The Discipline of the Member States**

Analysing the Member States' discipline regarding the principles of the two European treaties, it is noted that they were not protected as much by the German Government. Although the requirements set by Germany on monetary policy have been met, considering that in this way, the euro area and thereby the euro become credible on financial markets, fiscal and budgetary criteria were often violated.

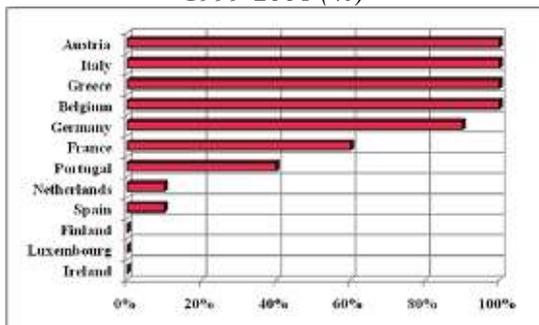
In terms of monetary policy, Germany has remained intransigent on the status of the European Central bank and on inflation target. It always refused to Heads of Government to put pressure on European Central Bank. It refused to define a common exchange rate policy, although the Governing Council may do so in the treaties. From this point of view, the German influence was felt in the European Central Bank, as the Bundesbank's governor has always defended the established policy – a policy designed for inflation targeting and to strengthen the credibility of monetary policy in Europe. Indeed, the European Central Bank inflation target was systematically performed in the euro area during 1998-2007.

When, in 2008, the recorded inflation exceeded the annual target of 2% due to the rising of raw material prices, the European Central Bank reacted by increasing interest rates, arguing that, so would avoid a wage-price spiral. However this decision was in some sense "unfortunate" because the effects began to manifest financial shock. In May 2010, the European Central Bank's decision to purchase Treasury bills on secondary

market in certain Member States who were in difficult positions was controversial both in Germany and within the European Central Bank [2].

Regarding the budgetary rules, the Germany’s vigilance was much weaker. It was accepted a political compromise that allowed countries that were not fulfilling the Maastricht convergence criteria, to join the euro area, as statistics show. Thus, according to Eurostat, Italy and Belgium had, in 1999, a national debt of over 110% of GDP, while when Greece was admitted to the Eurozone in 2001, had a debt of 103,7% of GDP. After the first phase, the public debt criterion began to be breached by more and more countries, including France and Germany after 2002 (see Figure 1).

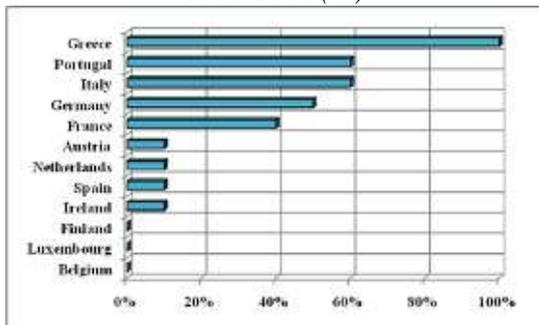
*Figure 1. Frequency of exceeding the reference level of public debt criterion in 1999-2008 (%)*



Source: Eurostat Data, authors’ calculations

Regarding the budget deficit, as Figure 2 suggests, countries have often exceeded the reference value of 3% (Greece, Italy, France, Germany, Netherlands, Austria, and Portugal).

*Figure 2. Frequency of exceeding the reference level of budget deficit criterion in 1999-2008 (%)*



Source: Eurostat Data, authors’ calculations

Repeated failure to comply with the set

criteria show that often, other governments have ceased the pressure to achieve budget adjustments for fear of being fined themselves when they face such problems.

The limits’ overcoming was tacitly accepted. Germany has registered, according to Eurostat, exceedings of the budget deficit in 2002-2005, which required the revision of the Stability and Growth Pact in March 2005, contrary to the Bundesbank’s behaviour. It should be noted that after this episode, the German budget deficit come back below the reference.

Conditions induced by the current crisis faced by Eurozone are a test about the sustainability of monetary integration in Europe based on the relationships between the main drivers of the euro area economy, France and Germany.

Political crisis is manifested not only through raised tensions between the two countries, but also through tough reactions from other euro area countries, reactions to the policy of the large European countries. Such a situation calls into question the development of a European political community that should extend beyond the institutional framework.

Fiscal policy coordination, by the Eurogroup, has become more difficult as further austerity measures, taken individually by each member country, are far from having had a common denominator. In these circumstances, we actually are witnessing a trial, at least temporarily, of divergence between the tax policies of European Union countries [3].

There is, however, a formal compromise, especially in the euro area countries, whereby the European Commission gained skills for national budgets analysis, before being submitted for approval by the national parliaments, a process that could be defined as a verification of their constitutionality from the current Stability and Growth Pact or from an improved Stability and Growth Pact.

The measure practically exceeds the formal commitment made by Member States through the Treaty, which rather induces the perception of distrust in the government behaviour "tormented" by austerity measures, than understanding of an assistance form from the European Commission, in a critical period for the European Union. The disagreements between France and Germany

merely highlight that the problem of economic policy coordination within the European Union and the euro area remains a delicate one on long term, despite the prepared consensus of G-20 meetings.

The "Europe 2020" declarative urges to speed up the fiscal sustainability and the fiscal consolidation plans, taking into account the risks. It should be stressed however that it insists on the need to observe the potential GDP as a benchmark indicator for sound economic policies, and that the increasing of the growth potential will be made in conjunction with the long-term fiscal consolidation.

#### 4. Financial Evolutions

According to the recent analysis, in 2011 the euro area financial system was affected by the increased market sovereign debt crisis, manifested in the overall trend of decline in the European financial integration process [5]. Internal affairs of member countries weaken the motivation for monetary integration.

No doubt that poor governance of the euro area reflects investors' perception about the capacity of countries from the union to manage economic and financial problems within the union, including the existence of sustainable levers by which to support vulnerable countries.

The hesitations regarding the way of financial support, the political divisions between countries and the domestic economic problems deepened tensions in financial markets, pointing out the tendency of differentiation by country of financial options for investors. Thus, the surge in the euro area differences between yields on government bonds was determined mainly by:

- national factors, the differentiated perception of member countries regarding both the sustainable fiscal position and the national economy perspective;
- the phenomenon of overestimation of risk and the growing demand for "safe" assets. Such a phenomenon is specific periods of tension and uncertainty in the market.

The distrust of foreign investors is manifested by the massive selling of

government bonds of those countries having vulnerable position, particularly Italy and Spain, securities that are purchased mainly by the local investors. Such a trend of concentration of financial problems to the country in need weakens the motivation for the financial support coming from other euro area countries, dragging along an increased risk for disintegration of the euro area.

#### 5. Conclusions

Shortcomings in the governance of the euro area, caused and exacerbated by the global financial and economic crisis have brought into attention the current importance of political will behind the single currency project. This political will has remained firm on monetary policy, but clearly weakened regarding the budget balance.

The effects at the country level have become crucial in the evolution of sovereign bond market yields, reflecting differences in the fiscal position and economic outlook for the euro area and an increased aversion to risk among investors, with their portfolio orientation to safe assets, with the role of protecting against risk.

Given the problems of governance in the euro area, with its financial implications, we consider that the split of the European currency area is not any more an impossible event.

There is a predisposition to manifest a chained phenomenon: national economic problems, which are clearly a priority for national authorities, weaken motivation to keep them in the euro area, inducing a distrust sentiment related to the common governance of the union.

The solution to this situation remains the policy – the willpower of the national authorities will solve the current crisis, with a reconsideration of integration based on genuine cooperation and solidarity between countries.

The euro area is a public "product" [2], and this requires responsible governance from the part of decision makers, taking into account the political discipline.

The debate on European governance was intensive and often divergent, emphasizing the need for clarity and simplicity in governance, as the Sapir report (2004) noted: *„the picture that emerges is one of confusion*

*and tension – confusion created by the complexity of the system and diversity of the roles performed, tension in the gap between goals and means” [6].*

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## Foreign Direct Investments – Determinant of Economic Growth for the New Member States

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### Abstract

*Global economy is strongly influenced by the capital flows between states, impacting on their development*

*Even if the motivation of international investment is the wish of investors to obtain higher income and profits in the host country than in the origin country, these earnings are positive for both sides, generating benefits for host country also, by: capital and technologies transfer, implementing a performing management, higher productivity and higher wages.*

*The countries receiving FDI feel, after a longer period, the effects of these capital intakes, through higher GDP and labor productivity.*

**Key words:** globalization, foreign direct investments, exports, transnational companies.

**J.E.L. Classification :** E22, O11.

### 1. Introduction

Global economy is strongly influenced by capital flows between countries, impacting on their development. Various aspects of this exchange were the main issue concerning renowned economists (A. Smith, D. Ricardo) in the last centuries, but theories regarding capital exports and imports have only been formulated in the last decade, this phenomenon becoming viable only after World War Two. David Ricardo's studies show that profit can be obtained from foreign commerce or from relocation the production, or from relocating the production function, on competitive advantage, based on the differences in the cost of opportunity between states.

Adam Smith analyzes the issue of free trade, considering it to be a way in which we can all win, a way to bring well being. In his

work „The wealth of nations” (1776) he issues the theory according to which the wealth of a state is represented by its production and commerce, thus encouraging the idea of exchanging

Foreign capital flows start at the beginning of the 21st century, mostly as portfolio investments and loans. This was determined by the need to finance economic activities. Those times, United Kingdom, but also France, held the largest part of this type of investments, especially made in recession or economic crisis periods.

After World War and the economic crisis of 1929-1933, the top of capital exporting countries change, United States became number one, for exports, and Germany became number one, for imports.

The motivation on international investment is the wish of investors to obtain higher income and profits in the host country than in the origin country. Both exporters and importers of capital benefit from it, the latter receiving the advantage of having a scale economy, of eliminating customs borders by getting closer to the final user, or by the access to resources, which can lead to lower production costs.

### 2. Transnational corporations, promoter of globalization.

Transnational companies are one of the main engines of the globalization process, involving the entire market in terms of production and capital. This issue is intensely analyzed in specialty literature, in different approaches, sometimes controversial.

Globalization is passing to a system based on networks of interdependence and interconnecting. The motivations of the companies for internationalizing the assets, are getting the highest profit with the lowest costs, and also an increase of rentability.

Countries with low costs for raw material and labor force are preferred.

Transnational companies generate a series of advantages for the host country: capital and technologies transfer, implementing a performing management, higher productivity and higher wages. The higher quality of products adds to the list – therefore higher exports competitiveness and higher production volume.

Transnational corporations lead to the globalization of production, organization competence and systems. This is why they are considered promoters of globalization

In the specialty literature, professor. Noritake Kobayashi's study [1] stands out, which analyzed the model of Japanese corporations starting from 1978. His research led to determining 5 phases for transnational companies development:

1. Export from the origin country
2. Localizing the production in the host country
3. Integrating in the economic activities of the host country
4. Coordinating regional activities.
5. Developing methods and means and methods for organizing and managing global activities.

In N. Kobayashi's opinion, only the companies with the origin country in Europe and North America managed to reach level 5, while the rest only managed to reach the level if integrating in the economic activity of the host country (level 3).

There are also negative effects, such as: transfers to other countries of a part of the transnational companies' assets, or short term reducing the jobs, at the same time, increasing the unemployment. These are the effects of the restructuring of the privatized companies, for increasing the efficiency. On the long run, the increase in competitiveness may generate new jobs, as a consequence of the developments of the upstream and downstream activities. The budget may be negatively influenced. Fiscal facilities, that reduce budget income, are used in order to get investors.

With the restructurings and privatization, new expenses appear, with the unemployment fund. On the long run, this situation can be fixed.

Another disadvantage for the host country is the lack of research and development

activities, which TNC prefer to have in the origin country.

Transnational companies (TNC) play an important role in the globalization process, through the capital, technology, managerial skills transfer to the host country. Even if the specialty literature identifies 5 development levels for these companies, there are mainly 3 directions: increasing the exports, globalizing the production and globalizing the organizational systems.

TNC get to obtain higher added value in the host country, because internationalizing the production leads to lower costs, because of the lower wage level in the FDI receiving country [2]

Liberalizing commerce, capital markets, investments, a lower control of multinational companies brought advantages for the TNC and determined the creation of strategic partnerships, mainly in the automobile, aeronautic and IT industry.

A strong connection between the host country and the TNC is represented by FDI. Starting branches in various countries generated jobs; transfers generate an increase of productivity – decisive contribution to improving the wage level in the host country. Among other benefic aspects we can mention developing and modernizing the means of transportation, as well as improving the training and skills level of the labor force.

### **3. Foreign direct investments – dynamic tool of TNC in the process of globalization.**

“Foreign direct investment is a category of international investments that reflects the goal of an entity residing in a country (direct investor) of getting a lasting interest in a company residing in another country (direct investment)”[3]. In this case, the author identifies the direct investor as the TNC, which, through its branched, invests abroad (FDI).

The goods and services manufactured in the receiving countries do not bear custom fees, this way avoiding the protectionist measures and may keep the market easier than through exports.

FDI had an accelerated worldwide dynamics. If in 1980, their value per capita was 170 USD, in 1990 the grow by 131%, becoming 394 USD per capita. Ten years later they reach 1221 USD per capita and in

2010, 2785 USD/capita, 16 times higher than 30 years ago. [4]

Compared to the FDI, GDP doubled between 1980 and 1995, and in the next 15 years, it grew by approx. 75%, reaching the value of 9178 USD/capita in 2010.

As far as international commerce is concerned, this grew in the last years, reaching the value of 12.4 billion USD (2010) compared to 5.1 billion USD in 1995.

In conclusion, the analysis of the three indicators shows that the FDI intensified, having an yearly growth rate higher than the one of international commerce and real GDP.

The UNCTAD international statistics reports show the interdependence between FDI and globalization. Both integration and globalization favor the free movement of capital, technology, information, goods and services.

#### 4. Determinant factors and consequences of the FDI evolutions in the new EU Member States

EU investments in the CEE countries prove the efforts for integrating these regions. There is an increase in capital flows to these regions, due to the policies adopted by the two parties, but also as a consequence of the Single Market regulations, which favor this kind of investment. (table 1)

As it can be seen in the previously mentioned table, as the relations with EU consolidated FDI grew, especially in Romania, Slovakia and Hungary, but the contraction period came soon so that these investments didn't get to reach the expected results.

The economic and financial crisis, felt much earlier in the developed countries, because of the accentuated interdependence with the large powers, determined investors to be more prudent, preferring to withdraw from the CEE market, not willing to take the risk on this region, where the economical and financial problems that were to appear would have left much more significant marks.

Economic integration leads to scale economies, cuts in production costs, increasing the competitiveness, all these leading to the increase of profit.

Table 1 - Inward foreign direct investment flows (mill EUR)

	2005	2006	2007	2008	2009	2010
Bulgaria	2,345	5,197	7,691	5,762	1,966	1,579
Czech	8,937	3,896	5,996	3,972	1,501	4,913
Cyprus	526	487	1,019	298	1,400	117
Estonia	2,252	1,407	1,994	935	1,212	1,138
Lethonia	365	978	1,477	682	-417	190
Latvia		2,382	1,066	1,004	-169	457
Malta	15	149	500	325	260	270
Poland	6,735	13,637	14,243	9,762	8,078	5,702
Romania	5,324	8,454	6,536	8,491	3,709	2,127
Slovakia	1,648	3,255	2,030	3,501	-563	763
Slovenia	629	499	1,085	1,102	-204	145
Hungary	5,909	5,015	2,342	4,197	-3,500	503

Source: Eurostat[5]

As it can be seen both in Table 2 as well as in Picture 1, in 1999 only Poland and the Czech Republic owned over 0.5% of the global FDI, and Hungary, 0.3%. The rest of the CEE countries had under 0.1%. Over the years, with the accession of these countries to the EU, the situation changed. In 2005, Slovakia and Estonia reached values of 0.25% and 3% respectively, from the total global FDI. It is important to analyze Romania and Bulgaria, which recorded much higher values than other countries in the area.

Table 2 – Inward foreign direct investment flows (Percentage of total world)

a)

	1999	2000	2001	2002	2003	2004
Bulgaria	0.076	0.072	0.098	0.147	0.365	0.458
Cyprus	0.075	0.061	0.114	0.169	0.156	0.147
Czech	0.581	0.355	0.683	1.353	0.367	0.67
Estonia	0.028	0.028	0.065	0.046	0.162	0.129
Latvia	0.032	0.029	0.016	0.04	0.053	0.086
Lithuania	0.045	0.027	0.054	0.116	0.031	0.104
Malta	0.079	0.044	0.03	-	0.169	0.053
Poland	0.667	0.673	0.69	0.658	0.801	1.734
Romania	0.094	0.075	0.14	0.182	0.383	0.867
Slovakia	0.039	0.138	0.192	0.661	0.377	0.408
Slovenia	0.01	0.01	0.045	0.259	0.053	0.111
Hungary	0.304	0.197	0.476	0.478	0.373	0.575

Source: UNCTAD

b)

	2005	2006	2007	2008	2009	2010
Bulgaria	0.399	0.534	0.629	0.565	0.283	0.174
Cyprus	0.121	0.128	0.113	0.232	0.483	0.391
Czech	1.186	0.374	0.53	0.37	0.247	0.545
Estonia	0.292	0.123	0.138	0.099	0.155	0.124
Latvia	0.072	0.114	0.118	0.072	0.008	0.028
Lithuania	0.105	0.124	0.102	0.117	0.015	0.051
Malta	0.069	0.126	0.051	0.048	0.064	0.084
Poland	1.048	1.341	1.195	0.851	1.156	0.778
Romania	0.66	0.778	0.503	0.798	0.409	0.287
Slovakia	0.247	0.321	0.182	0.269	-	0.042
Slovenia	0.06	0.044	0.077	0.112	-	0.067
Hungary	0.785	0.466	0.2	0.423	0.173	0.191

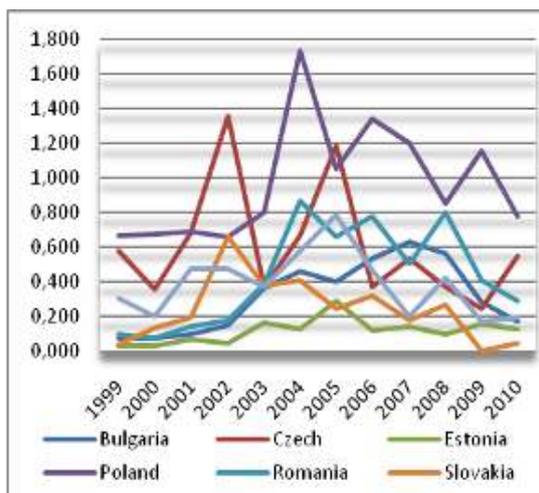
Source: UNCTAD

Romania recorded record values in 2004 (0.867%) but also in 2008 (0.798%). Like our country, Bulgaria had an upward trend starting with 2002 reaching in 2007 the maximum value of 0.629% of the total global investments.

Most of the new member states had to suffer from the shrinkage of the FDI after 2007, as a consequence of the economic and financial crisis.

From the total value of global FDI, the new member states draw led FDI than in the pre-crisis period, reaching in 2010 values under 0.4%, from the total FDI.

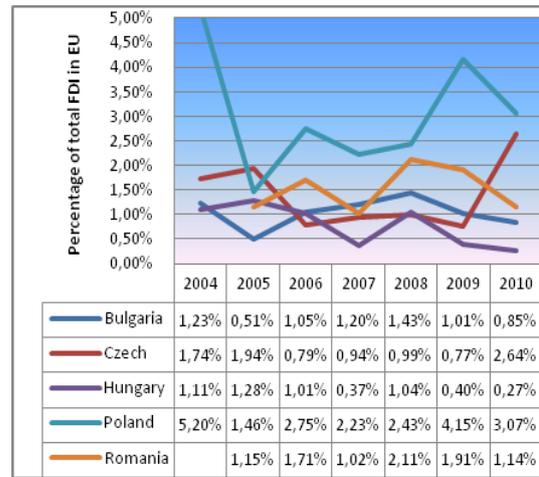
Picture 1 – FDI weight in total global FDI



Source: UNCTAD

According to UNCTAD, the economic shrinkage after 2008 did not affect Poland significantly, which in 2008 has almost 0.8% of the total global FDI.

Picture 2 – FDI percentage in total EU FDI



Source: UNCTAD

Analyzing FDI in the European Union we notice that there are a series of differences among the new member states. Poland is an atypical case, which, from values under 1.5% of total EU FDI reached 4.15% in 2009, and continues to keep this value over 3%.

Based on Eurostat, another country whose FDIs seem to not be affected by the economic crisis is the Czech Republic; on the contrary, if the other countries are decreasing (in terms of FDI), the Czech Republic manages to reach 2.64%, which is much higher than the one before the start of the global economic crisis.

## 5. Conclusions

Foreign direct investments have a great importance in the globalization process, benefiting both the investor and the receiver.

These types of investments are considered to be the most profitable for both partners, but also for the economic, social and political climate.

As previously shown, FDI became the base element for TNC, more important than foreign trade, because they lead to increased productivity, new jobs, higher budget income for the host country, through taxes.

If in the past, the exports were the main connection mechanism between countries, their place is taken by FDIs, source for economic growth and progress for the developing countries.

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## European Merger Policy

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### Abstract

*Laws designed to protect/generate competition to varying extents have appeared in most parts of the world. In Europe such competition policies mainly emerged after the Second World War, not only at the national level but also at the supra-national level. From a governance perspective, competition policy constitutes nothing less than the most developed example of supranational regulation.*

*In the first part of the paper we focus on the different views and philosophies that have influenced EU competition policy. Further, we present the actual Merger Regulation - an example of separate jurisdictions agreeing to analysis of certain mergers in one supra-national framework. In the second part of the work, we present the details regarding the European Commission exclusive jurisdiction to review concentrations with a Community dimension and the mergers that do not have a Community dimension, reviewed by the competition authorities of the Member States applying national law. Here, we show that, in several cases, national Governments set aside merger control rules to facilitate the creation of “national champions” or used them as a protectionist tool to disrupt undesirable transactions. Finally, we remember that the competent authority in Romania for the review of mergers is the Competition Council. nu va depăși 150 de cuvinte și se va redacta cu caractere de dimensiune 11 pt., scrise la un rând, italic.*

**Keywords:** concentration; competition policy; merger control.

**J.E.L. classification:** K12, L4

### 1. Introduction

It is a generally accepted principle that competition is desirable. Competition tends to lead to cost efficiency, low prices and innovation. Markets that are competitive tend to lead to a higher level of consumer welfare in both the short-run and the long-run than markets that are not competitive. In its First Report on Competition Policy (1972), the Commission wrote : „*Competition is the best stimulant of economic activity since it guarantees the widest possible freedom of action to all. An active competition policy makes it easier for the supply and demand structures continually to adjust to technological development. Through the interplay of decentralized decision-making machinery, competition enables enterprises continuously to improve their efficiency which is the sine qua non for a steady improvement in living standards. Such a policy encourages the best possible use of productive resources for the greatest possible benefit of the economy as a whole and for the benefit, in particular, of the consumer*”. [1]

The competition law was intended to guarantee freedom of competition and to prevent the emergence of economic power, to protect opportunities and relationships as well as to promote efficiency. The focus on structure, relationship, and freedom of action is consistent with the long-standing political support for competition law from industry, and particularly from the small-business sector.

The traditional view of competition law is that it contrasts with this regulatory activity by being primarily negative and using only ‘second order’ incentives. Opting for competition law entails some belief that in most cases the market will produce the correct amount of competition and innovation, and competition law does not need to concern itself with substantive industrial policy but simply ensure that the

market functions reasonably well. As such, competition law does not embody decisions about whether firms should build plants or distribution mechanisms, or about the nature of their products. It simply sets a few global limits to behaviour, based not on the substance of commercial activity but on abstract notions of economic decency, and reactively enforces these.

It is intuitively appealing to proxy the level of competition a particular firm faces with the number of competitors it has. Current market shares can provide a very misleading picture as to the level of current competition. Equally, where barriers to expansion by existing players are low, current market shares are not a good proxy for market power. Finally, highly variable market shares indicate that a high current market share may only be transient and suggest the existence of significant competition between firms, thus implying relatively little market power. The two most common measures of market concentration are concentration ratios and the Herfindhal-Hirschman Index (HHI).

"Mergers" or "concentrations," usually includes structural combination, such as share or asset acquisitions, joint ventures, cross-shareholdings and interlocking directorates. Merger control tries to prevent the creation, through acquisitions or other structural combinations, of undertakings that will have the incentive and ability to exercise market power. In some jurisdictions, the test of legality is derived from the laws about dominance or restraints; in others, there is a separate test phrased in terms of likely effect on competition generally. The analytic process applied typically calls for characterising the products that compete, the firms that might offer competition, and the relative shares and strategic importance of those firms with respect to the product markets. An important factor is the likelihood of new entry and the existence of effective barriers to new entry. Most systems apply some form of market share test, either to guide further investigation or as a presumption about legality. Mergers in unusually concentrated markets, or that create firms with unusually high market shares, are thought more likely to affect competition. And most systems specify procedures for pre-notification to

enforcement authorities in advance of larger, more important transactions, and special processes for expedited investigation, so problems can be identified and resolved before the restructuring is actually undertaken. [2]

## 2. Economics of Market Concentration and State Intervention

In static neoclassical theory, market concentration - irrespective of the reasons of it - was considered harmful. Neoclassical theory clearly indicates a case for competition policy. In essence, strong scepticism towards market power should guide competition policy. [3] In '30, the concept of workable competition emerged from the literature as a concept to counteract the view that perfect competition is not a reliable basis for making normative appraisals of the working of actual markets (J. Clark). The authors of the Treaty of Rome used the concept of workable competition, moreover, many of the distinguishing features of European competition policy seem to fit into this theoretical framework. It is noteworthy that the European Court of Justice, in its leading *Metro* judgement, referred to the concept of *workable competition* as being the type of competition that was necessary to achieve the economic objectives of the EC Treaty.

In '40, an ordoliberal policy was developed based on the work of W. Eucken - "Fundamentals of the national economy" which has established a "theory of order" as the foundations of a "ordering policy." For the author, economic liberalism that is found in the market economy is the economic system that made the best possible allocation of resources. Ordoliberal policy is based on building a full order of competition. Ludwig Erhard has been revealed between ordoliberals, considering the social market economy as a specific form of economic order and rules. He is considered the "father" of the law in Europe against restraints of competition, struggling to enforce competition law against all opposition. In the especially striking example of competition policy, Katja Seidel (2008) has shown how the entrepreneurial leadership of Commissioner Hans von der Groeben and Director- General Pieter VerLoren van

Themaat helped to unite their civil servants behind a broadly ordoliberal conceptualization of a „competition society” which has guided Directorate-General (DG) IV policy to the present day.

After the emergence of neoclassical price theory, a fundamental step forward in competition theory dates back to the Harvard School’s Structure – Conduct – Performance (SCP) paradigm somewhere around the 1940’s. The SCP paradigm was developed by Edward S. Mason at Harvard University. The original empirical applications of the new theory were by Mason’s colleagues and students, the most famous of whom was Joe S. Bain. *“Market structure is a term used to define the characteristics within which firms operate in a given product market. The principal characteristics are the number of firms and their size. Also relevant is the market power of the firms’ customers, the ease with which new firms can enter the market and old ones can exit it”*. Adherents of the Harvard School correctly observed a relationship between industry concentration and profits, but erroneously inferred that those profits were the result of artificial market power. Bain aggravated the mistake suggesting that entry barriers were pervasive, and found that necessary up-front capital expenditures, incumbent efficiency, and other difficulties frustrated entry into concentrated markets and perpetuated market power.

According to Piraino, the Harvard School approach had many advantages. If antitrust analysis under the Harvard School was not perfect, at least it was certain. The courts were able to indulge in a presumption of illegality for many types of conduct without engaging in a complicated analysis of the economic circumstances in the relevant market. Since the outcomes of trials were so predictable, business executives understood the type of conduct they should avoid. Firms in concentrated industries were effectively deterred from transactions that increased concentration levels in the relevant market. The Harvard School approach, however, also had serious disadvantages. Harvard School jurists were too quick to find fault with aggressive competition. The courts and agencies prevented large firms from engaging in competitive conduct that could have benefited consumers and would have been perfectly permissible for firms with

lower market shares. In European policy, the Harvard ideas that the structure of the market has an impact on the ultimate performance of the market is clearly reflected in the field of merger control. This result forms the emphasis of the inquiry on whether the concentration *„creates or strengthens a dominant position”* (Regulation 4064/89). There is no explicit efficiency defence. Efficiencies are often seen as evidence of market power, rather than as benefits which may outweigh the anti-competitive consequences of mergers. *“The implications of the SCP paradigm for competition policy is that we can identify which market structures lead to anticompetitive results and devise a competition law that is designed to modify or prevent market structures that are linked with poor economic performance.”* [4]

The theoretical weaknesses of the structuralist approach and the lack of empirical support for the SCP led in the late 1960s and early 1970s to extensive criticism of antitrust policy and the Harvard School by a number of influential economic and legal scholars at the University of Chicago (A. Director, R. Bork, R. Posner, F. Easterbrook and G. Stigler). In Chicago approach, merger control is partially denied, although the school did not argue in favour of total abolition of competition policy. Only very large horizontal mergers leading to monopoly are seen *“worthy of serious concern”*. [5] The control of vertical or conglomerate mergers is as such rejected.

Researchers working in the tradition of the Chicago school of industrial economics maintain that high profitability in a concentrated industry has to be interpreted as a reflection of superior efficiency of larger firms over smaller ones, not as a reflection of market power. In addition, Posner argued that there was no basis for automatic judicial intervention against a merger where the combined market share of the four largest firms in the market was less than sixty percent. One of the most influential researchers in this tradition is Demsetz (1973) who argued that if a high concentration industry enjoys high profitability then the profitability of large firms in that industry should not be different from the profitability of small firms. He found that the profitability of larger firms was in fact higher than smaller firms

which he regarded as proof that larger firms were more efficient than smaller firms.

The contestable market theory also had implications for merger control. In principle, the message of contestability theory is that policy intervention in market processes is unnecessary, if entry and exit are free and easy. In this case, potential competition as well as actual competition will influence market performance. In practice, the prescriptions of contestability theory seem often to have been applied in a free and easy manner, without the kind of detailed analysis necessary before it would be safe to conclude that a particular market could be treated as “workably contestable.” S. Martin stated in his article “The Theory of Contestable Markets” that *“a simple way to summarize the insights that contestability offers to policymakers is to say that public authorities should make markets as contestable as possible, given the constraints imposed by other (and possibly noneconomic) goals”*. [6] By the early 1990`s, the Chicago School had completed a revolution in antitrust analysis. In US the Merger Guidelines were revised several times (in 1982, 1984 and 1992) to take account of developments in economic thinking concerning the competitive effects of mergers. In the 1992 Guidelines there is no longer an explicit reference to the S-C-P paradigm; there is also explicit scope for an ‘efficiency defense’, which clearly reflects the influence of the Chicago School.

In Europe, the fact that the economic doctrine of the Chicago School has not influenced European competition law at that time is clearly apparent from the decisions in *AKZO* and *Tetra Pak II*. The Court of Justice accepted a price-cost comparison as the yardstick by which to establish predatory pricing. Abuse of dominant position must be deemed to be present once prices fall below the level of average variable costs.

Beginning in the `80, economists developed new game theoretic models of imperfect competition and industrial organisation which supported concerns by an increasing number of antitrust scholars and practitioners that the efficiency explanations of the Chicago School, while valid in certain cases and circumstances, were insufficient and inadequate explanations of firm conduct or market structure and generally led to a too lenient interpretation of antitrust law. Largely

derived from an analysis of competition in oligopolistic markets, many of these new game theoretic models by “Post-Chicago School” economists identified both the ability and incentives of firms to act anti-competitively through strategies designed to exploit unilateral or collective market power. Contributions to the literature include horizontal mergers (Farrell and Shapiro 1990); vertical mergers facilitating collusion (Nocke and White 2007); and anti-competitive vertical mergers (Riordan and Salop 1995).

A less direct but also important influence of these modeling techniques is in the specific prediction of a merger’s effects. Some of this work has been purely theoretical, looking at the effects of mergers in models where merger is an equilibrium outcome and not merely an assumption (Farrell and Shapiro, 1990). Some applications have been in the development of simulation techniques to predict the effects of mergers, that rely on demand models calibrated to match current industry data regarding price, market shares, elasticity of demand for the product as a whole, and cross-elasticities of demand between products (Werden and Froeb, 1994). These demand models have also led to econometric techniques for estimating brand-specific demands, particularly as they may be affected by the prices of other brands (Baker and Bresnahan, 1985; Bresnahan, 1989) and thus provide estimates of the effects of mergers that eliminate independent pricing. As Brennan stated, these techniques are the result of theoretical advances and increases in computing power, but a major contributor has been the vast quantities of retail purchase data from bar-code scanners at checkout counters.

In general, merger analysis became more heavily economic in the 1990s. Economic concepts now pervade the federal merger guidelines, and merger analysis, whether performed by prospective merger partners or antitrust agencies, routinely involves close collaboration between economists and attorneys.

A new economics doctrine - innovation economics has emerged in the last decade through the work of a wide range of scholars and postulates that innovation (the development and adoption of new products,

processes, and business models) drives growth. As a result, it makes an explicit effort to understand and model those forces and factors conducive to innovative activity, seeing such advances as a result of intentional activities by economic actors, including Government. Adherents of the innovation doctrine argue that antitrust policy — and merger policy specifically — need to incorporate analysis of longer-term dynamic effects. The innovation doctrine makes it clear that the focus of antitrust thinking should be on the long-term trajectory of product value and price, not just current consumer welfare measured by short-run prices. Again, as Porter argues: Since the role of competition is to increase a nation’s standard of living and long-term consumer welfare via rising productivity growth, *the new standard for antitrust should be productivity growth*, rather than price/cost margins or profitability. [7]

In recent years, antitrust enforcement has increasingly focused on innovation issues. In September 2009, for example, the FTC and the Antitrust Division asked whether the Merger Guidelines should “*be updated to address more explicitly . . . the effects of mergers on innovation.*” [8]

### 3. Brief Overview of European Merger Control

If competition is a force which is widely considered to have many positive effects it is thus not something that can be taken for granted to exist. Laws designed to protect/generate it to varying extents have therefore appeared in most parts of the world. In Europe such competition policies mainly emerged after the Second World War, not only at the national level but also at the supranational level with the establishment of the European Coal and Steel Community in 1951 and the European Economic Community in 1957. Gradually, a competition policy ethos has developed in which the Commission, or rather its Directorate-General for Competition (henceforth; the Competition DG), has far-reaching powers to regulate mergers. It is undeniable that competition policy is at the core of economic governance in the EU and has been so for quite awhile. The Treaty of

Rome made no explicit provision for merger control. It was only in December 1989 that the EC Merger Regulation (ECMR) brought explicit merger control at the European level. The primary legislation governing mergers is Council Regulation 139/2004 (the “Merger Regulation”) which came into force on 1 May 2004 (replacing ECMR).

In Romania, the Competition Council, as national competition authority, enforces and ensures the application of the national and Community rules on competition. The activity of the Competition Council is fulfilling two main functions: a preventive one, involving the surveillance of the markets and of the respective market players and a corrective one, aiming at re-establishing and developing a normal competitive environment. Therefore, the mission of the Romanian Competition Authority can be synthetically defined as to protect and to stimulate the competition on the Romanian market so as to develop a normal competitive environment, finally ensuring a better promotion of consumers’ interests. The competent authority in Romania for the review of mergers is the Competition Council. The substantive test applied by the RCC in merger control proceedings is whether a concentration leads to significant impediments to efficient competition on the Romanian market or a substantial part thereof, especially by the creation or strengthening of a dominant position on the Romanian market or a part thereof.

#### **Regulation 139/2004 - Make the Administrative Processes more Effective**

Regulation 139/2004 has reaffirmed the division of jurisdictional boundaries between the national and supranational competition regimes. Put simply, merger policy remains a core EC competence. The revised ECMR reinforced the degree of European governance and incorporated several refinements to make the administrative processes more effective. One of the most noticeable additions directly involves undertakings who are now entitled for the first time to trigger the referral process themselves.

From May 2004, concentrations which would not otherwise fall within the Community dimension, but which are

capable of being reviewed under the national competition laws of “*at least three Member States*”, can be dealt with by the Commission at the request of the merging parties (Article 4(5) ECMR) so long as all merging parties are in agreement. Alternatively, in the pre-notification stage and according to (Article 4(4) ECMR) the merging parties may, via a so-called reasoned submission, request the Commission to refer the concentration to a Member State “*where the concentration may significantly affect competition in a market within a Member State which presents all the characteristics of a distinct market*”.

In both instances the companies will therefore continue to benefit from ‘one stop shop’ merger control. In this sense the revisions to the ECMR are expected to produce a more streamlined and improved system of referrals. In practice this change means more cases will be referred to the Commission as the key competition regulator. [9]

### **Transactions Caught by Merger Regulation**

The generic term used for transactions caught by the Merger Regulation is “concentrations”. The European Commission has exclusive jurisdiction to review concentrations with a Community dimension. Mergers that do not have a Community dimension may be reviewed by the competition authorities of the Member States (“NCAs”) applying national law. The examination of concentrations by the Commission is conducted by officials in the Directorate-General for Competition (DG COMP). There are currently five units specialising in mergers, broadly speaking along sectoral lines (e.g. DG COMP Unit B3 handles merger cases in energy and environment, Unit C5 handles mergers in the field of information, communication and media ...), which report to the Deputy Director-General for Mergers and Antitrust. They are supported in harder cases by members of the Chief Economist’s team.

According to European competition policy, „*a concentration shall be deemed to arise where a change of control on a lasting basis results from: (a) the merger of two or more previously independent undertakings or parts of undertakings, or (b) the acquisition, by*

*one or more persons already controlling at least one undertaking, or by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect control of the whole or parts of one or more other undertakings. The creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity shall constitute a concentration*”(Council Regulation (EC) No 139/2004, art. 3).

Control shall be constituted by rights, contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking, in particular by: ownership or the right to use all or part of the assets of an undertaking; rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking. Control is acquired by persons or undertakings which: (a) are holders of the rights or entitled to rights under the contracts concerned; or (b) while not being holders of such rights or entitled to rights under such contracts, have the power to exercise the rights deriving therefrom.

A concentration has a Community dimension, if [10]: the combined aggregate worldwide turnover (from ordinary activities and after turnover taxes) of all the undertakings concerned (in the case of the acquisition of parts of undertakings, only the turnover relating to the parts which are the subject of the concentration shall be taken into account with regard to the seller(s)) is more than EUR 5 000 million (special rules apply to banks), and the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 250 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

In case these thresholds are not met a concentration has nevertheless Community dimension, if: the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 2 500 million, and in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned is more than EUR

100 million, and in each of at least three Member States included for the purpose of the second point above, the aggregate turnover of each of at least two of the undertakings concerned is more than EUR 25 million, and the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 100 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

Concentrations with a Community dimension must be notified to the Commission prior to their implementation. Where a concentration raises serious doubts as to its compatibility with the market, the Commission can carry out detailed on-the-spot investigations.

The competition authorities may measure market concentration using the number of pregnant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure revenues in the relevant market. The competition authorities also may consider the combined market share of the merging firms as an indicator of the extent to which others in the market may not be able readily to substitute competition between the merging firms that is lost through the merger [8]. The competition authorities often calculate the Herfindahl-Hirschman Index (“HHI”) of market concentration.

It should estimate of the market share in value (and where appropriate volume) of all competitors (including importers) having at least 5 % of the geographic market under consideration. On this basis, provide an estimate of the HHI index pre- and post-merger, and the difference between the two (the delta). After this, it must be indicated the proportion of market shares used as a basis to calculate the HHI and the sources used to calculate these market shares and provide documents where available to confirm the calculation.

The *Guidelines on the assessment of horizontal mergers* therefore indicate, in Section III, specific market share and concentration levels to specify in which situations the Commission is likely or not likely to have competition concerns. According to well-established case law, very

large market shares — 50 % or more — may in themselves be evidence of the existence of a dominant market position. However, smaller competitors may act as a sufficient constraining influence if, for example, they have the ability and incentive to increase their supplies.

A merger involving a firm whose market share will remain below 50 % after the merger may also raise competition concerns in view of other factors such as the strength and number of competitors, the presence of capacity constraints or the extent to which the products of the merging parties are close substitutes. The Commission has thus in several cases considered mergers resulting in firms holding market shares between 40 % and 50 % (Case Nestlé/Ralston, points 48-50) and in some cases below 40 % (Case Rewe/Meinl, 1999), to lead to the creation or the strengthening of a dominant position.

Certain mergers, by reason of the limited market share of the companies concerned, are not likely to significantly impede effective competition. An indication to this effect exists, in particular, where the combined market share of the merging firms does not exceed 25%. This indication derives from Recital 32 of the EC Merger Regulation. However, it does not apply to cases where the proposed merger is likely to give rise to co-ordinated effects.

To complement the above indicia, the Guidelines also apply the Herfindahl-Hirschman Index (“HHI”), and the change in the HHI from pre-merger to post-merger (“delta”) as first indications of the change in competitive pressure in the market following the merger.

The Guidelines indicate that the Commission is unlikely to identify competition concerns in a market with a post-merger HHI below 1.000, and that such cases normally do not require extensive analysis.

The Commission is also unlikely to identify competition concerns in a merger: with a post-merger HHI between 1.000 and 2.000 and a delta below 250; with a post-merger HHI above 2.000 and a delta below 150; except where some special circumstances are present, which somehow invalidate the HHI as a useful proxy for the change in competitive conditions. This may relate, by way of example, to the following instances: (a) a merger involves a potential

entrant, or a recent entrant with a small market share; (b) one or more merging parties are important innovators in ways not reflected in market shares; (c) there are significant cross-shareholdings among the market participants; (d) one of the merging firms is a maverick firm with a high likelihood of disrupting coordinated conduct; (e) indications of past or ongoing coordination, or facilitating practices, are present; (f) one of the merging parties has a pre-merger market share of 50% or more.

The HHI indices accordingly give a useful indication to the parties to the merger as to when a merger is unlikely to cause concerns. They do not give rise to a presumption of either the existence or the absence of such concerns.

Non-horizontal mergers pose no threat to effective competition unless the merged entity has a significant degree of market power (which does not necessarily amount to dominance) in at least one of the markets concerned. The Commission will examine this issue before proceeding to assess the impact of the merger on competition.

Market shares and concentration levels provide useful first indications of the market power and the competitive importance of both the merging parties and their competitors.

The Commission is unlikely to find concern in non-horizontal mergers, be it of a coordinated or of a non-coordinated nature, where the market share post-merger of the new entity in each of the markets concerned is below 30 % and the post-merger HHI is below 2.000.

In principle, when the jurisdictional thresholds are satisfied, notification is mandatory and must be made prior to implementation. The notification itself can be made at any time once a recognised “triggering event” has occurred. There is no filing deadline. The Commission may impose a fine of up to 10% of the aggregate turnover of the undertakings concerned where those undertakings, either intentionally or negligently, fail to notify a concentration in accordance with Article 4 or Article 22(3) prior to its implementation, unless the parties are authorised to implement the deal either under Article 7(2) (public bids) or Article 7(3) (derogation). Notification must be made by the merging parties. The notifying parties

(or their representatives) sign a formal declaration at the end of Form CO. In the case of a hostile bid, where the target business does not cooperate in the preparation of the Form CO, DG COMP will verify the accuracy of the notifying party’s estimates by sending requests for information to the target business. [11]

#### **4. Conclusion**

The competition policy was intended to guarantee freedom of competition and to prevent the emergence of economic power, to protect opportunities and relationships as well as to promote efficiency. EU competition policy can rightfully be said to have been influenced by many different views and philosophies. The most influential schools in the US – Harvard, Chicago and post-Chicago – have most likely left prints in the application of merger control. Likewise, Austria and the German city Freiburg were important outposts for competition law thinking in Europe. It is undeniable that competition policy is at the core of economic governance in the EU and has been so for quite awhile.

Merger control tries to prevent the creation, through acquisitions or other structural combinations, of undertakings that will have the incentive and ability to exercise market power. The Treaty of Rome made no explicit provision for merger control. It was only in December 1989 that the EC Merger Regulation brought explicit merger control at the European level, which was replaced with Council Regulation 139/2004 (the “Merger Regulation”). The new legal framework reinforced the degree of European governance and incorporated several refinements to make the administrative processes more effective. The Merger Regulation is an example of separate jurisdictions agreeing to analysis of certain mergers in one supra-national framework.

The European Commission has exclusive jurisdiction to review concentrations with a Community dimension. Mergers that do not have a Community dimension may be reviewed by the competition authorities of the Member States applying national law. The competent authority in Romania for the review of mergers is the Competition Council.

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# Effectiveness of Tax Incentives on Innovation Technology in the European Union

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## Abstract

*Increasing research and development activities, especially in the private sector, it is possible through tax incentives for companies with unfold research and development activities. A tax incentive represents an important determined in innovative behavior. For designing and measuring public support to research and development activities it is often not sufficient to focus only on tax rate effects of research and development activities, tax incentives and the design of a tax incentive must be in accordance with the framing tax system in order to be effective. Though this research is revealed that the tax incentives brings no increase innovation.*

**Keywords:** *innovation, tax incentives, research and development*

**J.E.L. classification:** E62, O32

## 1. Introduction

Economic and fiscal instruments specifically targeting innovation will increase research and development activities. Governments as drivers to create innovation policies, tax planning, including transferring intellectual property to low tax jurisdiction, spill over positive effects in the economy.

When we talk about innovation we are referring to change that can take different forms:

- product innovation – changes in the products or services which an economic entity offers;

- process innovation – changes in the ways in which they are created and delivered;

- position innovation – changes in the context in which the product or services are introduced;

- paradigm innovation [1] – changes in the underlying mental models which frame what the economic entity does.

Supporting innovation is an important objective in all countries. Governments use tax systems to help overcome barriers to innovation by reducing the cost of undertaking innovative activities.

## 2. Tax incentives for innovation

It is undeniable that existing regulations have certain deficiencies and that they have contributed to a certain extent the emergence of the global crisis.

Many studies have focused on the reasons that investments in R&D indicating that they are due to the fact that they can be directly linked to enhancements in the “knowledge-based economy.” These studies have showed that 30 to 50 percent of today’s economic growth can be directly linked to product innovation development and innovation technologies. The “knowledge-based economy” and R&D activities have a very clear impact on these new business drivers.

To streamline R&D activities companies choose their research location taking into account the level of technical expertise and transparency of regulations and ruling.

There are many more choices for placing an R&D facility. First, through all of these operational issues, then ending up focusing on the bottom line and figuring out where is it most cost effective. So, the operational and

infrastructure issues narrow the field for where you can select an R&D facility, and then ending up with cost as the final issue. National Academy of Sciences did a ranking of various companies in their approach to figuring out where is the best location to put an R&D facility. So, they had stability of the economy and the government, as one of them. Market for products in the country meaning, that company wants to be where your customers are or where you think your customers will be. The company focus is on quality of the R&D personnel, intellectual property protection, university collaboration, import and export restrictions, and then cost [2].

To streamline costs and obtain some economies the companies carries out R&D activities in specialized centres. Additional tax allowance for R&D expenses are relevant to the activity of many multinational groups present in Romania.

Incentives are established by organisations outside the company, usually public administration bodies or insurers; these incentives may act at national, regional or sector level. With regard to the economic aspect of incentives, there are two major categories:

- financial incentives (positive or negative), such as insurance-related incentives, funding schemes, and tax-based incentives (tax reduction or specific taxes);
- non-financial incentives, including recognition schemes such as awards; aiming at positive recognition but not having substantial direct financial implications.

The main focus of this report is on external financial incentives (insurance-related incentives and public incentive schemes), and to a lesser extent on non-financial incentives.

Tax incentives for R&D activities is to reduce the taxable income for eligible taxpayers, by deducting additional 20% of the expenditure incurred by them in the current fiscal year for research and development activities, and by applying the methods of accelerated depreciation for equipment and equipment for research and development.

Tax incentives are granted for research and development activities that led to getting

research results, recoverable by taxpayers, oneself, in order to increase revenues.

Eligible expenditure in determining the deduction is given additional taxable income are:

- depreciation of tangible fixed assets acquired or created by taxpayers in new condition, used in research and development;
- expenditure on wages of personnel directly engaged in research and development;
- expenditure on tangible fixed assets maintenance and repairs performed by third parties;
- depreciation of intangible fixed assets, purchased by the taxpayer, used in research and development;
- operating costs, including: expenditure on consumables, expenses on materials of small inventory, raw material costs, expenditure on experimental animals and other similar products used in research and development activities;
- Overheads expenses that can be allocated directly or proportionally of research results by using an allocation key.

Only those eligible expenses recorded in the accounts, on the basis of supporting documents, according to the applicable accounting rules.

To be eligible for tax incentives for research and development the costs shall be costs incurred by the taxpayer for the purposes of the income. Additional deduction is calculated quarterly/ annually, as appropriate.

Eligible expenditure taken into account the deduction is additional to the profit taxation determination are as follows:

- depreciation of tangible assets created or acquired by the taxpayer as new and used in research and development;
- costs of staff wages directly engaged in research and development activities;
- costs of maintenance and repairs performed by third parties;
- depreciation of intangible assets, purchased by the taxpayer, used in research and development;
- operating costs, including costs of consumables, expenses related to the materials of small inventory, raw material costs, expenditure on experimental animals, and similar products used in research and development.
- Overhead costs which can be allocated directly or proportionally, of research results by using an allocation key.

In order to determine the amount that represents additional deduction in calculating taxable income, eligible expenses are added together and will be included in tax register.

Accelerated depreciation for equipment and equipment for research and development activities are carried out according to art. 24 of the Tax Code.

### 3. Conclusions

Fiscal policy are generally considered the most effective environmental policy tool available to governments. Where well-designed environmental taxes have been levied, these taxes have been show to be effective at inducing innovation. So, governments need to consider how to best improve their approach. Skilfully harnessing the tax system offers a robust and inded innovative way forward.

Fiscal policy stabilization is a necessary but not sufficient condition for sustained economic growth.

Technological innovation is an important factor in the competiveness of a company and the main driver of growth in productivity and in increasing standard of living.

Human resources and new technologies, in conjunction with the innovative capacity and to generate future benefits of investments represent the essential details of the process of economic growth, which can be mentioned in particular the principles of sustainable development in the “knowledge-based economy”.

### 4. Acknowledgement

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## Sovereign Debt Crisis in the Eurozone– Towards an Inevitable Reforming of the Euro Institutions

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### Abstract

*The Eurozone is facing the deepest crisis since its foundations. The subprime crisis that surged in the United States spread into a banking, then economic crisis. Markets were won by panic and overreacted to risk, generating the European sovereign debt crisis.*

*The article is structured as follows. In the first section, I revisit the main causes and factors that made the sovereign debt crisis possible. In the second section, I study the challenges the Eurozone is facing in the process of restabilising market confidence and putting European peripheral economies on a sustainable path. Third section assesses the main proposals, such as the introduction of the European Monetary Fund and the creation of a Eurobond market and considers the advantages and the drawbacks of these solutions. Finally, the last section concludes and makes an assessment on possible outcomes for the Eurozone. Reforming its institutions appears compulsory for its future survival should a further crisis emerge.*

**Key words:** Euro Zone, sovereign debt, fiscal union, budget deficit, eurobonds

**J.E.L. classification:** G01

### Section 1: Emergence of the Crisis: constructing factors

Until the burst of the subprime crisis, the Eurozone was considered a stable area for investment, benefiting from markets confidence. The creation of the Eurozone, together with the Lisbon Strategy, was aimed at enabling sustainable growth for member countries, stimulate innovation and creating real convergence within its members, all this through common monetary policy. It has

proved a bitter failure. European growth was weak and real convergence, notably on competitiveness, did not see light, the opposite happened. Blind confidence in financial markets virtues and fiscal competition are the main causes of the European Crisis. The theoretical convergence mechanism was the following: interest rates in countries where they were high prior to the Eurozone construction should follow a downward trend to converge towards Germany's low interest rates. This did indeed happen. This allowed very low capital costs in these countries. Increasing profitability in productive sectors would generate capital inflows financing highly productive investments. This in turn would facilitate productivity catching-up and therefore competitiveness on international markets. Productivity increase would generate real wage adjustments harmless to competitiveness, as they would at most be equal to labour productivity gains. Therefore, raising internal demand, due to revenue increase, should have been compatible with maintaining external equilibrium. A virtuous circle would enable progressive catching-up by countries with lower living standards towards the level of advanced Eurozone economies.

Unfortunately, this virtuous circle proved to be inconsistent with reality. Divergence accumulated within the Eurozone exacerbated financial and economic crisis effects on some fragile European Countries: financial liberalization with no macro prudential controls found fertile land: low interest rates, low and stable inflation, financial innovation allowing risk transfer (mainly through the titrisation process). For example, in Spain lowering interest rates were accompanied by large external capital inflows, coming especially from Germany and France. They all grubbed in housing

speculation, mainly through the financing of Spanish banks private debt emission.

What resulted was a sore in the housing prices, a collapse in saving, increased internal demand, high inflation compared to the European Central Bank’s goal, real wage increase, competitiveness loss, a digging current account deficit and therefore the necessity of external capital to support excess demand (deficits). Similar phenomena occurred in Greece and Ireland, in an environment of total indifference of the banking supervision.

These factors caused profound fragilities in the peripheral countries when the crisis burst. Having accumulated large public debts, they had less manoeuvres to put their economies onto a recovering path. Having tied hands on the possibility of using currency depreciation in order to regain competitiveness, their only weapon available was fiscal policy. Or, these policies worsened public debt levels and made debt sustainability unforeseeable for financial markets.

Another element that is less mentioned by European Authorities is the heterogeneous fiscal system within the Eurozone, generating asymmetric effects during the crisis. Indeed, in the Eurozone we may distinguish between three groups of countries, according to their fiscal strategy:

- One group of countries with low tax incomes (Spain, Portugal, Ireland)
- A second group of countries with very high tax incomes (Belgium, Italy, France, Austria, Finland)
- A third group of moderate taxation combined with favourable investment tax policies (Germany, Holland)

It is striking to observe that the most affected economies during the crisis are the ones with the lowest fiscal revenues rates in their GDP. These low rates are either the result of very low labour/investment taxation (Portugal, Spain, and Ireland), either a mix between low taxation and high fiscal evasion (Greece).

It is worth mentioning that the fiscal revenue contribution to GDP is an important factor, as noted above, but is not the only one, as the fiscal revenues’ structure also gives us hints concerning difficulties undergone by peripheral Eurozone countries.

Indeed, it appears that the most fragile countries are the ones with low labour taxation. Ireland, Greece, Portugal and Spain all tax relatively little labour comparing to other EU member states. Nonetheless, the beneficiaries are not the same: in Ireland low taxation concerns both employees and employers, and specially the last ones (Ireland has been doing fiscal dumping for many years now. For example, employers’ contributions amount to 11% in Ireland, whereas in France they represent 45% of the gross wage). On the contrary, Portugal and Spain support mostly employees. In Greece, taxation is low on both employers and workers.

Table 1: Budget revenues, 2008, % of GDB

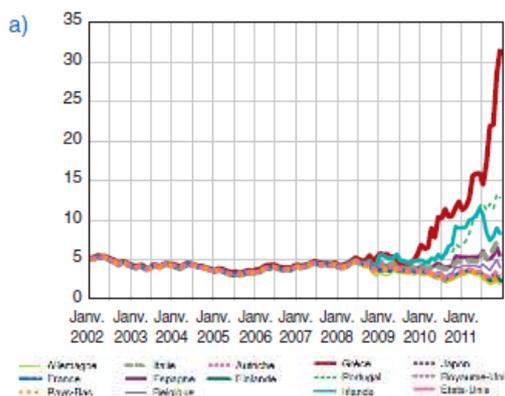


The darker the blue marks, the larger the taxation charge is.

### Debt crisis development

Starting 2009, spread on sovereign debt within the Eurozone started to increase, reaching dramatic levels through mid 2010. Thus, sovereign bonds with the same maturity, issued by different national governments were starting to be considered as imperfect substitutes. This spread boom reflected two separate but interconnected risks: a liquidity risk and a default risk. Considering the first one, it is the obvious result of the market panic and “flight to

safety” syndrome. Following the subprime crisis, markets turned to very safe assets, i.e. governments bonds of developed countries (United States, German, and to a less extent, France). This crowding-out of government bond demand increased prices of German and American government bonds, lowering the liquidity on the other European Government Bonds and thus decreasing prices and raising yields. Nevertheless, considering public debt



Source: « Dette publique, politique monétaire et stabilité financière »: Banque de France – « Revue de Stabilité Financière » – No 16, April 2012

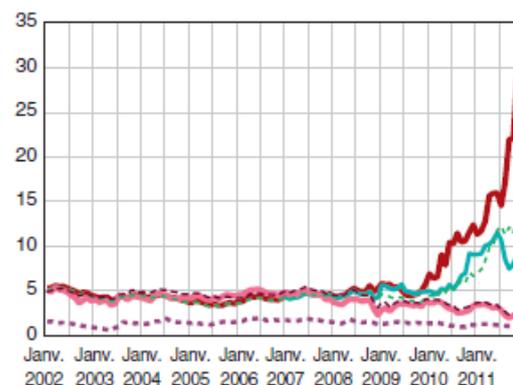
We may notice from the graphic above that, while the most affected economies are those of Greece, Ireland and Portugal, Spain and Italy also suffer from relatively high increases in bond spreads, though less significant than the first group. It is nevertheless noticeable that these former economies are much bigger thus posing an increasing risk for European Zone Stability, should markets loose confidence in there capacity to reimburse their debt.

**Eurozone Economies’ response to the crisis**

Following the economic crisis, budgetary responses made by European governments have known various stages: the first one, started in 2009, was focused on sustaining economy through recovery plans. Or, their importance and structure was different from the first beginning. Programs adopted within the EERP (European Economic Recovery Plan), diverged on more than 9% GDP! For example, when Ireland was already in an austerity cure, Luxembourg and Spain were just starting recovery programs. However, starting from 2011, austerity or at least budgetary neutrality prevailed in the

accumulation and macroeconomic disturbance the peripheral economies are suffering, the default risk became real, all the more that these countries’ defaults could have a contagion effect on the Eurozone as a whole.

Figure nr. 1: 10 Years Government Bonds Yields (base points)



Eurozone.

BCE’s monetary policy was very active as well. Having cut interest rates to historical low levels, the BCE embarked in audacious unconventional policies, from assuring unlimited liquidity to European markets (de facto replacing the inter-bank market) to buying equity in order to support the public and private bond markets. The two main programs were The Covered Bonds Purchase Programme (CBPP) and the Securities Markets Programme (SMP). The BCE also adopted other measures, known under the name of “Enhanced Credit Support”: extending the range of collateral accepted in the main refinancing operations, increasing the horizon of the MRO through 3 months, 6 months, 12 months and 2 exceptional 36 months Long Term Refinancing Operations.

**Section 2: Challenges and difficulties facing the Eurozone in restabilising market confidence**

In order to fully understand specific difficulties faced by the Eurozone and the reasons for the persisting Sovereign Debt Crisis, one must come back to the Structure of the European Institutions.

The advantages of a single European currency were as follows:

- A decrease in transaction costs: no

more need to change money when arriving in another country; no more uncertainty on the part of importers about what a contract would actually end up costing or on the part of exporters about what promised payment would actually be worth.

- Beneficial effects on trade

However, a single European Currency also had drawbacks, mainly giving up economic flexibility. When the single European currency was first proposed, an obvious question was whether it would work as well as the dollar does in America. And the answer, clearly, was no – as Europe is not fiscally integrated: German taxpayers don't automatically pick up part of the tab for Greek pensions or Irish bank bailouts. And while Europeans have the legal right to move freely in search of jobs, in practice imperfect cultural integration — above all, the lack of a common language — makes workers less geographically mobile than their American counterparts.

That is the main reason for which many American and British economists have always been sceptical about the euro project. U.S.-based economists had long emphasized the importance of certain preconditions for currency union — most famously, Robert Mundell stressed the importance of labour mobility, while Peter Kenen emphasized the importance of fiscal integration.

That being said, dismantling the Eurozone would have important costs and the issue is rather to find solutions. Nonetheless, it is true that not taking into account in the texts of the different treaties the possibility of a Eurozone country to go out was a big mistake. Denying a problem doesn't make it disappear, it just postpones it, risking bursting with an even more violent force.

What started as a Greece crisis culminated in a Euro Crisis as a whole. While there is no doubt on Greek authorities' responsibility on the nature of their budgetary problems, it is worth noting that financial markets and Eurozone authorities also bear their part of responsibility, for letting this crisis degenerating in a systemic risk. Concerning the role of financial markets, it is well known that they overreact to economic conditions: periods of euphoria alternate with periods of depression amplifying movements in asset

prices that are not always related to economic fundamentals. It is worth noting the role of rating agencies, which systematically failed to foresee coming crises. And after the crisis surged, they overreacted, by downgrading countries notations, leading to a significant increase in government bonds rate and deepening their recessions and macro-economic problems.

### **Section 3: Assessment of the main proposals: the European Monetary Fund and the Eurobond market**

In the face of the Greek crisis and the risk of contagion to other non-core Eurozone economies, 2 main proposals are interesting, the creation of an EMF (see Gros & Meyer, 2009) and the emergence of a Eurobond market (De Grauwe & Moesen, 2009). Daniel Gros and Thomas Mayer have suggested establishing a European Monetary Fund (EMF) that could, under certain conditions, financially support Member States Euro Zone

In detail, the proposal suggests the financing of the EMF through contributions (in terms of penalties) from those States that do not comply with the budgetary discipline as laid down in Union law. Only those Member States that do not meet the reference values for government debt (60% in relation to GDP) and for the budgetary deficit (3% in relation to GDP) would be required to make a payment. Moreover, the Fund shall be allowed to borrow money. If a Member State encounters financial difficulties, it could, upon submission of an adjustment programme, call on the guarantees of the Fund in an amount equivalent to its previously deposited contributions.

Additional drawings would be possible only if the State agreed to further conditions and financial budgetary disciplinary restraint. In case the financial support provided by the Fund does not suffice, Gros and Mayer have suggested rules to make an orderly sovereign default possible.

Currently, no such procedure exists. Thus, the insolvency of one State would have incalculable consequences for other Member States, giving it a certain potential for extortion. According to the proposal, the European Monetary Fund shall guarantee an amount equivalent to 60% of the GDP of a Member State, which would make sovereign

default a manageable risk.

The main drawback of this proposition consists in its legitimacy. Indeed, one may argue that this proposition goes against the “no-bailout” provision of the Maastricht Treaty.

However the proposal has the merit of making the no-bailout rule credible and thus gives teeth to the threat not to bail a country out. The drafters of the Maastricht Treaty had failed to appreciate that, in a context of fragile financial markets, the perceived (and real) danger of a financial meltdown makes a “pure” no-bailout response unrealistic. As with the case of large, systemically important banks, market discipline can be made credible only if there are clear provisions that minimise the disruptions to markets in case of failure.

Authors identify two key advantages to their proposal: first, the funding of the EMF should give clear incentives for countries to keep their fiscal policies in order at all times. Secondly, and perhaps even more importantly, the EMF could provide for an orderly sovereign bankruptcy procedure that would minimise the disruption resulting from a default. However, one must take into consideration the organisational and legal constraints (for detailed analysis of the Treaties’ Articles, see Ulrich Häde, 2010). Furthermore, to make only delinquent countries pay for assistance would be politically untenable. Sooner or later the payers would claim possession of the fund and deny any right in deciding how to use it to those who had not contributed to it. The two aims of strengthening the hand of the virtuous countries and of making the non-virtuous pay for assistance are mutually incompatible.

The Greek Crisis and the soaring of government bond spreads also brought to light the idea of creating a Eurobonds market. The issue of euro denominated bonds would be guaranteed collectively by the governments of the euro Zone. These could be issued by a European institution such as the European Investment Bank (EIB), or directly by the member states’ governments. In both cases the guarantee would be provided by these Eurozone governments which have the taxing power to back up such a guarantee. The advantage of such a

Eurobond issue is that countries which now face high spreads would have an easier and cheaper access to the financing of their budgetary stimulus programme. But this feature is also its drawback. Countries like Germany object. They fear that such a joint euro bond issue will create a free-riding problem. The governments of Ireland, Greece, Portugal, Italy etc. which today face high spreads will have fewer incentives to conduct sustainable fiscal policies. As a result, the countries with low spreads, and especially Germany, may have to bail out the governments of these countries in case of default.

Whatever one may think of the motives of Germany, the German resistance to a joint euro bond issue is a fact of life. The question then is whether this opposition can be reduced by going some way towards relieving the German fears that it will have to pay the bills. De Grauwe and Moesen make an interesting proposal, resumed hereinafter:

- First, each euro government would participate in the issue on the basis of its equity shares in the EIB.
- Second, the interest rate (coupon) on the euro bond would be a weighed average of the yields observed in each government bond market at the moment of the issue. The weights would also be given by the equity shares in the EIB.
- Third, the proceeds of the bond issue would be channelled to each government using the same weights. Fourth, each government would pay the yearly interest rate on its part of the bond, using the same national interest rates used to compute the average interest rate on the euro bond.

What are the advantages for the different countries?

Concerning Germany, much of the fear that a common euro bond issue would lead to a free riding problem forcing Germany to pay the bill disappears in this scheme. Greece would pay the interest rate it faces in the market today. Thus the incentive to free ride on Germany would decline. In addition, Germany would pay the same interest rate it pays when issuing government bonds on its own. Thus contrary to other proposals for joint euro bond issues, Germany would not be penalised by a higher interest rate. This

leads to the question of what the benefits are for Greece. The main benefit for Greece arises from the fact that Greece faces the problem that it may be shut out from the market, as long as the flight to safety syndrome exists. Thus the common euro bond issue is a gate for Greece to access funding, which it may not have as easily when it issues bonds on its own.

### **Conclusions: Eurozone’s necessary reforms**

Currently, none of these proposals has seen light. Greece has been receiving support from the IMF and the European Financial Stability Facility (meant to be replaced by a permanent rescue organism starting 2013 – European Stability Mechanism). However, risks in other fragile economies persist and markets may soon attack these bonds markets, or even countries like France, considered as one of the safest.

While political union is not reasonably foreseeable in the short/medium term, fiscal integration appears essential for the Eurozone survival. Reasonable but strong steps must be taken in order to convince the markets on the future of the Eurozone. One may start with converging taxation schemes in different European countries. Another important working would be on financial and credit regulation in the Eurozone and macro-prudential policies.

As Krugmann put it in a Times article “The Europeans have shown us that peace and unity can be brought to a region with a history of violence, and in the process they have created perhaps the most decent societies in human history, combining democracy and human rights with a level of individual economic security that America comes nowhere close to matching. These

achievements are now in the process of being tarnished, as the European dream turns into a nightmare for all too many people”. European Governments and people may as well think about these words when refusing to cooperate and reform Europe’s institutions.

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## Management Strategies of Country Risk within Financial Institutions

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### Abstract

*Financial institutions, like any other company for that matter, have as a main objective the diversification and expansion of revenue and profit sources. To this purpose they have expanded ever more their activity across national borders.*

*But, as it is well known, especially if we relate to the current economic-social and politic circumstance, this strategy increases the risk of financial loss, exposing the bank to country risk.*

*And as “the secret of success for a company is to be prepared for any risks, when they will occur”, all banks must possess a country risk management process which, although it varies depending on the volume and the complexity of the international activities include a series of steps which must be implemented mandatory.*

**Key words:** country risk, financial institutions, country risk management

**JEL Classification:** F21, G24, G32

### 1. Introduction

“It is true that on a road not everyone can be a railway engine, therefore, as the English politician Benjamin Disraeli (1804-1881) stated, “One secret of success in life is for a man to be ready for his opportunity when it comes”.

This statement is very important also for the risk management theory if we extrapolate it and we adapt it to the specific of the economic theory, as follows: “the secret of success for a company is to be prepared for any risks, when they will occur”.

Since today’s business world relies on the markets’ expansion at a global level more and more companies participating to the international economic activity, the

management activity was faced with new challenges.[1]

This is because, as it is well known, especially if we consider the current economic, social and politic conjuncture, this strategy increases the risk of financial loss, exposing the company, regardless of its field of activity, to country risk.

Therefore, a key mechanism, an integral part of all decisions in international affairs is represented by country risk management.

A component of the international management, country risk represents the totality of strategies undertaken by companies which are becoming internationalized in order to reduce their operations [2]. Adopting such appropriate measures has the effect of reducing the company’s vulnerability.

### 2. Minimum principles to be taken into account in developing the country risk management systems

The financial institutions are expanding more and more their activity abroad, in order to diversify and expand their sources of revenue and profit.

But, it is well known that this strategy increases the risk of financial loss, exposing the bank to country risk.

Therefore, all banks must have a process for managing country risk which, even though it varies depending on the volume and complexity of the international activities, mandatory includes:

- Written policies and procedures for risk management;
- Supervising the board of directors;
- A system for assessing country risk;
- A system for analyzing country risk;
- A system specially created with the purpose of reporting the country’s exposure;
- The country’s exposure limits;

- Permanent monitoring of condition on the partner country;
- Internal and audit controls.[3]

For example, currently, the rules regarding country risk management for the banks in India, only when the net exposure is equal or greater than 2% of total assets, it is required to formulate a management strategy for country risk. The exposure is calculated by subtracting from the gross exposure the guaranteed, credit insurance, etc.

The policies and strategies, clearly defined, well documented and approved by the board of directors, should focus on indentifying the problems, their measurement and monitoring, and also on establishing the risk tolerance limits. For this purpose it is required to draw clear lines in terms of the responsibility for the country risk management decisions, establishing thus and equilibrium between the local branch managers, the regional management committees and the headquarter management.

The country risk assessment should be undertaken at least once a year. It is advisable to rely on internal systems, but also to relate to the external agencies assessments. Therefore, the local “trends” must be monitored and even those from different countries with similar characteristics.

When conditions deteriorate, the institutions must increase the frequency of monitoring.

If the risk is high, the monitoring must be performed in real time.

The sources of information for conditions monitoring come from subsidiaries, respectively from the reports of local employees, of local country risk assessment departments, but also from external sources.

The level of the allocated resources for conditions monitoring should be directly proportional with the level of exposure and with the recorded level of risk.

Also, the procedures should include the limits of exposure to risk, which are established by the bank’s General assembly. These are, periodically reviewed, at least once a year and should not be greater than the accrue capital. [4]

The frequency for assessing the risk profile of a country must be based on the nature and the volume of exposure of the bank towards this country. For smaller

exposures or countries with a higher degree of transparency, the bank can use the foreign rating agencies.

Furthermore, these limits should not be treated as binding targets, but as maximum limits.

Following the analysis of individual countries, the bank must establish the exposure limits taking into account the followings:

- The bank’s strategy regarding its international activities;
- The bank’s availability to expose itself to risk towards the respective country;
- Understanding the opportunities to operate in the respective country;
- The bank’s predisposition to support international business needs of bank’s local customers.

These exposure limits are proposed for approval by the bank’s executive management board and subsequently are made available to subdivisions and to the involved staff. [5]

Although the exposure limits “country by country” are commonly used, the banks should establish also correlation due to systematic factors. This is because it is recognized that the problems of an unstable country affects also all the countries with which it has close economic ties, debtor profiles, capital markets and similar structures of the financial system.

Sub-limits may be established, which can be classified under the following criteria[6]:

- Due date (short term, long term);
- Type of company (financial institutions, corporation, state owned);
- Country risk type (sovereign, transfer);
- Product type (commercial loans, project finance, derivatives, etc);
- Secured or unsecured;
- Region;
- The economic sector of the debtor;

The banks should monitor regularly the compliance with the exposure limits, and each change must be reported to the board of directors for approval and should be published in the “Annual Report” whereas is important for establishing the value of the bank’s assets and earnings[7].

The procedures comprise as mandatory steps also stress tests and planning scenarios.

This involves early identification of issues that can occur as a result of country risk materialization and of solutions to reduce damage and risk.

Through stress test it is assessed the potential impact of different scenarios created according to the country risk profile.

### 3. Methods of protection

A protection alternative, in terms of exposure to the risk in the host country, is represented by the provisions.

For example, in the Risk Management Guide for the banks in India it is provided a percentage of net exposure, depending on the degree of risk as follows [8]:

*Table.1. Categories of risk for banks in India*

Risk category	Class risk ECGC	Provisions percentage (%)
Insignificant	A1	0,25
Low	A2	0,25
Moderate	B1	5
High	B2	20
Very high	C1	25
Restricted	C2	100
Without credit	D	100

*Source: Financial Intelligence Unit-India*

Banks use 7 ratings, drawn by the Export Credit Guarantee Corporation of India Ltd. (ECGC).

Another option for protection is represented by the subjection of external debtors to the warranty criteria.

To be accepted as provision substitutes in the bank account, the securities must meet the following conditions [9]:

- to cover total exposure;
- to be unconditional and irrevocable;
- guaranteed to meet on demand the obligations;
- to demonstrate they meet the legal requirements;
- the securities must be approved by the board of directors of the guarantor, who undertakes the obligation to inform the bank when changes occur in the financial situation, changes that could negatively affect the ability to honor the guarantee.

In order to check the compliance of these internal rules, the members of the board must ensure that the country risk management process includes also an internal and external audit process, which will provide an opinion on the accuracy of the information used when monitoring the countries, to determine whether the limits of exposure are well defined and reasonable, if there are adjusted according to the rating evolution, etc.

The results are presented in the audit report and are sent back to the bank’s board of directors. But, these steps are reviewed annually, taking into account for their implementation the bank’s experience.

If a few years ago, banks, like all other companies interested in the expansion of their investments across national borders, were more relaxed and less prudent when establishing the investment strategy in a developed country, currently the situation has changed.

This is because the perception towards risk must be reconsidered [10].

Thus, the mere cataloging of national economies in developed/developing countries, unsafe/non-risky is no longer efficient, if we consider that today a developed country can be more risky than a developing one.

We recall in this respect Greece who is far more risky than India, situation which was not true a few years ago, Australia, who increased fees and charges for the sale of resources, even though it is not an unstable economy, poor or corrupt.

Also, the time has passed, when the standards and the best practices for managing the risks had as a source the “Occident”, countries like Brazil, India, China, registering important progress in this direction. Therefore, the increase of country risk is threatening especially the developed countries, and the emergent economies may benefit if the governments continue to improve their policies for attracting foreign investments.

Important in this context is the creativity, the ability to adapt quickly to the new global context because, as A. Einstein argued, “it’s in crisis that inventive is born, as well as discoveries, and big strategies. Who overcomes crisis, overcomes himself, without getting overcome.”

#### 4. Conclusions

Thus, a clear identification strategy, assessment, monitoring and country risk controlling constitutes an essential lever, but not sufficient, through which the bank can avoid engaging in excessive risks due to its international activities.

An important condition for insuring the efficiency of this activity is that the rating given to a country shall reflect its true risk profile whereas, the rating is used as a basis for determining the exposure limits. Precisely why, even though bank can use the assessments made by leading rating agencies, they should not consider them as a substitute for their own assessments.

Reality has shown that when country risk management is not implemented, the cost for compensating loss far exceed those for implementing and application of country risk mitigation strategy.

The most important role of country risk management is represented thus by the opportunity growth which is added to the general management.

In conclusion, “our life is the result of the choices we make. To put the blame on those around us, on the environment, on other external factors, is to give these things the power to control”[11].

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## Low Costs on the European Shipping

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### Abstract

*The freight rates and second hand prices in the dry bulk market seem to be stationary. By unit root tests, an established tool for testing for random walk in economic time series, the random walk hypothesis can be rejected in most cases for the freight rate samples. This result is in contrast to the findings of a number of papers. However, the results confirm classical shipping market that indicate stationary in freight rates, which is not the case if the freight rates follow a random walk. By transforming all observations from US\$ to Japanese yen detrended freight rates and prices seem to become stationary and volatility is reduced.*

**Key words:** shipping, market, costs, freight rates, perspective

**J.E.L classification:** M16

### 1. Introduction

There is a large literature on the stochastic property of shipping freight rates and asset value. Recently, a number of empirical studies have questioned the result of many classical papers. The classical view seems to be that freight rates and prices have mean-reversion or trend-reversion properties, whereas the new empirical studies mainly conclude that freight rates and prices follow random walks. This study focuses on the price dynamics of the international dry bulk shipping markets. That is, the paper focuses on the international markets for sea transport of coal, iron ore, grain, bauxite, alumina and phosphates, i. e. the five large major dry bulks, and residual group often referred to as “minor bulks”. Minor bulks comprise a large number of products transported in bulk, e.g. steel, forest products, cement and metals.

If a price process follows a random walk the probability distribution will be independent of its path, i.e. history, and present level. Hence, the probability of a given change in the price process is identical irrespectively of whether the price is high or low. This implies that the price does not change. For example, if the freight rate follows a random walk there is no force that pushes unusually high or low freight rates towards a normal level or a trend.

Early empirical studies of the bulk shipping markets are Tinbergen’s type from 1931 and 1934. These papers are a part of Tinbergen’s major contribution to the development of business cycle theories, but are also seminal from the perspective of maritime economics. The 1934 paper mainly focuses on the freight rate formation during the years 1880 to 1991. The major commodities traded at that time are almost the same as today, even though trade volumes and patterns have changed significantly. Tinbergen derives relations between the freight rate development and demand indexes, tonnage capacity and fuel costs. During the period that Tinbergen studies, there was remarkable technological and organizational development, which reduced transportation costs. This includes lower crew/tonnage ratios, increased fuel efficiency and declining shipbuilding costs. As Tinbergen points out, the competitive pressure in this close to perfectly competitive industry implies that decreasing costs means a downward trend in freight rates.

In the 1931 paper Tinbergen introduces the “durable good cycle”, exemplified by the shipbuilding cycle, in contrast to “non-durable good cycles”. High freight rates trigger ordering of vessels, which will cause a downward pressure a freight rate when the vessels are delivered. But, as it takes time from ordering a vessel until delivery, the fall in freight rates will not be instant and in the meantime very high freight rates may occur. Eventually, freight rates

will return to lower levels and in some cases, even a freight rate depression may follow if too much capacity is constructed. The speed of reversion after a depression will depend on how fast demand catches up with any surplus capacity or in extreme cases surplus capacity may be demolished. Due to the "time to built" effect it is hard to match demand and capacity at all times. Tinbergen argues that both freight rates and shipbuilding tend to move in cycles, and he suggests modeling these patterns as sine waves.

See also Hawdon [1] for a classical paper on related tanker market. The suggestion that freight rates, as part of their stochastic nature, have a downward trend when they are high and have an upward trend when they are low has been referred to as the "mean reverting" nature of freight rates. The assumption of mean reversion in freight rates has been used in theoretical asset valuation papers, e.g. Bjerksund [2] and Tvedt [3].

Tinbergen's two fundamental assumption about dry bulk shipping market prices, the downward trend in price due to increased efficiency and the cyclical or mean reversion pattern due to delayed capacity adjustment, do not seem to hold empirically according to recent studies. On the contrary, results indicate that dry bulk shipping market prices follow random walks.

## **2. Overview of the modern empirical literature**

Berg-Andreassen [4] studies the dry bulk markets by investigating freight rate observations from the Baltic Freight Index (BFI). This index was compiled from freight rates on different dry bulk shipping routes, and was used for futures trading in freight rates at the Baltic International Freight Futures Exchange (BIFFEX). Daily observations from April 1985 to December 1988 are studied for ten selected routes in the BFI. Using the augmented Dickey-Fuller test, which has become the standard tool for testing for random walks, Berg-Andreassen concludes that the freight rates follow random walks. This implies that the process is non-stationary but the first difference is stationary, i.e. it is integrated of order one. Berg-Andreassen also studies quarterly observations from 1980 to 1989 of freight rates and of second

hand prices for dry bulk vessels. The result are equal to those of the daily observations of freight rates, i.e. all series seem to follow random walks. In Berg-Andreassen [5] ten years of quarterly observations from three BFI routes are tested for order of integration. For each of routes both spot freight rates and time charter [6] freight rates are available. Berg-Andreassen concludes that all freight rates are integrated of order one, which indicates that the variables follow random walks. Kavussanos and Nomikos [7] also argue that the BFI follows a random walk. The focus of their paper is to investigate the unbiasedness hypothesis of the BIFFEX futures prices.

Veenstra and Franses [8] study monthly freight rates for three capsize and three panamax [9] routes. Observations cover the period September 1983 to August 1993. using an augmented Dickey-Fuller test without a time trend on the natural logarithm of the observations, they conclude that all series are non-stationary at a 1% level. At a 5% level the null hypothesis of non-stationarity can be rejected for two of the panamax routes. Despite this, Veenstra and Franses assume for the rest of their study bulk markets that the log of the freight rates are integrated of order one. Their main conclusion is that the freight rates follow random walks but are co-integrated. This is also the general result of Veenstra [10].

Kavussanos [11] studies the volatility in dry freight rates, both spot and time charter freight rates. He uses monthly data from 1973 until 1992, where the time charter market is represented by an aggregated freight index and the spot market is represented by an aggregated index as well as data series representing each of the three vessel types; capsize, panamax and handysize [12]. The log of all of these data series is reported to be integrated of order one and are co-integrated.

Glen and Rogers [13] study freight rates index for the Cape size market and find that for all routes the freight rates in level form are non-stationary, but for the first difference the unit-root hypothesis can be rejected.

Hale and Vanags [14] focus on the stochastic nature of relation between the second hand values of handysize, panamax and capsize vessels. They study monthly observations from October 1970 to July 1988 for each of the vessel types, and conclude that all variables are

integrated of order one and, hence, seem to follow random walks.

Glen [15] extends the data set used by Hale and Vanags to cover monthly observations for the period 1979 to 1995. Basically, he confirms the result of Hale and Vanags that the log of the second hand values are integrated of order one. He also concludes that the asset prices are co-integrated.

Kavussanos [16] studies the volatility in dry bulk second hand values. Monthly observations from 1976 to 1995 are studied. When using a methodology for seasonal data Kavussanos reports that the log of all second hand prices are integrated of order one. In the paper time charter freight rates are also studied and are found to be stationary, which contradicts the results of Kavussanos' 1996 paper, but no test of this is presented.

With only a very few exceptions, the evidences seem very strong from the modern literature that freight rates and second hand values in the dry bulk shipping markets follow random walks. This means that high prices not necessarily are followed by lower prices and vice versa. The next section of this paper re-establish the result from the empirical shipping literature as regards the lack of stationarity in dry bulk freight rates and second hand values. For completeness new building prices are also included in this study. Thereafter an alternative perspective is suggested: the study is carried out on the same set, but the denomination of the observations is changed from US\$ to Japanese yen.

### 3. Data

The dry bulk data set used in this paper are all observations from the SeaWin database, which is based on observations from Clarkson Research Studies Ltd of London, Fearnleys of Oslo or Gothenburg Chartering. Three new building price series are available; the new building price of a 30,000 dwt handysize bulk carrier, a 60,000, to 70,000 dwt panamax bulk carrier and a 120,000 to 140,000 dwt capsizes bulk carrier. The quarterly new building prices in million US\$ are available from 1<sup>st</sup> quarter 1970 to 3<sup>rd</sup> quarter 1999, i.e. 119 observations. The three second-hand value series that are available are: the price of a five old 30,000 dwt handysize bulk carrier, a

five year old standard panamax bulk carrier and a five year old standard capsizes bulk carrier [17]. The freight rates are represented both by time charter (TC) equivalent spot rates [18] and spot rates in US\$ per tonne. The time charter equivalent spot rates are denoted in US\$ per day, for a 30,000 dwt handysize bulk carrier, a 60,000 dwt panamax bulk carrier and a 120,000 to 150,000 dwt capsizes bulk carrier. The time charter equivalent spot rates are available from 1988, to 1999 on a weekly basis, a total of 591 observations. The spot rates in US\$ per ton include the cover of voyage related costs and three routes are studied; coal 120,000 tons from Hampton Roads/Roberts Bay (HR/RB) to Japan, coal 65,000 tons from US Gulf? ARA and grain 55,000 tons from US Gulf to Rotterdam. Observations of the spot rate in US\$ per ton are available from 1984 to 1999, a total of 748 observations. In addition, the Baltic freight Index (BFI) is studied. The index has been compiled on a daily basis from 1985. data from 4<sup>th</sup> January 1995 to 5<sup>th</sup> October 1999 are studied, i.e. 3722 observations.

The price series of new building and second hand values, that are reported monthly and quarterly by shipbrokers, are based on a very low number of observations. The number of new building contracts and second hand sales fluctuate substantially, and during some months no transactions are carried out at all, or the contracts are related to non-standard tonnage. Hence, data are in many cases not based on actual observations but on the brokers' best estimate of current market. It is more appropriate to use monthly or weekly data for the spot freight rates due to the high number of freight transactions in the market. When it comes to the daily observations of the BFI index, sub-index values are occasionally substituted by the ship brokers' best estimate of the current market in the cases that no transactions has been carried out.

### 4. The traditional perspective on freight rates and values

To test for random walk, the augmented Dickey-Fuller test is used. This method is applied in most of the empirical papers presented above. Both the augmented Dickey-Fuller regressions with and without a trend are studied.

Generally, it is not possible to reject the random-walk hypothesis. The only exception in our study is the spot rate in US\$ per tones for the coal, 65,000 tones from US Gulf/ARA, rout and grain, 55,000 tones from US Gulf to Rotterdam, rout for which the null hypothesis of non-stationarity can be rejected at 5% and a 10% level, respectively, in case of no trend. This is in accordance with the findings of Veenstra and Franses, that spot rates for the panamax vessels seem to be stationary. Hence, our study confirms the general result that shipping freight rates and values seem to follow random walks but study also confirms that the panamax spot rates may be an exception.

### **5. The perspective on freight rates and values**

Demand for the large dry bulk vessels are mainly generated by transport to Asia and Europe. Iron ore, coal and grain dominate the dry bulk trades. The main exporters of iron ore are South America and Australia (together about 70%) and the main importers are Japan, other Far East and Europe (total about 90%). North America contributes to only a very marginal share of world iron ore trade, about 7% of export and less than 4% of imports. Coal export is dominated by Australia, North America and South Africa (total about 70%) and the main importers are Japan, other far East and Europe (total about 90%). Grain export is dominated by North America (above 60%) and imports re dominated by Asia (above 50%).

North America is unique since the region combines a huge natural resource base with a high degree of industrialization. Hence, the region is almost self sufficient as regards commodities transported in dry bulk vessels and is therefore close to independent of dry bulk shipping services for imports. However, dry bulk vessels are used for exporting coal, grain and some other commodities like forest products, from North America. Japan, on the other hand, is totally dependent on the dry bulk fleet for importing almost any commodity used by the domestic industry.

In the early 1970's European yards were still major players in the market for bulk carrier construction, but for most of the period studied here Japan has dominated the international market. Due to a continuous improvement in

efficiency, Japan has been able to keep its large market shares despite rising wages. Today, also South Korea and China are major suppliers of bulk tonnage in addition to Japan. Europe has a very minor role in this market and the USA has not constructed large bulk vessels for free international trade for decades.

Both from a demand for shipping services and from a ship building perspective Japan is major player in dry bulk market, and in an over-all perspective, Japan together the rest of Asia, is most probable more important for the dry bulk market than the USA. Most transactions in international shipping are, however, carried out in US\$. On the other hand, if the fundamentals in dry bulk shipping, both regards demand for shipping services and the construction of new capacity, are mainly influenced by Asia in general and Japan in particular, then an Japanese yen perspective may be more appropriate when studying the log run relations in the dry bulk markets than usually US\$ perspective.

Below the unit root analyses are repeated but all observations of new building prices, second hand values and freight rates are converted from US\$ to a Japanese yen denomination, using each periods' end Yen/US\$ exchange rate.

By changing the denomination of the data from US\$ to Japanese yen the dry bulk freight rates seem to be stationary. Time charter equivalent spot rates for panamax and handysize dry bulk carrier seem to be stationary around a trend, i.e. trend-reverting. The trend seem to be slightly downward, as we should expect from gradual improved efficiency in a close to perfectly competitive market. The freight rates, measured in yen per ton, for 65,000 tons of coal and 55,000 tons of grain, i.e. panamax lots, seem to be stationary, maybe a slight downward trend. For time charter equivalent capsize spot rates we cannot rule out the random walk hypothesis, even from the yen perspective. The freight rate in this market seems to be more volatile than the freight rates in the market for the smaller dry bulk vessels. The number of capsize vessels is much lower than the number of panamax and handysize vessels and long-term contracts are more frequent. Hence, the capsize spot market may be more exposed to short-term market imbalances than the markets for smaller vessels. This may explain the lack of structure in capsize freight rates. However, at a 10% level the yen

per tone freight rate of 120,000 tons of coal, i.e. a capsized lot, seems to be stationary.

The BFI in this data set is a combination of capsized, panamax and handysize freight rates and of US\$ per ton freight rates and short time charter freight rates. At a 5% level of significance the random walk hypothesis can be rejected for the BFI. Hence, the stationarity result for the BFI is not as strong as for the panamax and handysize freight rates but stronger than for the capsized.

For the newbuilding and second hand values we cannot reject the random walk hypothesis when values are measured in Japanese yen. The only exceptions are the capsized and panamax values at a 10% level of significance. The second hand market does not directly influence the total transport capacity or the utilization of the existing capacity, as the new building and freight market fundamentals, which to such a large extent are governed by the development in the Asian economies. The main asset players in the bulk markets are independent owners in Europe, especially Greek shipowners. Traditionally, they have a US \$, or local currency, perspective on their investments. Nevertheless, in the long run second hand values should follow a pattern consistent with the trend in new building values and freight rates. A five-year-old vessel, like in the available data, may for another 15 to 25 years, and therefore, the value of the vessel is in most cases heavily influenced by new building prices. From the unit root tests, it seems as if the new building prices follow a random walk whereas the freight rates are stationary. Hence, it seems reasonable that there are only weak indications of stationarity in second hand values.

## 6. Conclusions

By changing the perspective from US \$ to Japanese yen freight rates in the dry bulk shipping industry seem to be stationary. These results apply to all “deep sea” dry bulk vessels sizes, i.e. handysize and panamax vessels. Hence, the empirical result confirms what traditional models of the shipping markets suggest. That is, high freight rates trigger increased supply via new building and increased utilization of existing tonnage and low freight rates trigger reduced supply via lay-up and

scrapping of vessels. Therefore, freight rates are mean reverting.

The dry bulk shipping markets are mainly influenced by Asia, both as regards demand for shipping services and ship construction. Non-Asian ship owner generally view international shipping as a US\$ industry. This study indicates that this perception may be somewhat misleading, since yen denominated prices probably better reflect the fundamental changes in the industry and, hence, give more valuable feedback to the market agents. Investing in a shipping asset probably means to go long in a yen related asset, which implies a substantial exchange rate risk from the perspective of an investor who wishes to maximize his US\$ fortune.

In recent years China’s position in the dry market has increased significantly. Hence, future studies along these lines may include a basket of Asian currencies, not only Japanese yen. For prices in other markets the choice of the most appropriate currency, or basket of currencies, may not be straightforward. Nevertheless, the currency that for historical reasons is used for international transactions may very well be inappropriate when searching for long run economic fundamentals.

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revenue. This makes the spot freight rate comparable to the time charter freight rates.

## Is the Adhering to the EU a Way to Face the Crisis' Challenges ?

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### Abstract

*The paper realises a comparative analyses between an EU member state, a candidate one and Switzerland, in order to point out the importance of the adhering to the EU under the present global crisis using the main economic indicators during 2007-2011 and to understand why Switzerland is better placed as Germany under the crisis' impact. A distinct part of the paper deals with the analysis of the recovery packages implemented by these three economies in order to face the crisis and their effects. Moreover, the paper realise forecasts for 2012 and 2013.*

*There are two main conclusions of the paper. First, it is not necessary to adhere to the EU if the economy is efficiently. Second, Switzerland will not adhere to the EU on short-term and it has pertinent argues to do this.*

**Keywords:** business efficiency, economic recovery, national identity, foreign exchange intervention.

**JEL Classification:** F15, F43, O11.

### 1. Introduction

The Central Europe represents, by its position, the geographic, political and economic nucleus of the EU27. All countries from Central Europe adhered to the EU, excepting Switzerland. This is why we consider being usefully to realise a comparative analysis between Germany and Switzerland. Both countries are placed in Central Europe. First of them is foundation member of the EU and one of the most important economies in the world. Switzerland is not member of the EU, but it is one of the most efficient economies in the world. On the other hand, Iceland became an active candidate country to adhering to the

EU.

The latest report of the World Economic Forum ranks 139 countries by assessing business efficiency, innovation, financial markets, health, education, institutions, infrastructure and other factors [1], [2].

In this top, Germany ranks the 6<sup>th</sup> position with a score of 5.41. It ranked the 11<sup>th</sup> rank in the world according to basic requirements and the 13<sup>th</sup> rank according to the efficiency enhancers. The best German economy rank (5<sup>th</sup>) is based on innovation and sophistication factors.

Switzerland achieved the 1<sup>st</sup> rank in the same top, with a global competitiveness score of 5.74. It held on to the top spot in 2011, thanks to high ranks for basic requirements (3<sup>rd</sup>); innovation and sophistication factors (1<sup>st</sup>) and the second-most efficiency enhancers in the world, per the WEF.

Iceland had the 30<sup>th</sup> rank in the top with a global competitiveness score of 4.75. Its best rank (21<sup>st</sup>) is connected to innovation and sophistication factors. According to basic requirements and efficiency enhancers, Iceland ranked 31<sup>st</sup> and 33<sup>rd</sup> ranks in the world economy.

But Germany is the “steam engine” of the EU’s economy. Still the early industrial era, the German economy was a leader, an innovator and a beneficiary of the world economy globalisation. Nowadays, services support about 70% of GDP, industry – 29.1% and agriculture 0.9%. The German representative goods are cars, mechanical systems, metallurgical products and chemicals.

Germany has a strategic geographic position; it adjoins Denmark, Netherland, Belgium, France, Luxembourg, Switzerland, Austria, Czech Republic and Poland.

Switzerland became a member of the UN in 2002. It adjoins Germany, France, Italy, Austria and Liechtenstein [3]. Its economic policy is based on the idea: “thinking

globally, working in partnership and acting nationally”.

Switzerland economy depends on the foreign processes, especially of globalisation. The country has a modern approach of the international relationships. As a result, the Swiss foreign economic policy is focused on three axes: the agreements with the EU, the free trade agreements with EFTA and the international trade progressive liberalisation under the WTO. Even that the EU is the main trade partner, Switzerland refused to adhere to the EU still 1992.

On the other hand, the Swiss economy is very stable, with a stable currency and with the “legendary” financial transactions’ secret, which transformed it into a “financial Eden” for investors and investment. Practically, the Swiss economy is based on the constant FDI flux. Nowadays, Switzerland became a model for other countries, based on precision and fine industry, trade and finances. As a neutral country, Switzerland offers a safe banking climate and good investment environment.

R&D is very important; the Swiss economy spends 2.9% of GDP to these activities. Only four other countries in the world have greater expenditures to R&D than Switzerland: Israel, Sweden, Finland and Japan.

Almost whole labour activates in services and in SMEs. 99.7% of the Swiss enterprises have less than 250 workers. On the other hand, Switzerland has 12 companies in Global 500 top in 2010 [4]. These companies are the following: Nestle, Novartis, Roche, Credit Suisse Group, UBS, ABB, Zurich Financial Services, Syngenta, Holcim, Richemont, Swiss Re and The Swatch Group.

Germany has 20 companies in the same top: Siemens, E On, SAP, Deutsche Telekom, Basf, Allianz, Bayer, Daimler, RWE, Deutsche Bank, Volkswagen, Munich Re, BMW, Henkel, Deutsche Post, Linde, Metro, ThyssenKrupp and Fresenius Medical Care.

Iceland started a powerful economic recovery in 2011, which is forecasted to continue in 2012 and 2013. It will be supported by high private consumption growth rates and a important gross fixed capital formation process.

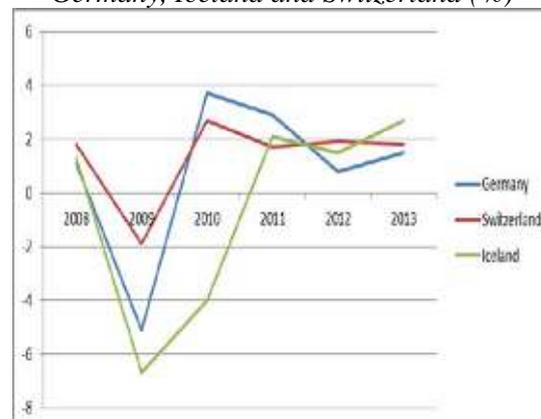
## 2. The evolution of the German, Iceland and Swiss economies during 2007-2011

In 2007, the German economy had a GDP growth rate of 2.7% and the Swiss economy of 3.1%. The economic conjuncture was favourable during the first months of 2008, but the Swiss economy was not able to avoid the negative effects of the crisis from the financial markets and the global economy’s slowdown. Iceland was the same economic growth rate as Germany in 2008.

During 2008-2009, the GDP growth rate decreased in Germany, from 1.1% to -5.1%. In 2010, the German economy emerged from the crisis and the GDP growth rate was 3.7% (2.9% in 2011). The EU forecasts talk about GDP growth rates of 0.8% in 2012 and 1.5% in 2013 [5],[6].

Switzerland faced to the same lower GDP growth rates in 2008 (1.8%) and 2009 (-1.9%) as a result of the global crisis’ impact [7]. In 2010, the economic growth rate was 2.7% and in 2011, 1.7%. The forecasts are optimistically: 1.9% in 2012 and 1.8% in 2013 [5],[6].

Figure 1. Economic growth rates in Germany, Iceland and Switzerland (%)



Source: personal contribution using EC information

Iceland started with a GDP growth rate of 1.3% in 2008. It was followed by two difficult years, 2009-2010, when the economy achieved negative growth rates (-6.7% and -4.0%). The forecasts talk about positive growth rates: 1.5% in 2012 and 2.7% in 2013 [6]. The trend of the GDP growth rate in Germany, Iceland and Switzerland is presented in Figure 1.

Practically, the three countries will have the same economic evolution during 2012-

2013, even that only one of them is member of the EU27.

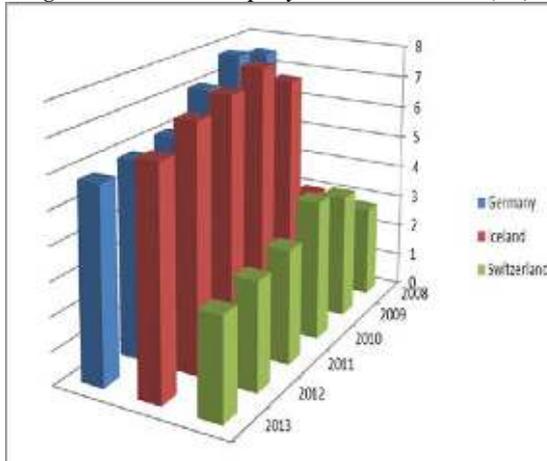
An important effect of the global crisis is that on the labour market. The unemployment rate in Switzerland was relatively low. It varied between 2.8% in 2008, 3.8% in 2009 and 4.2% in 2010. The unemployment rate started a decreasing in 2011. The unemployment rate will decrease, from 3.2% in 2012, to 3.0% in 2013.

Germany faced to higher unemployment rates: 7.5% in 2008, 7.8% in 2009 and 7.1% in 2010. The forecasts talk about a relative decrease of the unemployment, from 6.1% in 2011, to 5.9% in 2012 and 5.8% in 2013 [5].

The unemployment rate in Iceland was lower in 2008: 3.0%. It increased to 7.2% in 2009 and 8.0% in 2010. The same recovery process started in 2011, when the unemployment rate was 7.6%. The forecasted unemployment rates will be 7.3% in 2012 and 6.7% in 2013.

According to this indicator, Switzerland had a better position. Moreover, the forecasts are better for Switzerland than Germany (see Figure 2). The unemployment rate in the Swiss economy is lower than in many other EU's member states, as well.

Figure 2. The unemployment rate trend (%)



Source: personal contribution using EC information and [www.tradingeconomics.com/Economics/Unemployment-rate.aspx?symbol=CHF](http://www.tradingeconomics.com/Economics/Unemployment-rate.aspx?symbol=CHF)

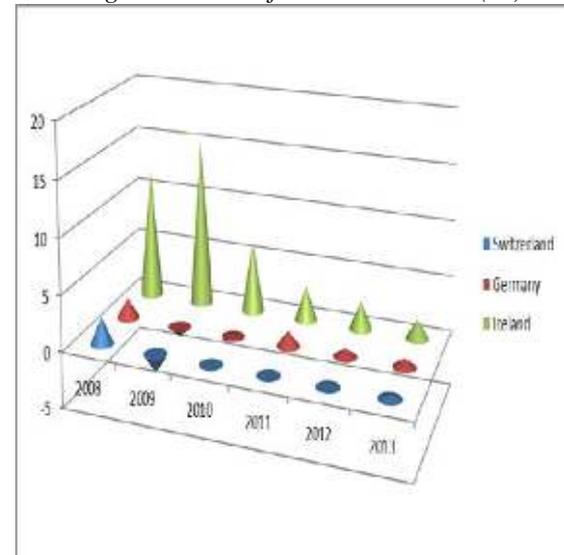
Another important economic indicator is the inflation rate. Germany achieved low inflation rates during 2008-2011: 1.8% in 2008, -0.8% in 2009, 0.2% in 2010 and 1.4% in 2011. The forecasts talk about 0.7% in 2012 and 0.8% in 2013.

Switzerland performed negative inflation

rates: 2.4% in 2008, -1.7% in 2009, -0.4% in 2010 and -0.3% in 2011 [7], [8]. The deflation from 2009-2011 was supported by core measures which were closed to deflation. Moreover, Switzerland began to intervene in the currency markets, buying up large amounts of Euros between March 2009 and June 2010. The forecasted inflation rates will be 0.1% in 2012 and 0.4% in 2013.

Iceland started to high inflation rates: 11.8% in 2008 and 15.3% in 2009, but succeeded to decrease them, from 6.5% in 2010, to 3.1% in 2011. The recovery process will continue: 2.6% in 2012 and 1.8% in 2013 (see Figure 3).

Figure 3. The inflation rate trend (%)



Source: personal contribution using EC information

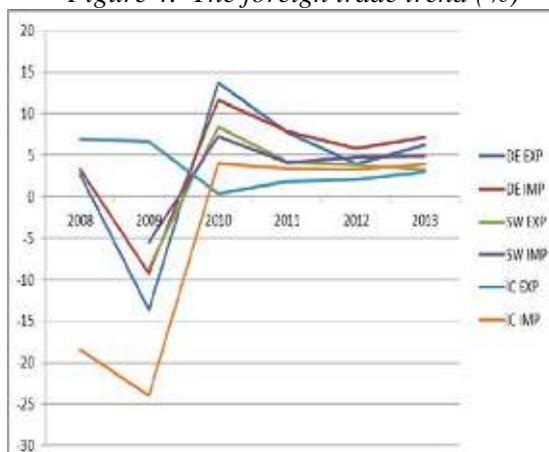
During 2008-2009, Switzerland had inflation rates greater than Germany. Moreover, both economies faced to deflation in 2009. The forecasts are more optimistically for the Swiss economy. As a result, the differences between the inflation rates in Switzerland and Germany will grow.

Many specialists consider that the greatest impact of the present global crisis is on the foreign trade. The German economy quick recovery was supported by the world trade terms improvement and the high competitiveness of Germany's export sector. The German exports grew by 13.7% in 2010, after an important decrease in 2009 (-13.6%). Some moderation of export growth is projected for 2012 and 2013, reflecting still relatively weak demand from some key trading partners which are exiting the crisis

more slowly and a certain normalisation of the situation after the sharp post-crisis bounce-back in global trade. On the other hand, the imports are projected to grow faster than exports in 2012-2013. As a result, the growth contribution of net exports would move close to zero (-0.6% in 2012 and -0.2% in 2013). The recovery of world trade will remain crucial to sustain the upswing of the German economy, including domestic demand.

Switzerland succeeded in exports rebounded strongly in the second quarter of 2010, mostly due to strong growth in pharmaceutical and machineries exports to Asia. The exports' growth rate during the present crisis, had the lowest level of -8.6% in 2009, but it achieved a peak of 8.4% in 2010. The real growth in exports of goods and services is expected to continue more moderately in 2012-2013. On the other hand, the imports will grow in a similar way, albeit slower than exports, and subsequently, the net external contribution to Swiss GDP growth should be slightly zero towards the end of the forecast period.

Figure 4. The foreign trade trend (%)



Source: personal contribution using EC information

Iceland succeeded in achieving exports positive growth rates during 2008-2011, with a peak of 7.0% in 2008. The trend will be positive: 2.1% in 2012 and 3.0% in 2013. On the other hand, the imports had high negative growth rates in 2008 (-18.4%) and 2009 (-24.0%). The recovery started in 2010. The imports annual growth rates will be higher than those of the exports: 3.3% in 2012 and 3.9% in 2013 (see Figure 4).

### 3. The economic recovery packets implemented by Germany, Iceland and Switzerland during the present global crisis

Under the European Economic Recovery Plan, Germany implemented two stimulus packages (autumn 2008 and January 2009) which covered measures connected to incomes and expenditures, in order to support the households, to improve the access to financing, public investment and training.

The German government approved a big stimulus package (50 billion Euros) and a supplementary budget which covers tens of billion loans. The next package covers infrastructure investment, tax decreasing and support for the automotive.

The supplementary budget was connected to loans of 36.8 billion Euros in 2009 and 50 billion Euros in 2010. As a generally point of view, the funds are oriented to the most affected areas. Some instruments are temporary, but others are permanently. The main economic measures implemented by the German government are:

- funding protection: at the end of 2009, Kreditanstalt für Wiederaufbau (KfW) created a supplementary financing instrument of about 15 billion Euros;
- investment stimulating: still 2009, the German government decreased the depreciation rate of the movable assets by 25% and extended the special depreciation facilities for SMEs, by increasing the asset and income thresholds to 335000 Euros and 200000 Euros, as well. The Federal Government stimulated supplementary investment for the building energy efficiency and the CO<sub>2</sub> pollution decrease using 3 billion Euros in 2009-2011. Moreover, KfW will finance the less structural financed regions with other 3 billion Euros;
- tax incentives for families: still 01.01.2009, the German Government grew the taxable income deductions' level for those traders which use maintenance and renovation services and doubled the taxation decrease to 20% of 6000 Euros. This measure will operate during 2009-2011;
- automotive facilities: exemption of payment of first registration for 1 or 2 years for those cars which achieve Euro 5 and Euro 6 auto standards. The German government will action in order to establish acceptable

regulations related to the CO<sub>2</sub> emissions at EU level in 2012;

- SMEs’ supporting: Germany signed agreements with EIB in order to obtain loans from SMEs: 5 billion Euros in 2007, 8 billion Euros in 2009 and 8.5 billion Euros in 2010;
- jobs’ security and training: extension of the special program for those workers with advanced age and low skilled, in order to prevent their reduction.

The Swiss government announced first stimulus package on November 2008. It was about 890 million CHF. In 2009, Switzerland implemented another recovery package of 700 million CHF. The main reason to implement the second package was the worst economic outlook and it used short-term target measures. The second package supported the rail and road infrastructure, R&D, environment, energy and tourism. Other measures were focused on strengthening export risk insurance, access to buildings and property encouraging, allowances extension related to the work time reduction and specific fiscal measures for families. The CHF appreciation decreased the Swiss exports. On the other hand, the financial problems of the UBS represent challenges for the Swiss economy under the global crisis. As a result, the government prepared the third economic recovery package.

The National Bank of Switzerland decreased the interest rate, from 0.5% to 0.25%, a historic minimum, and bought foreign currencies and bonds in 2009 [9]. It was for the first time when a central bank from a developed country included the foreign exchange intervention as a component of the monetary policy.

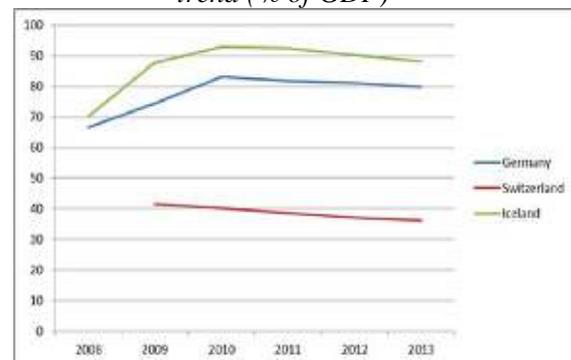
After this action, the National Bank of Switzerland announced that it remains ready for a steady action in order to prevent an irrational appreciation of the franc against the Euro [10].

In the context of the three-year collective wage agreement adopted in spring, the Iceland government took additional spending commitments, comprising additional public investment as well as social protection, active labour market policy and education measures. As a result, expenditure adjustment measures in 2011 are expected to account for 1% of GDP instead of 2% as initially foreseen, and total spending is likely

to exceed the initial level. A continuation of fiscal consolidation is, however, assumed for 2012 and 2013, leading to a gradual reduction of the fiscal deficit and allowing for a marginal decrease of the general government debt-to-GDP ratio below 90%.

As a result of the recovery packages, the three countries tried to improve their general government gross debts. The EU forecasts talk about the Switzerland’s success in decreasing this debt. Germany and Iceland will face to the same high general government gross debt (see Figure 5).

Figure 5: The general government gross debt trend (% of GDP)



Source: personal contribution using EC information

#### 4. Conclusions

The Switzerland’s position is difficult to explain related to its geopolitical position, because it has common borders with France, Germany and Italy, which are foundation members of the EU. Moreover, Switzerland is not an island as Iceland. On the other hand, Switzerland represents a success story of multiculturalism, because it adopted French, German and Italian religions, languages and cultures, as well. From the political point of view, Switzerland has a political regime and political parties like its neighbours.

From a demographic point of view, 870000 EU citizens are residents of Switzerland and 700000 citizens cross the borders in both directions every day.

The Swiss economy is powerfully integrated in the EU: 60% of the Swiss exports and 80% of the imports are related to the EU.

All these above elements can support an easy adhering of the Switzerland to the EU, but it is far from being realised yet. The main element which supports it is the “national

identity”, because Switzerland didn’t faced to wars, dictatorship, foreign occupation and colonisation during the latest two centuries [12].

On the other hand, the Swiss political regime is very interesting: a law can be put under a referendum if 50000 of Swiss citizen do not agree it. Practically, this direct democracy represents one of the most important obstacles against Switzerland’s adhering to the EU.

There are important economic reasons to deny the integration. The Swiss employers are the only European employers which do not agree the adhering, because it would cause an important VAT increase (from 7.6% to 15%) and a more important financial contribution to the EU budget of 3.5 billion CHF.

On the other hand, Switzerland signed 120 agreements with the EU. Under the present global crisis, the EU’s position became more aggressively and the cooperation the Swiss economy more difficulty.

As a result, the short-term adhering to the EU is impossible, as long as the Swiss citizens benefit of a lot of the EU advantages and are not forced to face the inconveniences.

On the other hand, Iceland forced the adhering to the EU27. It is able to achieve and to maintain the EU economic standards, but it faces to a high gross public debt (92.4% of GDP in 2011). We really cannot see the advantages of the adhering for Iceland.

An indication would be made: it is relatively simple to adopt a position like Switzerland made, but only the economy is able to achieve the same results like the Swiss one. For Romania, for example, such a position is impossible.

Nowadays, the adhering to the EU is the best solution for two kinds of economies: those which are able to achieve at least the same economic performances as the EU average and other economies, which are not able to find another solution to their economic environment improvement [13].

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# The Role of Knowledge and Innovation for Sustainable Development. Research on European Union Countries

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## Abstract

*In contemporary society knowledge and innovation are seen as vital sources and driving forces for sustainable development, one of the major goals in the world we live today, a subject of great interest for researchers and policy makers. Given this context, the paper aims to analyze and determine the role of EU countries performances in innovation, in generating knowledge, in promoting and using high “green” technologies for their progress towards sustainable development, as evaluated by different systems of measurement for both issues of interest.*

*The methodology is based on methods of analysis and synthesis, of interpretation and relevant comparisons. The paper focuses on identifying the successful key factors of knowledge and innovation systems in determining a sustainable approach and behaviour in society. The results of the research may have a large impact for scientific community preoccupied with knowledge, innovation and sustainable development issues.*

**Key words:** knowledge, innovation, sustainable development

**J.E.L. Classification:** Q01, O32

## 1. Introduction

Achieving sustainable development, most common defined as “the development that meets the needs of the present without compromising the ability of future generations to meet their own needs” [1] requires an understanding of the complex interplay of environmental, economic, and social processes at different scales, from local to global.

While many factors play an important role in development, knowledge and innovation have always been recognized to be critical tools for advancing sustainable development. In contemporary society knowledge and innovation are seen as driving forces for growth and changing factors through new technologies, generating worldwide a higher and higher interest for research, development, information, technology and their roles in society [2].

In this generous context of analysis we bring into discussion the way in which the performance in knowledge creation and innovation is reflected in the progress towards sustainable development, in order to identify the successful key factors of knowledge and innovation systems for sustainable development. The subject, of great interest for scientific community and policy makers, is obviously extensive and complex and needs to be approached from different perspectives. The paper cannot and does not attempt to offer answers to all questions, rather it sets a stage for discussion, exploring some of the many ways in which knowledge and innovation are used in connection with sustainable development.

The paper is structured in two parts: the first part presents some landmarks from literature regarding knowledge and innovation roles for sustainable development and the second part approaches a research on this topic for the European Union (EU) countries, using methods of analysis and synthesis, of interpretation and relevant comparisons. The paper ends with a section of conclusions regarding the main ideas of the empirical research, with implications for further research.

## 2. Knowledge and Innovation for Sustainable Development: Literature Review

Making knowledge and innovation serve sustainable development is a complex challenge, because all concepts cover several aspects which need to be addressed.

Debates about the relationship between science, knowledge, technology, innovation and development have a long history, with formal discussions going back more than 40 years, a period of time of great interest for determining the potential of science and innovation to address development challenges.

Before making any analysis on the topic, it would be necessary to clarify some of the concepts involved. Amongst many possible definitions, *science* can be defined as the process of generating *knowledge*, *technology* refers to the application of *scientific knowledge*, while *innovation* refers to developing new ways of doing things in a place or by people where they have not been use before. Innovation makes use of science and technology, but it goes far beyond them [3]. Thus, innovation could be considered the embodiment, combination or synthesis of knowledge in original, relevant, valued new products, processes or services [4].

Different studies have showed that knowledge and innovation offer powerful opportunities for developing and disseminating approaches which help the transition towards sustainability [5]. Innovation can foster and promote sustainable development as long as it is not limited exclusively to environmental technologies, but considers a combination of all forms of innovations potentially conducive to sustainable development: process innovations, product innovations, organizational innovations and market innovations [6]. Innovation is, therefore, not simply a matter of installing devices, but of transforming society and its value systems [7], it isn't just about developing new technology, but includes new processes and new ways of solving old problems through creative thinking [8].

Innovation combined with scientific research has always constituted a driving force of transformation in our societies, as any form of innovation involves change [9], but the scale of innovation is also relevant. It is considered that only disruptive, unpredictable innovation can change our unsustainable patterns [10], [11].

We live in a time of unprecedented advances in knowledge creation, technology and innovation, all playing a prevalent role in the globalization of exchanges, in the creation of new living patterns and in the distribution of assets, knowledge and products. The world is globalised and interconnected more than ever, but, in spite of great efforts and the evident progress worldwide, there are still socioeconomic disparities, both within and between countries.

First research agendas on the subject [12] argued that focus should be oriented towards increases in investment and funding, as well as building up of institutions and infrastructure - to support science, technology and innovation in and for the interest of less developed countries. This kind of initiatives contributed to significant achievements in time, as the scale of science and technology for development has increased.

However, dimension has proved not to be the most important feature. Due to a combination of factors, as well as socio-political environments and education systems discouraging creativity, innovation and entrepreneurship, globalization does not concur with a widespread reduction of inequalities.

Current pattern and debates about the linkage between science, innovation and development argue that much more attention should be given to the *direction*, *distribution* and *diversity* of scientific, technological and innovative activities [13].

Moreover, education reform should be a top priority, aiming to focus on initiatives which stimulate creativity, sustainability and original thinking. New models of intellectual property protection need to be devised in order to stimulate technology diffusion to all areas of the world. Resources should be channelled towards generating new tools and technologies into the hands of people who need them most. Generally speaking, we need social and political environments respecting human rights, freedom of speech, justice and the rule of law, as without these kinds of reforms sustainable development initiatives are less effective [14].

As stated by “A New Manifesto”, a new critical global politics of innovation is needed, requiring fundamental redistributions

of attention, resources and power. The result will be a flourishing of a more vibrant and creative diversity of pathways – scientific, technological, organizational and social.

### 3. The Relation between Innovation and Sustainable Development in European Union Countries

Both innovation and sustainable development are difficult issues to measure and there is no one method agreed upon, as both are very complex, multi-dimensional concepts.

Still, there are different systems of measuring and evaluating the level of sustainable development or the innovation performance at country level.

#### 3.1. Research Methodology

In order to establish the research sample – two groups of EU countries: one group of countries appreciated as more sustainable developed and another group of EU countries considered less sustainable developed, we approached the following methodology. We took into consideration the country rankings according to two of the most relevant indicators of sustainable development: Human Development Index (2011 Ranking) [15] and Environmental Performance Index (2010 Ranking) [16].

In the research sample of the group including more sustainable developed countries we chose to include the countries found in both of the rankings, considering the top 10 EU countries in each ranking. Thus, these countries are: Austria (AT), France (FR), Germany (DE), Netherlands (NL) and Sweden (SE).

Applying the same procedure, but choosing the countries found in both of the rankings among the 10 EU countries with the lowest scores (at the bottom of the rankings), we established the research sample of the group including less sustainable developed countries: Bulgaria (BG), Estonia (ES), Hungary (HU), Malta (MT), Portugal (PT) and Romania (RO).

In order to evaluate the innovation performance of the selected countries and to highlight the type of connection with their level of sustainable development, we took into consideration the results presented by

The Research and Innovation Union Scoreboard 2011 [17].

This report provides a comparative assessment of the innovation performance of EU countries, based on The Summary Innovation Index (SII), which distinguishes between three main types of indicators, measuring eight innovation dimensions (*Enablers*: ‘Human resources’, ‘Open, excellent and attractive research systems’, ‘Finance and support’; *Firm activities*: ‘Firm investments’, ‘Linkages& entrepreneurship’, ‘Intellectual assets’; *Outputs*: ‘Innovators’, ‘Economic effects’) with a total of 25 different indicators.

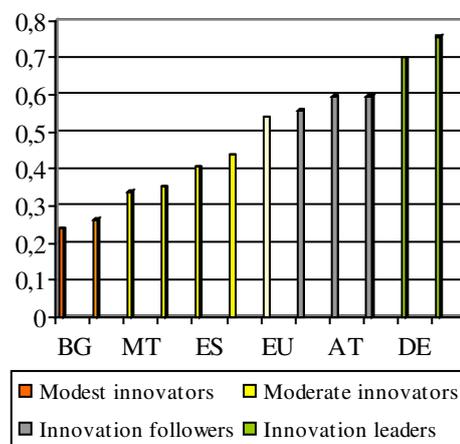
For data interpretation we used methods of analysis and synthesis, of interpretation and relevant comparisons.

Although providing a synthetic, relevant imagine for the connection between innovation and sustainable development, the research methodology generates some limitations, as the dimension of the analyzed groups of countries and the research character might not lead to generalised results. However, it may be a starting point for further research, by analyzing other dimensions of the topic using complementary methodology.

#### 3.2. Research Results

For the selected countries, innovation performance is presented in Figure 1, as follows.

Figure 1: Innovation performance of the selected countries (SSI 2011)



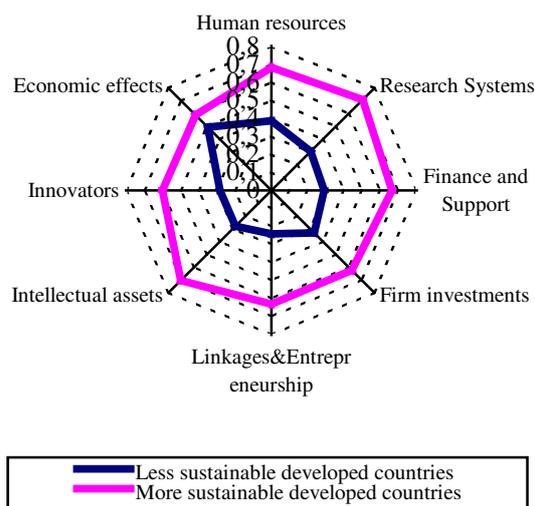
All investigated countries in the group of those more sustainable developed score

above the EU average and place themselves as innovation leaders (Sweden – the highest score in EU, and Germany) or innovation followers (Netherlands, Austria and France). Innovation leaders and followers share a large number of strengths in their balanced national research and innovation systems, with a key role of business activity and public-private collaboration, reflected in their level of sustainable development.

Also, all investigated countries in the group of those less sustainable developed score below EU average and place themselves as modest innovators (Bulgaria and Romania) or moderate innovators (Malta, Hungary, Estonia, Portugal), being characterized by unbalanced research and innovation systems, with impact and consequences for their development.

In order to identify the strengths and the weaknesses of the research and innovation system of the selected countries, in correlation with their level of sustainable development, we present their innovation performance according to the eight dimensions mentioned above (Figure 2).

*Figure 2: Innovation performance per dimension of the selected countries (own calculations according to SSI 2011)*



The investigation of the selected countries regarding their innovation performance per dimension highlights that all countries in the group of those more sustainable developed

prove relative strengths in all of the eight dimensions, with the highest scores for “Research systems” and “Intellectual assets” indicators. This demonstrates their interest and capacity in building open, excellent, attractive research systems, as well as in supporting development of intellectual capital, both reflected in the outputs of the innovation activity, given also the high level of human resources qualification.

The investigated countries in the group of those less sustainable developed, for all dimensions score much lower than those in the group of more developed countries. The lowest scores are registered for the following indicators: “Linkages& entrepreneurship”, “Innovators” and “Finance and Support”, suggesting weak linkages between the science base and enterprises, insufficient and/or inefficient use of R&D funding, particularly reflected in the very low shares of SMEs introducing product or process innovations, as well as SMEs introducing marketing and organization innovations.

The most visible differences between the two groups of the selected countries are recorded for the following dimensions: Intellectual assets, Research systems and Finance and Support, all reflecting weaknesses at the level of inputs for innovation performance.

Our analysis, as presented above, emphasizes the strengths and the weaknesses of the innovation systems in the investigated groups of countries, suggesting the key factors of success in generating innovation performance. Thus, one of the priorities aims the reform of the research system, for a better administrative capacity and infrastructure, for making it more attractive to quality human resources. Increasing the volume of funding and financing for research, development and innovation (public or private) is also very important, but more important is their efficient allocation and use. Another engine of the innovation mechanisms comes from the private sector; therefore, it is necessary to strengthen innovation capacity of companies by stimulating applied research for innovative products and services, by improving cooperation between industries and research centres. One of the solutions is partnerships and scientific collaboration, supported by a creative friendly environment.

#### 4. Conclusions

Generating and using knowledge is a vital source of sustainable development. Knowledge creation and innovation generate the emergence of new ways of thinking, new approaches and new solutions, which influence our thinking, acting and living sustainable.

Our research points out that countries with more sophisticated innovation systems are placed in the top of the rankings for sustainable development, while countries with weaker innovation performances have lower scores of sustainable development.

To support sustainable development, knowledge and innovation systems need open, flexible, performant research systems, better and more efficient financed, as well as supporting innovation initiatives and activities in the business sectors, both interconnected through partnerships and scientific cooperation. All these work as engines for change in the new development paradigm, to address both present and future challenges.

#### 5. Acknowledgements

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## Decent Incomes in the European Union

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### Abstract

*Income is one of the basic pillars of the global economic system. Whether it is salary, profit, dividend, interest rate or rent, the main purpose is to obtain an income as big as possible.*

*Current open market economy lead to the fact that incomes considered satisfactory just a few years ago, became today insufficient. Changes in the availability of natural resources, national and international economic context, inflation, unemployment, fiscal policies, Griffen and Veblen effects and a lot of other factors of different nature determine the reducing of purchasing power of money, subjecting income to a range of pressures.*

*The risk of poverty, exacerbated by the international economic recession, has led the international organizations to pay special attention to this macroeconomic segment.*

**Key Words:** work, income, risk, poverty.

**JEL Classification:** E24, J31, J83.

### 1. Introduction

The world is permanently changing, economic conditions evolving independent of the general-human will, which follows continuous economic development. Contrary to the wishes of all, the cost of living follows an upward trend, not always correlated with the income trend.

The general characteristics of global income are divergence and diversity. Thus, in some parts of the world if a particular activity is remunerated with a sum of money, in other parts, the same activity can generate a revenue much different.

Although the starting point of this problem is the standard of living specific to each economy in part, its effects have manifested at multidimensional level, economical, social,

demographical and educational, affecting the society as a whole.

### 2. The concept of „decent work”

The concept of "decent work" was developed by the International Labor Organization (ILO) in 2000. At the Millennium Summit it was adopted the Agenda for Decent Work. The term "decent work" contains a international objective in order to support the improving of working conditions, beyond the fundamental social rights, regarding these two issues separately.[1] In conjunction with the elimination of discrimination at work, guarantee of social protection, abolishing exploitation, ensuring a good dialogue with unions, decent work focuses on the ensuring of decent wages for workers and their families, allowing them a decent living.

Although brought in discussion recently, this concept has its source in art. 23 of the Universal Declaration of Human Rights adopted on 10th of December 1948 by the UN General Assembly which states: "Everyone has the right to work, to free choice of employment, to just and favorable conditions of work and protection against unemployment. Every people without any discrimination, has the right to equal pay for equal work. Everyone who works has the right to just and favorable remuneration that would provide for himself and his family an existence worthy of human dignity and supplemented, if necessary, by other means of social protection ". [2]

Annually, on 7th of October, it is celebrated the International Day of Decent Work. Although the economic and social world is at a crossroads, the world is faced with a situation that seems apparently paradoxical: although globalization opens new opportunities for economic and technological development there is an increase in the debates and promotion of the quality aspects of this development, its impact on the environment and social stability.

Agenda for Decent Work stipulates the uniformity of the comprehension of "decent

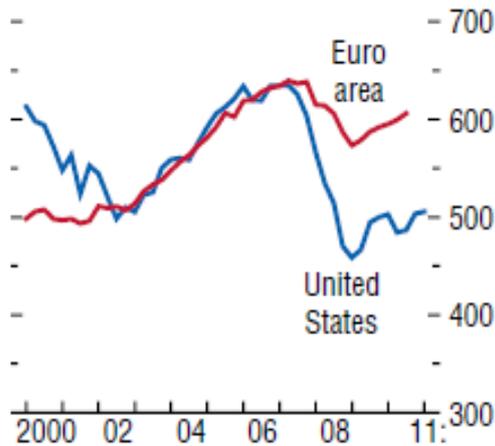
work", all the measures managed by now in this project standing at a conceptual level. Its medium term goal is to achieve a single system in order to assess all the progresses of the participating countries in implementing the principles of decent work. [3]

### 3. Romania in European context

In David Copperfield by Charles Dickens, one of the characters, Micawber, says: "The annual income is 20 pounds, annual expenditure is 19.96, results happiness. Annual income is 20 pounds, annual expenditure are 20.06, results mess." [4]

"Decent" is a purely subjective term. If a so-called average value is higher than what a household earns, then that value is the decent, the desirable one. In modern terms, if the annual expenses are less than the income, you have a good life. People can always spend more than they have and then consider themselves unhappy with their own revenues.

Figure 1: Household Net Income (2011)



Source: World Economic and Financial Surveys, International Monetary Fund, Press Report Release, September, 2011.

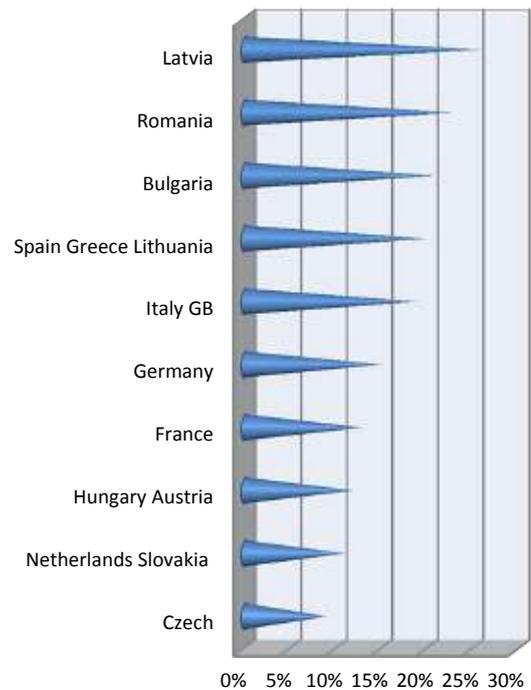
As shown in Figure 1, incomes had an upward trend during 2002-2006. The year 2007 was marked, in addition with the world economic crisis, by a deep reduction of incomes. This can be explained, in conjunction with many other elements, by the continuous migration of multinational companies. Their goal is to achieve minimum production costs. This is a generally true fact, but it was overly stressed by the economic crisis. Thus, different countries with developing economies are permanently competing to be chosen as the location for various suppliers in order to

provide cheap workforce and other favorable conditions for businesses, but often disadvantageous to workers.

In conjunction with this issue, ambiguous legislation may offer the possibility to be violated. Therefore, to achieve the proposed targets, multinational companies are constantly relocating. Initially, they relocated within the European Union, then in developing countries outside the EU, depending on the country that offered the "best" conditions.

All these elements lead slowly, but surely, to poverty. According to a Eurostat survey 8.6% of EU workers were at risk of poverty, in the year 2010. Therefore, from the whole of 81 million Europeans situated at the risk of poverty, 17 million are workers. [5]

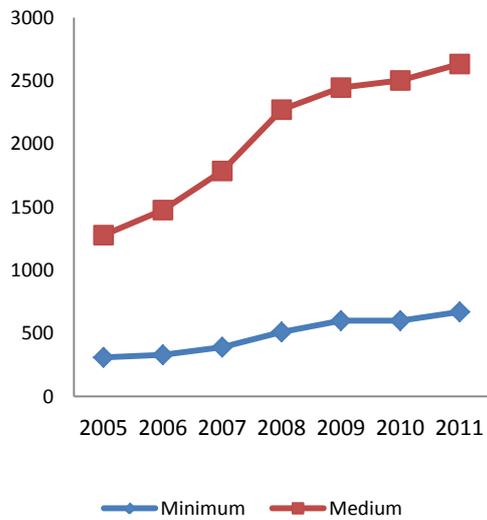
Figure 2: Percentage of the Population With High Risk of Poverty (2010)



Source: <http://ec.europa.eu/social>

Romanian experts in this field say that the number of workers at risk of poverty is 50% of the total Romanian workers; they are paid the minimum wage - 700 lei. "They cannot afford the basket containing those expenditures absolutely necessary for living, shopping cart which we have calculated at about 950 lei. This means that they, the 1,7 million Romanian employees, are living below decent conditions". [6]

Figure 3: The Evolution of Minimum and Medium Gross Wage in the Economy in Romania (2005-2011)



Source: <http://www.mmuncii.ro/statistici-55-view.html>

Between the minimum wage and the average there is an indissoluble connection. The percentage that the minimum wage represents in the average salary is a very widely used indicator. Thus, the European Union has set a target close to a ratio of 50%, concluding that the minimum wage should be half of the medium one.

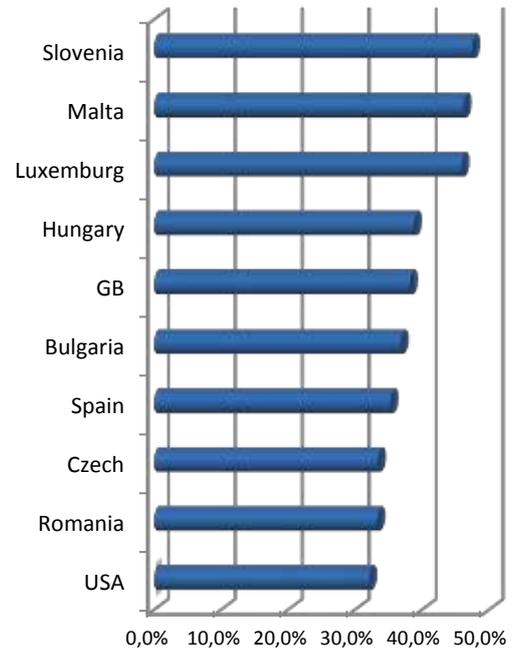
Table 1: Average Gross and Net Wages in Romania in Lei (2005-2011)

Year	Gross	Net
2005	968	746
2006	1146	866
2007	1396	1042
2008	1761	1309
2009	1845	1361
2010	1902	1391
2011	1963	1471

Source: <http://www.insse.ro/cms/rw/pages/castiguri1938>

In 2008, only Malta easily exceeded this percentage. Romania was situated on the last position, with a minimum wage of only 30.5% of the average. In 2010, the countries that were closest to this value are Slovenia, Malta and Luxembourg.

Figure 4: The Ratio of Gross Minimum Wage and the Gross Average Wage in the Economy (2010)



Source: [http://epp.eurostat.ec.europa.eu/statistics\\_explained](http://epp.eurostat.ec.europa.eu/statistics_explained).

The degradation of the European economic situation in the conditions of the global economic crisis made the target of 50% impossible to reach; nowadays no EU member state does not approach this percentage.

#### 4. Romanian legislative regulations

In Romania, stipulations relating to remuneration are set by the Constitution and Labor Code. Thus, art. 41 of the fundamental law of the country contains provisions regarding the right to work and the right to be remunerated. Article 41 - Employment and Social Protection of Labor states that: "The right to work cannot be restricted. The choice of profession, trade or occupation, and employment is free. Employees have the right to social protection. These rights regard the health and safety of employees, working conditions for women and young people, establishing a minimum gross salary per economy, weekends, paid holidays, work in special conditions or special training and other specific situations, established by law." [7]

According to art.154 from the Labor Code, the salary represents the consideration for the work of the employee, according to the individual labor contract, and for his work,

each employee has the right to earn a salary expressed in a specific quantity of money.[8]

The gross guaranteed minimum wage in Romania is 700 lei as of 01/01/2012, which corresponds to a net income of about 540 lei. Therefore, 18 lei per day will provide an individual and his family a decent living, which includes at least 3 meals per day, rental costs, facilitate maintenance, clothing, footwear, transport, etc. Suitable with the Universal Declaration of Human Rights, which states "the right to just and favorable remuneration that would ensure both the individual and his family an existence worthy of human dignity", in conjunction with the situation in Romania, mentioned above, but also with the fact that decent living is an abstract and absolute subjective term, in own opinion, I consider that any conclusion in order to analyse this information results directly from the mentions above.

## 5. Conclusions

In the current economic and social context, there are substantial concerns about the evolution of global revenues, about both short term consequences on employers and long-term consequences on workers and their families.

In the European Union, Bulgaria and Romania have the biggest poverty risk among the population, defined by the strategy Europe 2020. However, both countries are represented in an European study by at least one city in which citizens have an optimistic view on the perception of poverty, considering that this risk is minimal. On the other hand, in Belgium, considered among the countries with decent and very decent income, poverty is seen as a significant problem for most people.

Closely related to the income, Romania is facing different problems. These problems include the existence of high unemployment rate - along with Spain, southern Italy, Greece, Poland, Hungary, Bulgaria and Malta and the largest number of citizens living under the poverty line (severe lack of material resources) 32% of population, along with Bulgaria, 42% of the population.

Aside from these, it is developing an increasingly more pronounced difference in poverty risk between rural and urban areas; for example, 40% of the country population in Romania has difficulties accessing primary health care, compared to 15% in the city, a weakness point being also considered the

decrease of birth rate, along with Hungary, Croatia, Bulgaria and southern regions of Italy.

There is a number of organizations worldwide, international, national and regional which deal with the evolutionary aspect of income. International Labor Organization has paid attention to the implementation of common consistent and realistic social and economic policies. Developing and actively supporting the project Agenda for Decent Work is intended to be an alternative to global sustainable development, aiming the integration of this chapter in the whole of social and economic issues which the countries of the world are faced with.

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## Analysis of Banking Integration Degree in Romania

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### Abstract

*The process of economic integration between Romania and the Euro area has supposed the emphasis both of the trade and the financial linkages between these economies, especially during the period 2003-2008. Prior to the economic crisis, the foreign financial flows in have generated a fast increase of the non-governmental loan which determined the increase of the private consumption, investments, imports, respectively of the current account deficit and of the foreign private debt. The economic crisis started in 2008 emphasized the significance of the financial channel for the transmission of shocks as the increase of the Romanian economy's foreign exposure supposes additional financial flows to finance the service of debt. In order to assess the economy's degree of exposure to the financial shocks we have determined the degree of banking intermediation in Romania and the degree of banking integration with the economies of the Euro area.*

**Keywords:** real convergence; banking intermediation; non-governmental loan; exposure to shocks; financial crisis.

**Jel Classification:** F41; F42

### 1. Introduction

The financial integration constituted an opportunity in supporting the process of convergence of the Central and Eastern European countries during their expansion period, but it can also represent a threat due to the problems generated by the sequence of

crises within the Euro area. The financial flows which the emerging economies benefited from increase their financing dependence on foreign banks, especially from the Euro area, and this also generated their vulnerability to the financial shocks. This evolution is in compliance with the neo-classical view upon the effects of the economic integration. Thus, the decrease of constraints regarding the capitals circulation determines the capital owners to react according to incentives and to prefer the emerging economies in which the rhythm of increase for the profit is higher than in the advanced economies [16]. Thus, the emerging economies will record faster economic growth rates under the terms of emphasis of the current account deficit and of the increase of the foreign debt. The service of debt will be able to be easily financed as long as a withdrawal of capital to the original economies will not occur [11]. The attractiveness of the CEE economies has not been generated by their fast increasing potential only but also by other factors such as acceding the European Union, the liberalization of the capital account, the perspective of accession to the Euro area and the presence of foreign banking entities in this economies [6], [7]. The financial flows attracted by the emerging economies do not have the same degree of risk, the foreign investments making the emerging economies the least vulnerable [2], [12]. Thus, the entries of foreign direct investments in the CEE economies contributed to encouraging both of the economic growth and also of the structural convergence with the European Union under the terms of the changes which are specific to the sectoral structure and to

the trade structure. Moreover, the foreign direct investments constituted a stable financing source for the increasing current account deficit during the economic boom period. The economic literature asserts that the bank loans coming from foreign sources prove a high probability to be stopped during the economic recession periods – the emerging economies suddenly become extremely risky and the parent banks will reduce their exposure with respect to those economies [1]. Along with the increasing presence of the foreign banks in the CEE economies, a phenomenon of fast loans increase occurred, especially in the economies recording a low degree of financial inter-mediation at the beginning of the period, as it was the case of Romania, Bulgaria and the Baltic States [4], [5]. On the one hand, this process has been considered a normal one, being necessary to reach the intermediation levels recorded by the other CEE economies or by the countries within the European Union, and on the other hand it became excessive, thus determining the overheating of the beneficiary economies and the emphasis of the macroeconomic unbalances [9]. When the second perspective became significant, the central banks interfered and adopted measures to limit the expansion of the loans [3], [8]. However, the efficiency of these measures has been interpreted as a reduced one as they generated limited effects only upon loans. According to IMF, approximately 75% of the economies which recorded boom periods for loans also recorded banking crises or foreign currency crises, and the consequence is a tough landing after an expansionary period based on foreign savings [10].

In the first section of this study we have compared the structure of the financial-banking system from Romania with that of the other CEE economies and with that of the advanced economies from the Euro area. The objective was to determine the gaps among the degree of banking concentration, the degree of financial intermediation and the degree of exposure of the bank financing. If the differences between these indicators are bigger, a shock upon the financial banking sector (such as the financial crisis) will determine more asymmetric effects for the private economic agents from Romania and from the Euro area countries. However, there

is another factor increasing the relations between the banking systems, namely the increase in the share of the domestic bank assets owned by banks coming from the Euro area countries, and this aspect has been analyzed in the second section of this study. Its increase generated the emphasis of the financial relations, thus balancing a part of the gaps referring to the structure of the banking system.

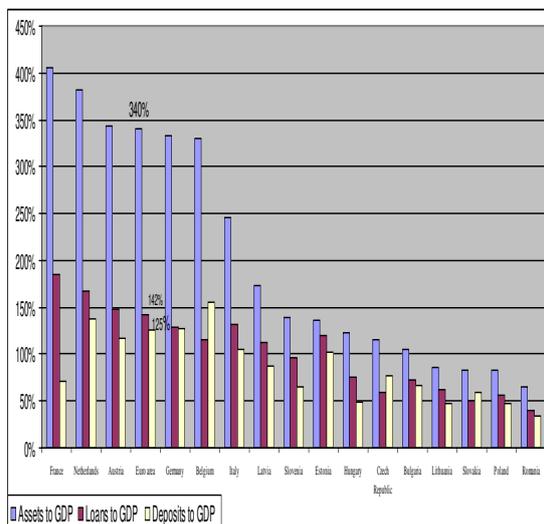
## **2. The features of the Romanian Banking System. Comparative Analysis**

Romania is characterized by the lowest degree of financial intermediation (determined at a share of the loans/assets in the GDP) in the European Union, in spite of an extremely high rhythm of increase of loans during the period 2001-2008. As for the financial-banking integration, more than 80% of the bank assets from Romania are owned by banks belonging to economies from the Euro area, respectively EU-27. The result is that there is a potential symmetry with the financial shocks which influence the economies with exposure upon Romania, but this creates the probability of occurrence of significant contagion effects upon the bank financing in the Romanian economy. If before the economic crisis from 2008, the presence of foreign capital in the domestic banking system was considered as an opportunity for the Romanian economic growth process, at present, this may constitute a threat to the economic re-launching under the terms of the decrease of capitalization achieved by the parent banks.

The degree of financial intermediation, calculated according to the share of the assets, loans and deposits in the GDP of the banks activating on the Romanian territory, continues to be much below the average of EU, of the Euro area and even below the values recorded by the new member countries. Thus, in 2010, the share of the bank assets in the GDP was of 65%, the share of the loans in the GDP was of 40%, and the share of deposits was of 34%. Generally, the highest values of financial intermediation degree are recorded by the advanced economies of EU, respectively of the Euro area. As for the entire Euro area, the share of the bank assets in the GDP was of 340% in 2010, that of the loans was of 142%, and that

of the deposits was of 125%. As for the CEE countries, the average bank assets were approximately equal to the GDP, while the loans were approximately 65% of the GDP (figure 1). As for the new EU member countries, there are also a few exceptions regarding the direct relation between the level of economic development and the degree of financial intermediation. Thus, two of the Baltic economies (Latvia and Estonia) have bank assets by 74%, respectively 36% higher than the GDP, and the bank assets from Bulgaria are approximately equal to the GDP from 2010. With reference to the loans, the two Baltic economies are quite close to the level recorded by economies belonging to the monetary union, such as Germany or Belgium. Even though it has a low degree of financial inter-mediation, Romania is characterized by a quite high share of loans in the total bank assets. This indicator recorded an increase in all the CEE economies, considering that it decreased up to the level of the entire Euro area, becoming stabilized at approximately 43% during the last five years.

Figure 1. Degree of banking intermediation in the CEE countries and in the Euro area core countries

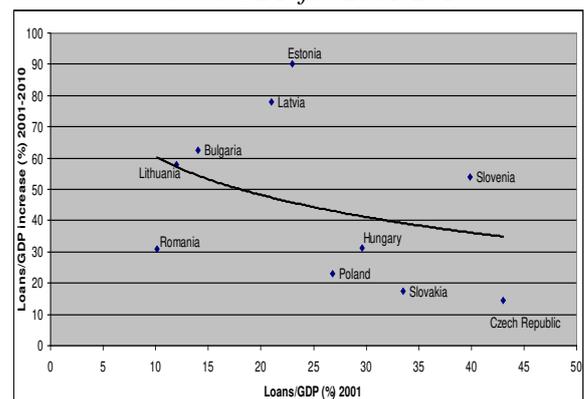


Source: CEE Banking Sector Reports 2006; 2009; 2011

As for the CEE economies (as an average), there was an inverse relationship between the share of the private loans in the GDP in 2001 (considered as reference year) and the increasing rhythm of this indicator during the period 2001-2010, according to figure 2. Thus, economies such as the Czech Republic

and Slovakia recorded a slower rhythm in increasing the share of the loans in the GDP, considering the quite high initial values of this indicator. On the contrary, the degree of financial intermediation recorded by the Baltic economies, Bulgaria and Romania are mostly due to the increase of its value during the last ten years, thus increasing their vulnerability, in case of decrease of foreign capital flows. It is not an accident that these economies, along with Slovenia, significantly contracted during the first year after the occurrence of the economic crisis. Generally, most of the CEE economies recorded the highest dynamics of loans during the period 2005-2008, when the degree of financial intermediation increased by 17.6% in Romania, by 30.1% in Bulgaria, respectively by 33.4% in Slovenia. An exception is the Baltic economies which recorded a higher dynamics during the period 2001-2005. Starting from 2008, the rhythm for the increase of loans decreased below 10% in most of the CEE economies, and this resulted in the restriction of the banking intermediation degree. Poland recorded increases of loans exceeding 13% during the period 2008-2010, and the increase of the inter-mediation degree was higher than that recorded during the period 2005-2008.

Figure 2. Evolution of the share of private loans in the GDP for 2001-2010

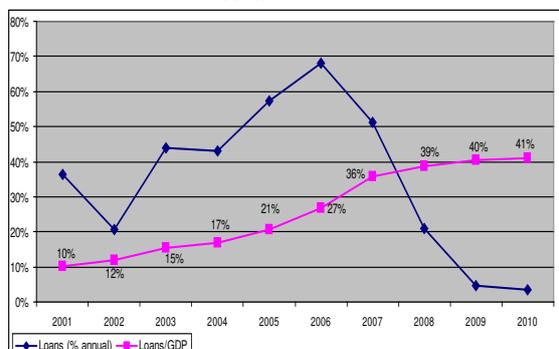


Source: CEE Banking Sector Reports 2006; 2009; 2011

The low level of the financial intermediation from 2010 (calculated as a share in the GDP of the non-governmental loan given by the domestic loans institutions) may be explained by the occurrence of initial conditions characterized by a difficult access to loans of the Romanian private economic

agents. Under the terms of a high inflation rate and of a low macroeconomic stabilization, the share of loans in the GDP was of 10.1% of the GDP only in 2001, and the loans to the population was of 7% of the total level of the non-governmental loan only (figure 3). During the period 2003-2007, the rhythm of increase for loans was of more than 40% per year, generating doubling of the intermediation degree in 2005, respectively in 2008. As a consequence, the annual variation of the loans induced certain vulnerabilities to the Romanian economic growth process, which materialized in the tough landing started in the 4<sup>th</sup> quarter of 2008. The relation between the evolution of loans and the economic growth process is a two-ways one. Thus, the increase of revenues resulted in an increase of financial reliability of the possible customers, respectively in optimistic expectancies regarding the macroeconomic evolution, which generated an increase of loans, which also encouraged consumption and investments. The apparently virtuous relations have been blocked by the economic and financial crisis, resulting both in the decrease of revenues and also in the decrease of private loans rhythm. Under these terms, the share of the private loans in the GDP has been restricted during the last three years to approximately 40%. In its structure, half is represented by loans given to population and half to companies, and, if considering their purpose, only 5.7% of the loans were on mortgages. The loans given to the population recorded the highest dynamics during the period 2005-2007, when their share in the GDP increased by 2.5 times, to approximately 18%.

Figure 3. Evolution of the private loans in Romania



Source: CEE Banking Sector Reports 2006; 2009; 2011

The main determinants in the evolution of the non-governmental loan during the last three years have been influenced both by the offer and also by the demand of loans. With reference to the offer, it is a matter of persistence of aversion to risk of the banks, as a result of accumulation of a high volume of non-performing loans and of the negative influence upon the profitability indicators exercised by the costs associated to provisions. We should not pass over the impact of increase which is 4 times higher than the governmental loan during the last 4 years, which induced the orientation of the banks' resources not towards the real economy but towards the coverage of the budget deficit and of the service of public debt. As for the demand, the non-governmental loan has been negatively influenced by the contraction of the population's revenues, as a result of the measures adopted in order to achieve the fiscal consolidation, and also of the persistence of the uncertainties regarding their level during the next period. Moreover, the private economic agents proved a higher caution in managing their available financial resources and the effect of this attitude was the restriction of consumption and the increase of saving tendency.

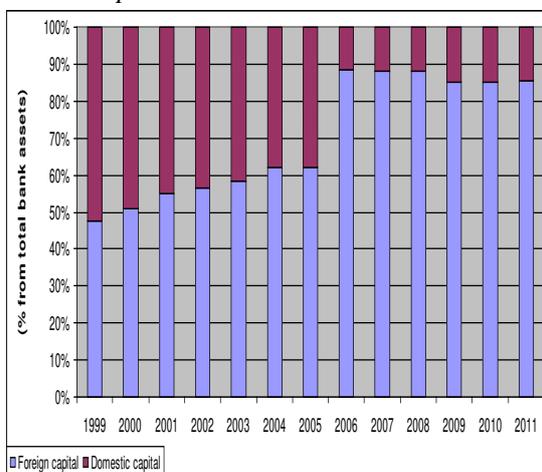
The fast increase of the private loans, with rhythms which even exceed 50% per year, induced certain vulnerabilities both to the banking system and also to the real economy. Some of them were increased by the majority share of the foreign bank capital in the domestic one, respectively by the higher share of foreign currency loans if compared to those in the national currency. The vulnerabilities specific to Romania were exceeded in intensity by those of the Baltic economies, however being less present in the Czech Republic and Poland.

### 3. Exposure of the Romanian banking sector

In the CEE economies, the banking sector is mostly owned by the banks with foreign capital, as they own more than 80% of the total bank assets in Hungary, Slovakia, the Czech Republic or Romania. In Poland, the share owned by banks belonging to the state is approximately 34%, while in Slovenia,

their share increased as a result of recapitalization, reaching approximately 63% of the total assets. As a consequence of the privatization of the Romanian banking system, the share of the foreign capital in the total domestic bank assets became a majority starting from 2000. The increasing tendency recorded for the share of the foreign capital became moderately higher until 2006, when, along with the privatization of the BCR, it increased, in an accelerated manner, reaching 88% and becoming stabilized to approximately 85% during the period 2009-2011, according to figure below.

Figure 4. The share of the foreign capital in the bank assets in Romania



Source: NBR database, 2011

As for the foreign capital stock invested in the Romanian bank system, there is a high exposure on Greece, Austria, the Netherlands and France. If compared to 2000 year, the share of the foreign capital stock owned by Austrian banks recorded the highest increase, reaching a maximum of 30% in 2008, and then decreasing to 21% in 2010. The Greek capital remains the majority (30 percents) with reference to the banks with foreign capital, however proving a decreasing trend, the same trend being followed by the representatives of the Austrian (21 percents) and French (4.3 percents) capital. The share of the Netherlands capital in the total foreign capital recorded a significant increase during 2010 (up to 15 percents), due to the supplements given when setting up the GE GarantiBank S.A. Subsidiary in May 2010.

Referring to the market shares, outlined by the share in the total Romanian bank assets,

the banks with Austrian capital continues to have the highest market share in the aggregate asset (38.8 percents), being followed by those with Greek capital (15.5 percents). In 2010 the banks from France had a share of approximately 15%, and those from the Netherlands of 14%, while the share of the Romanian bank capital in the total bank assets was of 14%. Greece records the highest market share in Bulgaria and in other Southern European economies, while in Poland, Hungary or the Czech Republic there is a more significant presence of banks from Belgium, Italy, Germany or France. In the first two economies, the highest market share is owned by banks with state-owned capital, with 30.9%, respectively 28.8% of the total national bank assets. According to the statistics of the Bank for International Settlements, Austria is the most exposed economy from the Euro area among the CEE economies, as the Austrian banks record 20.6% of the total Bulgarian exposure, 35.4% of the total Romanian exposure, 33.1% of the total exposure of the Czech Republic, respectively 26.7% in Hungary and 5% in Poland. Belgium is the most exposed in the Czech Republic (24.5% of the total exposure), Hungary and Poland, while Germany records the highest exposure in Hungary, with approximately 20.4% of the this economy's total debts.

#### 4. Conclusions

In conclusion, the brief analysis made in this study showed that the CEE economies, including Romania, are highly integrated from the banking point of view with entities coming from the EU countries, especially from the Euro area, which supported the recovery of the gaps recorded during the period 2001-2008. However, they induced a certain dependence of the banks from the emerging economies on the capitals coming from the parent banks, so that 90% of the debts of the banking system from the new member countries belong to banks from EU. Considering the high integration with these economies, the CEE region will be negatively affected by the current situation within the monetary union. Besides the increase of the sovereign risk in some countries, the maintenance of the vulnerabilities in certain European financial

systems may hinder the access to the foreign financing for the domestic banks.

## 5. Acknowledgment

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## Intra-Community Carousel VAT Fraud

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### Abstract

*The carousel fraud regarding the value added tax related to intra-community purchases is an undisputed presence, although unwanted, in the EU space. The mechanism in itself is structured on the transitory current condition for taxation of intra-community exchanges, which supposes, as a rule, the taxation of intra-community exchanges of goods performed between taxpayers, in the destination Member State. When our country adhered to the European Union, part of the economic agents in Romania sought to assimilate the fraud practices regarding tax liabilities, which have been noticed for many years in the EU space. As the phenomenon in itself occurs nowadays, I have proposed to analyze it, although due to the complexity of the phenomenon analyzed, I am aware that the present approach is neither exhaustive nor perfect, but, on the contrary, perfectible.*

**Key words:** fraud, intra-community acquisitions, taxation transitory condition, tax liabilities, reverse VAT charge, recapitulative statement, intra-State statement

**J.E.L. classification:** E62

### 1. Introducing - “Carousel” fraud

This type of fraud is apparently based upon a simple mechanism: the economic operator from the origin country invoices without charge of VAT (since he performs an intra-community delivery, which falls under the category of VAT exempt operations entitled to deduction) and the economic operator from the destination country shall apply the reverse VAT charge for such an operation (because he performs an intra-community acquisition, calculating and recording the VAT related to intra-

community acquisitions to the taxation rate in his country, both as VAT collected as well as VAT deductible, without paying it in reality). Following the performance of the intra-community acquisition, the economic operator involved disappears without having registered, declared and paid the VAT collected related to subsequent deliveries performed on his domestic market. This economic operator is called in the investigation practices of carousel fraud, due to his volatile “phantom” type behavior, as the “missing link” of the intra-community trade.

The carousel VAT fraud regarding the VAT related to intra-community transactions supposes a chain of successive operations of cross-frontier sales – purchases, which are performed within the community market by a group of economic operators that sometimes also seek to exploit, apparently in a legal manner, the differences between the taxation rates practiced by the EU Member States.

#### 1.1. Romanian legislation in such a field

Our country’s adherence to the EU economic structures imposed a series of modifications in the national tax legislation, in order to be harmonized with the European regulations in the field. The modification of the normative content of certain already existent regulations or the insertion of new ones referred to the legislation regarding the value added tax, since it was more alike the national legislation. Due to such reasons, by the modifications incurred to the Tax Code as of 1 January 2007, the following was aimed: the takeover of the community acquis regarding the value added tax in the content of Romanian tax provisions. The novelty of some concepts or mechanisms embedded in such indirect tax aims to accelerate the implementation of community directives. The transposition of VAT related European directives in the national legislation supposed,

in a priority manner, the conceptual definition of the following terms: “intra-community acquisition” and “intra-community delivery”.

## **1.2. “Intra–community acquisition ” and “intra – community delivery” operations**

The intra-community delivery is defined in article 128 paragraph (9) of the Tax Code as “a delivery of goods, which are dispatched or transported from a Member State into another Member State by the supplier or the person that performs the delivery or by another person on their behalf”. Actually, paragraphs 10 – 13 of article 128 of the Tax Code also define a series of cases related to intra-community deliveries, more emphasized on defining the non – transfers that do not fall under the category of intra – community deliveries. Both theoretically and practically, an economic agent from Romania who delivers goods to an economic agent from another EU Member State shall not perform anymore an export operation, but an intra – community delivery. This operation performed by the economic agent from Romania falls under the category of VAT exempt operations entitled to deduction provided that the terms foreseen in article 143 paragraph 2 letter a and paragraph 3 of the Tax Code are complied with and provided that the beneficiary communicates to the supplier in Romania a valid registration code for VAT purposes, which is assigned by the tax authorities from the Member State where he belongs to and in addition, there is a document that makes the effective proof of the goods’ transport.

The economic agents in Romania shall benefit from VAT exempt operations entitled to deduction for intra – community deliveries , even without complying with the terms previously mentioned, solely in the cases exhaustively enumerated in article 143 paragraph 2 letter a points 1 and 2 and letters b, c and d of the Tax Code. Although the general rule sets as principle that VAT payability occurs on the date when the generating fact occurs, and the generating fact occurs when the goods are delivered, pursuant to the provisions corroborated of article 134 paragraph 1 and article 134 paragraph 1 of the Tax Code, in case of intra –community delivery of goods we have an

exception from the general rule, pursuant to provisions of article 134 paragraph 1 of the Tax Code, in the sense that the payability of the tax occurs in the 15<sup>th</sup> day of the month that follows the one when the generating fact occurred, with the mention that the payability occurs upon delivery of an invoice if the invoice is delivered before the 15<sup>th</sup> day of the month that follows the one when the generating fact occurred.

It is very important to retain that pursuant to provisions of article 156 paragraph 1 of the Code, each taxpayer must draft and submit to the competent tax authorities by the 25<sup>th</sup> of the month that follows a calendar quarter, this date included, a revising statement concerning intra – community deliveries, according to the pattern settled by the Ministry of Public Finance, which shall contain the following information:

- total amount of intra – community deliveries of goods exempted from taxes, given the

- terms of article 143 paragraph 2 letters a and d, per each purchaser for which the payability of the tax was issued in the related calendar quarter;

- total amount related to delivery of goods performed within a triangular operation,

- foreseen at article 132 paragraph 5, letter b, which is performed in the Member State where the goods dispatched or transported arrive, per each beneficiary of the subsequent delivery to which a code T is assigned and for which the tax payability was issued in the related calendar quarter.

Pursuant to provisions of article 156 paragraph 3 of the Tax Code, the obligation to submit the revising statement previously mentioned refers only to the periods for which the tax payability for such operations occurs.

Pursuant to provisions of the Tax Code enforceable as of 1 January 2007, a company in Romania that purchase from another company situated in an EU Member State (the goods are transported in Romania), is not obliged to physically pay the VAT involved, but to register it by means of the mechanism called reverse VAT charge (both as deductible VAT, as well as collected VAT), as it results from the corroborated provisions of article 146 paragraph 1 letter e

and article 157 paragraph 2 of the Tax Code, including of methodological norms given for the application of the two legal articles. For that matter, the article 146 paragraph 1 letter e of the Tax Code regarding the terms according to which the deduction right is exerted for the tax related to intra – community acquisitions of goods mentions the purchaser’s obligation to possess a purchase support document and to record the tax as collected tax in the expense account related to the tax period in which the payability occurs.

Article 153 paragraphs 1 – 10 of the Tax Code regulate the general duties regarding the registration of taxpayers for VAT purposes and the main idea is that an economic agent must request the registration for VAT purposes to the competent tax authority within 10 days as of the end of the month when he reached or exceeded the limit of 35.000 Euro. Apart from the persons hereinabove mentioned, the obligation of registration for VAT purposes also comes, according to provisions of article 153 paragraph 1 of the Tax Code, to the taxpayer that is not recorded and that is not bound to be recorded pursuant to article 153, as well as to the non-taxpayer legal person, which intends to perform an intra – community acquisition in Romania over the limit of 10.000 Euro (we have to mention that the related obligation comes before the performance of the related intra – community acquisition). The conditions in which the persons registered for VAT purposes, pursuant to article 153 paragraphs 1 and 2 of the Tax Code, may request to the competent tax authority the cancellation of such a registration are regulated at article 153 paragraphs 5 and 6 of the Tax Code.

### **1.3. Reporting obligations related to intra – community transactions**

Related to those hereinabove mentioned, regarding the registration obligation for VAT purposes, new obligations appear, as follows:

- in case of those persons registered for VAT purposes, pursuant to article 153 of the

Tax Code, they shall submit the VAT related expense account (form code 300), the revising statement (form code 390) and the Intra-State statement;

- in case of those persons registered for VAT purposes, pursuant to article 153 of the

Tax Code, they shall submit the special VAT related expense account (form code 301), the revising statement (form code 390) and the Intra-State statement;

### **1.4. VAT related expense account**

The obligation for the draft and submission to the competent tax authorities of such an expense account comes to all taxpayers registered for VAT purposes, as they are defined in article 153 paragraphs 1 – 10 of the Tax Code. The model and content of such an expense account (also assigned in form 300) was modified and approved by Decree of ANAF President no. 273/2007, following to be used as of the statement of tax liabilities related to month May 2007.

There are some questions regarding the date when such expense account must be submitted. As a rule, from the provisions corroborated of article 156 paragraph 1 and article 156 paragraph 1 of the Tax Code, it results that the due time for their submission to the competent tax authorities is the 25<sup>th</sup> of the following month for the current month (this day included).

By waiver from the general rule, the taxpayers registered for VAT purposes, pursuant to article 153 of the Tax Code, shall proceed to the quarterly submission of VAT expense account provided they comply with the following requirements:

- pursuant to provisions of article 156 paragraph 2 of the Tax Code, the turnover from chargeable operations and/or exempted with deduction entitlement did not exceed the equivalent in lei of the 100.000 Euro limit, during the previous calendar year;

- pursuant to provisions of article 156 paragraph 6 of the Tax Code, the taxpayers registered for VAT purposes who meet the requirements in the hereinabove mentioned paragraph, must submit to the competent tax authorities, by the 25<sup>th</sup> of January (this day included) of the following year, a notification regarding the turnover recorded for the previous year;

Taking into account the legal text, it results that the taxpayers registered for VAT purposes and that fulfill the condition mentioned in article 156 paragraph 2 of the

Tax Code do not have the possibility to choose for the monthly or quarterly submission of VAT related expense account, as they must submit it quarterly and notify it according to the provisions of article 156 paragraph 6 of Tax Code.

Article 156 paragraph 2 of the Tax Code mention the data and information that the VAT related expense account must contain, and the following paragraph indicates the methods to correct the data incorrectly registered in such an expense account, in the sense that it may be corrected by the expense account of subsequent tax period and it shall be registered in the regulations case.

Article 156 paragraph 7 of the Tax Code mentions that by means of the Methodological Norms to apply the Tax Code, the following is settled: the cases in which the tax period for the submission of VAT related expense account is another one than the month of the quarter, and it shall not exceed the calendar year. To this regard, the tax period can be the following:

- semester, if the taxpayer only performs chargeable operations on a maximum period of  
3 calendar months from a semester;
- calendar year, if the taxpayer only performs chargeable operations on a maximum  
period of 6 calendar months from a period of one calendar year;

An extremely important aspect is found in the regulations of article 157 paragraph 2 of the Tax Code and it refers to the cases in which the taxpayers registered for VAT purposes, pursuant to article 153 of the Tax Code, perform intra – community purchases: they shall register in the VAT related expense account, both as collected tax as well as deductible tax, the tax related to intra – community purchases for which the related person is bound to pay the tax.

### **1.5. Special VAT expense account**

The pattern and content of such an expense account type (also assigned in form 300) was modified and approved by ANAF President Decree no. 254/2008, following to be used as of statement of tax liabilities related to the month January 2008.

The obligation to submit such a form pertains to the persons non – registered for

VAT purposes pursuant to article 153, but registered pursuant to article 153 of Tax Code, pursuant to provisions of article 156 paragraph 1 of the Tax Code;

As general rule, which is stipulated by provisions of article 156 paragraph 5 of the Tax Code, the VAT special expense account is only submitted for the periods in which the tax payability occurs, by the 25<sup>th</sup> (this day included) of the month that follows the one in which the operations’ payability occurs.

### **1.6. Revising statement**

Regarding this form, the following questions arise: who is targeted by the obligation of his submission, when does such an obligation occur and which is the legal term to submit the revising statement?

The obligation to draft and submit the revising statement to the competent tax authorities occurs in case of intra – community deliveries of goods (issue that has been previously tackled), as well as in case of intra – community purchase of goods.

Regarding the intra – community purchase of goods, the obligation to submit the revising statement pertains to the persons registered for VAT purposes, both pursuant to article 153 as well as article 153. The related form is submitted by the 25<sup>th</sup> of the following month and it shall contain the following:

- the total amount of intra – community purchase of goods, per each supplier, for which

this taxpayer is bound to pay the tax and for which the tax payability occurred in the related calendar quarter;

- the total amount of goods’ purchase performed in case of a triangular operation, for

which the supplier has assigned the beneficiary taxpayer as a person obliged to pay the tax.

As a rule regulated in article 156 paragraph 3 of the Tax Code, we have to retain that the revising statements are only submitted for the periods when VAT payability occurs for the related operations.

### **1.7. Intra – State Statement**

The new tax regulations regarding the intra-community purchases triggered, as it has been previously mentioned, a series of new obligations that shall determine additional administrative costs for the companies, to this regard, in the category of new obligations we can insert the Inter – State statement. This is regulated by Law no. 422/2006, by Decree no. 747/2007 of the President of National Institute of Statistics, regarding the settlement of value related thresholds for the collection of statistic data regarding the intra – community trade of goods in 2008 and Decree no. 748/2007 of the President of National Institute of Statistics, regarding the Norms concerning the completion of Intra – State Statistic Statement for year 2008.

### **1.8. Ways of carousel fraud performance**

Taking into account those hereinabove mentioned regarding the definition of intra – community delivery and intra – community purchase, registration and reporting related obligations for the persons that perform intra – community transactions, all of them represent the theoretic grounds for eth occurrence of carousel fraud. Next, we shall present a few ways by which such a fraud is being committed.

A first method, which is frequently met in our country and due to which it was called as the classic method refers to the intra – community acquisitions performed by an economic operator from Romania. A company from Romania, registered for VAT purposes pursuant to article 153 of the Tax Code, wishes to make an intra – community purchase from B company, which is located in a Member State. According to those previously mentioned, it results that A company could very well perform the related intra – community purchase, provided it is an honest economic agent acting in good faith and provided that it agrees upon registering its VAT liabilities. In reality, to drive through these tax liabilities, the decisional factors of A company shall found another “arrow” company, that is C company, of which the sole shareholder and administrator is a “puppet”, since the C company is actually controlled by all representatives of A company. Upon foundation of C company, it shall be optionally registered as VAT

taxpayer, but it declares an annual turnover under the limit of 100.000 Euro, in order to benefit from the possibility of quarterly submission of VAT related expense account (form code 300), pursuant to provisions of 156 paragraphs 2 and 3 of Tax Code. Later on, C company performs the intra – community purchases from B company and C company applies for such operations the reverse VAT charge. The merchandises thus purchased are later on invoiced to their real beneficiary, that is A company. For such internal delivery operations, C company hypothetically collects the related VAT and A company shall deduct, using as support document the invoices issued by C company, pursuant to provisions of article 155 paragraph 5 of the Tax Code. The hereinabove mentioned operations have a “precisely determined “service time”, that is a maximum period of 3 months, up to the due date foreseen regarding the duty of C company to submit the VAT related expense account. Just before the fulfillment of such a term, C company shall disappear, without being identified later on and without having registered, declared and paid the VAT collected following the internal deliveries performed by A company. Practically, the “sole object of activity” carried out by C company is the supply of support documents to A company with the purpose of VAT deduction by the latter.

Certainly, the company that commits the fraud is C company. Then another question arises: if A company can deduct the VAT related to supply invoices from its direct supplier, to the involuntary carousel fraud (without realizing it), it is entitled to deduct (and implicitly to compensate or reimburse) the VAT related to upstream operations. From this perspective, each company from the transaction chain related to intra – community operations shall be individually and distinctively analyzed, especially that in practice, between C company (the document supported intra – community purchaser) and A company (the actual intra – community purchaser and the “brain” of the entire mechanism), a series of other trade companies may be interposed (obviously, under different forms of support documents), with the purpose of dissociating the illicit character of the facts and of dissipating the cause liaison between C and A companies.

Taking into account those hereinabove mentioned, it results that the participation in the carousel fraudulent mechanism is not presumed, but it must be proved, starting with the correlative analysis of the cash flows, of documents’ circuit and of the effective route of the products. The relevant clues to this regard are the following:

- the correspondence between the delivery and payment terms are carried out, since the beginning, between the representatives of A and B companies;

- the merchandises are effectively directly dispatched from B company to A company (where they are accepted upon the dispatch date), and their payment is directly made to B company from A company, upon the order of C company;

- the information regarding the means of transport or delegations which are registered on the invoices/ waybills drafted by C company to A company is not real;

- the persons empowered to perform operations in the bank accounts of C company are the representatives of A company, who withdraw amounts of cash money, under different reasons: part withdrawal, payments to individuals according to the purchase tally sheets (obviously containing unreal data), payments of dividends, etc;

- the amounts cashed in the bank accounts of C company from its client A company, returns to A company in a direct manner or by means of other companies, according to certain service provision invoices that do not reflect real economic operations (generally, service provisions).

The second method regarding the carousel fraud is actually represented by an improvement of the one hereinabove mentioned, in the sense that the products finally reach from A to B company, i.e. their initial forwarding agent. This method may be identified with self – generating carousel fraud mechanism, with visible effects over the deduction in the price of the products, which make the object of such a transaction. This mechanism is structured on the fact that the delivery price of A company to B company (we shall take into account the delivery price VAT excluded because when A company sells to B company, A company performs an intra – community delivery, which falls under the category of VAT

exempt operations with deduction entitlement) is lower than the sales price initially practiced by B company to C company. A company may “support” such delivery price from “VAT income” collected following the transactions carried out, in upstream, with C company. Apart from the illegal tax implications in the income pertaining to the consolidated general budget, this method induces distortions (due to the prices) in the companies with evasion behavior (due to the “fake” price practiced on the market).

A third method in such a fraud type refers to simulated deliveries, which are performed by an economic agent in Romania registered with VAT purposes pursuant to article 153 of Tax Code, to an economic agent from a Member State, registered for VAT purposes pursuant to the specific legislation of the Member State he belongs to. To this regard, the company in Romania shall perform an intra – community delivery, it issues an invoice without charging the VAT pursuant to VAT code that pertains to an external economic agent from the community space, but actually he sells the related products on the black market. This method may be performed both by complicity of the external partner (that communicates his VAT code) or without his knowledge (for example, by the procurement of VAT code from different informational means). Obviously, the so – called “inter – community” delivery has to be identified by the economic agent from Romania in the VAT expense account, by the revising statement and by the Inter – State statement (the last one, according to each case, according to the cost limit, as it has been previously mentioned), and the data reported to public authorities in Romania shall be confronted later on with those reported by the external partner to the public authorities in his country. Nevertheless, in such period of time, the economic agent involved shall request the VAT reimbursement and later on, he shall “volatize” (by changing the social headquarters and by cession of his shares to hardly identifiable persons and that generally are not in the country anymore upon the date of tax verifications). We do not exclude that in reality, the converse situation may occur, that is the issue of an invoice by the external economic agent from the community space to

a company in Romania, either with the latter's complicity, or without its knowledge.

In brief, a fourth method, which is situated at the extremely sensitive boundary between legal and illegal (from the standpoint of the probation force) refers to the case in which an economic agent from Romania, registered for VAT purposes pursuant to article 153 of Tax Code, performs an intra – community purchase and declares all operations to this regard from legal point of view. Later on, it registers a very low trade margin and simulates the retail trade by means of electronic cashing devices. Actually, the related products are traded on the “parallel market” for much greater prices than those registered in the accounting evidence sheets (but situated under the market prices for the related products). The damage in such case is recorded in both profit tax as well as VAT (obviously, the one pertaining to the non – declared price difference). The “classic” example to this regard is represented by the intra – community flour purchase, simulating its retail trading (by means of electronic cashing devices, to individuals of whom the subsequent identification is not requested by law, and thus, they cannot be practically identified anymore), but in reality it is sold to different units of bread manufacture and pastry (which, in their turn, shall trade the finished product outside the tax charge area).

## 2. Conclusions

The effects of the measures regarding the confinement of such a field are not very visible. In March 2008, the European Commission adopted a series of proposals with the purpose of, if not eliminating, but circumscribing the phenomena within controllable limits. All related measures are, predominantly, administrative, aiming to strengthen the Inter – State cooperation in the

field and to track in due time eventual dysfunctions, by shortening the reporting period (by the economic agents) of performed intra – community transactions and to transfer between the Member States that information regarding intra – community transactions. Will they be enough to reach to the proposed target? Can we be optimistic given that the VIES monitoring system proved its restrictions in time? Haven't we started from the effect and not from the cause? The time is the only element that can provide answers in such directions, but regarding ourselves, we consider that we must tackle the cause of the phenomena, that is the radical change of the current taxation system by changing the taxation system to the destination with the taxation system at the origin. Nevertheless, for the implementation of such a desideratum, the unanimous consent of the Member States is needed, and from this point, the discussion becomes much more extended, given that certain Member States prove reticence in such direction.

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## Models of Economic Growth. Case Study: Central and Eastern Europe

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### Abstract

*Economic growth is a key concept in developing countries and in designing growth models becoming more efficient. This paper begins by defining the concept of growth, identifying and presenting the factors that contribute to achieving it, and finally the European growth model is outlined for attaining this objective. Given the global financial crisis started in 2008, were analyzed performance of growth models used in Central and Eastern Europe, an attempt to identify causes and effects. Thus, we have outlined three growth models: robust, moderate and a model with economic contraction.*

**Key words:** economic growth, crisis, GDP

**J.E.L. Classification:** E27, F43

### 1. Introduction

Robert Lucas, said that "once people begin to think growth will be hard to think about something else."

Literature attaches great importance to economic growth because it creates the potential to achieve major objectives such as exit from poverty of the underdeveloped countries or contribute to raising living standards in developed countries. To achieve these objectives it is necessary that this increase is accompanied by increased productivity, investment in technology, investment in human capital and correlating macroeconomic policies.

According to the American economist S. Kuznets, economic growth of a country is given by the ability to provide increasingly different economic goods, this capacity is based on high technology, but also on the

institutional and ideological adjustments required.

H.V. Arndt believes that the economic growth means income growth as average per capita, growth measured typically by GDP reported to population.

Economic growth refers to those changes taking place in order to increase macroeconomic results that are not expressed independently but closely with its determinants. Among these factors we mention the human factor (quantity and quality, as human capital), material factors (investment, existing real capital), information-technical factor (currently holds a key role). Growth results are measured through synthetic indicators such as gross domestic product, gross national product, national income (total or per capita).

In economic literature are often used the terms "zero economic growth" and "negative growth". The term "zero economic growth" was first used in a report for the Club of Rome and presented the situation where the absolute economic results and total population registered the same rate of growth per capita that the results remained constant. "Negative growth" shows that situation in which, during a certain period of time, macroeconomic results per capita know a downward trend, maintaining in the normal range a series of fundamental correlations of equilibrium, which requires reasonable compromises regarding efficiency and welfare[3].

Most times, economic growth is regarded as similar to economic development, so it is necessary to point out that the scope of economic development is much higher than the concept of economic growth.

In 1969, Dudley Seers emphasized the difference between growth and development concept. The concept of economic

development is multidimensional, encompassing the living standards of population growth, increasing incomes, reducing poverty and increasing continuous economic opportunities of individuals. So, economic development itself involves growth, there is no economic development process without an increase in long-term of macroeconomic results, but growth is independent of economic development[8].

## 2. The European model of economic growth

In the European model, stability, growth and social cohesion are complementary processes. Thus, macroeconomic policies and cohesion are well designed and underlies sustained economic growth. Also, high economic growth rates lead to economic stability and social cohesion in the long run. A fundamental pillar of sustainability of the European model is rapid economic growth, this model is focused on cohesion[1].

Classical and neoclassical theories of economic science gave a pessimistic nature of science, these theories considering that:

- the economy is stable and tends to full use
- leaves the neoclassical microeconomics models, taking into account the wishes of households, market structure,
- the investments have a short term effect on national income
- savings lead to lower consumption and aggregate demand, thus reducing national income in the short term.

Modern theories are more optimistic, highlighting the importance of technical progress, industrial knowledge. They stress that:

- technological progress is an endogenous variable that responds to market signals;
- there are increasing returns of production factors,
- increasing employment, income redistribution and economic growth are interrelated.

According to this model, institutions and policies governing the market are fundamental to sustained economic growth. The current European economy, is an information economy, information technology, putting the value of hard unconventional exhaustible resources or

inexhaustible, and the potential for knowledge and innovation capacity of human capital.

**Europe 2020.** Europe 2020 contains fundamental targets for the EU aims to achieve the economic and social fields, in 2020, that is during the interval 2011 to 2020, the whole Union. Europe 2020 is the successor to the Lisbon Agenda 2010, which has the same purpose, for the period 2000-2010.

Europe 2020 proposes three priorities for the next decade:

1. *smart growth* – economy based on knowledge and innovation;
2. *sustainable growth* - based on a competitive, clean and efficient economy;
3. *inclusive growth* - based on an economy that will generate higher rates of employment growth and economic, social and territorial cohesion.

Europe 2020 proposes five objectives for 2020. These objectives are:

- a. *occupancy rate: 75% (in the age group 20-64 years) through:* increased participation of young people, participation of older workers and less skilled, better integration of legal migrants;
- b. *total share of funds* (public and private) been allocated to research and development: 3% of GDP;
- c. *trinomial "20x20x20"* reducing greenhouse gas emissions by 20%, 20% energy efficiency or reduced energy consumption by 20%
- d. limit up to 10% of early school leaving rate of the population aged 18-24 years and achieve 40% share of the population completing tertiary education or equivalent and is aged between 30-34 years;
- e. 25% reduction in the number of people at risk of poverty.

Europe strategy 2020 lays down the institutional and economic policy conditions designed to achieve the objectives. These conditions are mainly: to restore macroeconomic stability, redirect public finances to a sustainable development, extensive coordination of economic policies between member states, labor productivity growth.

## 3. Models of economic growth in Central and Eastern

Taking into account variations in the main indicator of economic growth, gross intern product, in Central and Eastern Europe, there are distinguished three models of economic growth: sustainable growth, moderate and economic contraction.

**a. Poland, the strongest economy**

Poland has the highest economic growth, being the only EU country which had no negative growth since the recession.

Poland was the only state that managed to avoid economic Great Depression, and in the last quarter of last year registered the highest growth of GDP of EU countries.

What is the secret of Poland? One is the strength of domestic demand, which in case of weakness may be covered with exports competitive because Poland has a freely fluctuating currency. Poland has also strong links with Germany, the largest European economy, and a young workforce and receptive to new. Also, banking rules to prohibit foreign banks to take capital from Polish subsidiaries to cover losses elsewhere[5].

*Table 1. Main macroeconomic indicators of Poland 2009 – 2010*

Indicator	Poland
Economic growth 2010(%)	3,4
Economic growth 2011(%)	3,7
GDP (2009, billion euro)	310
GDP /capita(2009,euro)	8.131
Budget deficit (2009,% GDP)	7,1
Budget deficit(2009,billioneuro)	22,01
Public debt (2009,% GDP)	51
Public debt (2009, billion euro)	158,1
Minimum wage (S2 2010,euro)	317,58
Local stock market capitalization (billion Euro)	202,6

Source: IMF, Eurostat, INSSE

Poland will continue to benefit from domestic demand and investment growth and see it can be seen in this economy one sweet centers of Europe. Country perspective is attractive if compared to the region and even other emerging countries[6].

**b. Moderate economic growth - Romania, Czech Republic, Slovakia**

Czech economy contracted for the third consecutive quarter, while Romania is back in recession during January-March 2012 as the crisis in the euro area government adopted austerity measures hit domestic demand and reduced exports to Central and Eastern Europe.

Czech Republic, where the government cut spending and increase taxes to reduce the deficit this year of 3% imposed by the EU, has declined more significantly, by 1%, compared with the previous quarter. It was the third consecutive quarterly decline.

In Romania, the second poorest country in the EU, in 2009 economic crisis reached marginal areas of the economy such as services, tourism and tertiary sector, bringing a drop of 6% of Gross Domestic Product (GDP), 2010 was more serious, because there has been collapse of the construction sector and building materials, trained real estate collapse. Other areas affected were the insurance, banking, stock exchange, in a word and the financial sector was accompanied by a remarkable decrease in consumption, which led to a decrease of 10% of GDP this year[4].

In the first quarter of 2012 declined 0.1% compared with the previous three months, after the harsh winter led to the decline in production in January and has affected demand for its exports in the euro area.

In Romania and Bulgaria, where the pre-crisis boom was fueled by capital inflows from foreign banks, which increased domestic consumption, foreign lenders have reduced their exposure, leading to a decline in lending, affecting growth.

*Table 2. Main macroeconomic indicators of Romania and Czech Republic 2009 - 2011*

Indicator	Czech Republic	Romania
Economic growth 2010 (%)	2	-1,9
Economic growth 2011 (%)	2,2	1,5
GDP (2009, billion euro)	139	118
GDP /capita (2009,euro)	12.852	5.390
Budget deficit (2009,% GDP)	5,9	8,3
Budget deficit(2009, billion euro)	8,2	9,79

Public debt (2009, % GDP)	35,4	23,7
Public debt (2009, billion euro)	49,2	27,9
Minimum wage (S2 2010, euro)	311,39	137,3
Local stock market capitalization (billion Euro)	53,6	21,9

Source: IMF, Eurostat, INSSE

The only country that has resisted the trend was Slovakia, the euro area member state whose economy grew by 0.8% from the previous quarter, after opening a new production line at Volkswagen plant in its territory.

### ***c. Economic contraction - Estonia, Lithuania, Latvia, Hungary, Bulgaria***

Preliminary data on the evolution of GDP in the emerging European Union shows that Hungary's economy contracted on an annual basis for the first time since the peak of the global economic crisis in 2009[10].

Hungary, whose center-right government is trying to negotiate to obtain a loan from the IMF and the EU, the economy declined by 1.3%. Analysts warned that fourth quarter data may be revised downward, which would threaten the government estimates regarding the stagnating in 2012[9].

Bulgaria also affected by bad weather and weak euro zone has stagnated compared to the previous quarter and the annual rate of growth rate slowed to 0.5%.

By the start of the crisis, year after year, Estonia, Latvia and Lithuania were among the highest growth rates in Europe. For example, in 2006, Estonia's GDP grew by 11.2% and the economy of Latvia and Lithuania grew by 11.9%, respectively 7.5%. Moreover, unemployment in all three countries was below the EU average[2].

In addition, Estonia's economy is classified as part of the ten "most liberal economies in the world". At the same time, Estonia has adopted the euro in January 2011, while Latvia and Lithuania are cautious regarding entry into the euro area[11].

The global economic crisis, the Baltic economies have become, since 2008, more fragile, from spectacular increases in the previous period to recession: Estonia and

Latvia (until the end of 2008), followed by Lithuania (in 2009).

Since 2009, all three countries face unemployment rates "double-digit": 13.7% in Lithuania, 17.3% in Latvia and 13.8% in Estonia. Also in 2009, GDP decreased by 14.8% in Lithuania, with 18% in Latvia and 13.9% in Estonia, compared to an overall decrease of 3.7% among all countries in the "European emerging group".

Recoveries and returns are expected primarily from Estonia and Lithuania, IMF data for 2010 indicate a real increase of 3.1% in Estonia and Lithuania by 1.3%, while in Latvia the impairment is indicated by one percentage point, country that has responded to pressure from the EU and the IMF through a loan of 7.5 billion euros[7].

## **4. Conclusions**

The current financial crisis started in 2007, we analyzed the performance of European growth models applied in Central and Eastern Europe trying to identify causes and effects that led to economic growth or contraction against a. There have been highlighted three types of models of economic growth: a model of robust growth, sustainable (Poland); model with moderate growth countries (Czech Republic, Slovakia, Romania) and those with an economic contraction (Bulgaria, Hungary, Baltic States).

Being located in a central area and being able benefit both the structural and cohesion funds for modernization, development and attracting Western investors because of the human capital that they have, the countries of Central and Eastern Europe enjoy an advantage competitive compared to other emerging markets. Thus, for the economic recovery, Eastern European countries need to improve their models, either following the Polish model or finding variables that must be followed depending on their economic profile.

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## Analysing Romania’s Performance on Delivering the Economic and Social Targets of *Europe 2020* Strategy

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### Abstract

*After the deadline of the Lisbon Strategy was reached, its’ main objective is still actual, being maintained and promoted by its’ succesor, Europe 2020 Strategy. Employment is the most important component of welfare state policies and it supports both economic and social objectives. One of the most important factors to overcome the economic and financial crisis, starting the year 2009, was employment. Lisbon Strategy since its’ beginning, has been targeted towards acheiving an economic growth and creating new jobs, the EU leaders concentrating their efforts upon the future of economic growth and developing employment strategies post-2010. As a member state, Romania assumed the general targets of Europe 2020 alongside the national development tragets subsumed to this European document on delivering the social and economic target of Europe 2020. This paper presents a brief analysis of Romania’s performances for fullfilling the two flagship innitiavies that have an economic and social nature.*

**Keywords:** Europe 2020, employment, economic objective, social objective

**JEL Classification:** J20, J21, J22

### 1. Introduction

Two years after the deadline of the Lisbon Strategy was reached, its’ main objective is still actual, being maintained and promoted by its’ succesor, *Europe 2020 Strategy*. The political and economic ambition of the EU leaders was summarized inside this new strategy, as a response to the challenges of globalization and aging population,

phaenomena with which EU is faced to the day. The realistic goals set in Lisbon Strategy<sub>2</sub> (2005-2010) – *economic growth* and *employment* – prevented the trap of the first Lisbon Strategy, which was too general.

*Employment* is the most important component of welfare state policies and it supports both economic and social objectives. Social protection expenditures are a result of tax revenues and social contributions paid by the employed population, so the social budget becomes sustainable depending on the number of employed persons on the labour market. Maintaining a long-term unemployment rate, early retirement and a reduced integration of social minorities on the labour market, this mechanism is breakable, due to the increased social spending and decreased social income, which leads to an increasing state debt [10]. One of the most important factors to overcome the economic and financial crisis, starting the year 2009, was employment [2] and globally, since year 2000 there has been an increase in overall employment rate. However, the crisis will show wether this was a structural increase, induced by reforms of the labour markets and social systems, or a conjunctural one, due to the positive macroeconomic developepment [10].

The financial and economic crisis led to the reduction of employment and at national level, the unemployment situation got worse, even though, from a theoretical point of view the unemployment rate is placed around its’ natural trend [9]. Since 2008, when the financial and economic crisis began, milions were left unemployed, situation that brought new pressures on EU’s social cohesion, exposing, at the same time, a set of fundamental thruths about the challenges that the EU faces in this moment of transformation [11].

Romania, as a member state, but also as a EU-candidate, incorporated the Lisbon Strategy objectives and policies inside the national employment policy, being one of the Central and Eastern European Countries where the initial adjustments were visible in real wages and the employment decline was limited. In 2000, the Romanian employment rate was higher than in other CEECs, the average was 63%, comparable to the EU average – 63.4%[8]. Also, as a member state, Romania assumed the general targets of the *Europe 2020* Strategy alongside the national development targets subsumed to this European document [4].

## 2. Theoretical aspects of employment in the context of Lisbon Strategy and *Europe 2020*

Lisbon Strategy since its’ beginning, has been targeted towards achieving an economic growth and creating new jobs, even though its’ core was the creation of a knowledge-based society, the creation of a European Social Model and innovation, the EU leaders concentrating their efforts upon the future of economic growth and developing employment strategies post-2010 [7].

From a theoretical approach, in the specialised literature two extreme views have emerged, regarding the transition to the market economy. The first view states that the main force behind the reform process involves the collapse of the public sector, combined with a slight increase of the private sector, which does not cover the losses of the public sector, but leads to higher unemployment rates and influences other public reforms, by blocking them. The second view states that the main force behind the transition is the rapidly growing private sector, which would be sufficient to absorb redundant workers of the public sector, therefore, the high unemployment rate would be a consequence of a “healthy” process of reallocating human resources [1].

The functioning of the EU market economies is influenced by the “flexibility” of the labour market, allowing it to be associated with rapid reallocation of human resources in the most efficient way possible, being responsible for generating economic growth [5]. For Romania, these factors are highly important, as a result of the reform

process and due to our country’s preparation to access the EU alongside adopting the Lisbon Strategy objectives: reallocating economic activities, open markets, reforming the labour market and restructuring the national business environment.

Romania’s transition to the market economy and the ongoing and dynamic process of integration in the EU, altered significantly the labour demand by decreasing the employment rates and the participation rate to the labour market, resulting the search of possible mechanisms of balance: interregional labour mobility and regional wage flexibility [6].

## 3. Analysing Romania’s performance on delivering the economic and social targets of *Europe 2020* Strategy

The European Commission, through *Europe 2020* Strategy, puts forward two flagship initiatives to catalyse progress in the social inclusion area. First, there is „An agenda for new skills and jobs”, which aims to modernise labour markets and to allow people to develop their skills throughout their active life. This agenda also states to increase labour participation and aims to better match labour supply and demand, including labour mobility. *Europe 2020*’s 7<sup>th</sup> flagship initiative is the “European Platform against poverty”, and its’ main target is to ensure social and territorial cohesion, so that all EU citizen can benefit from economic growth and the creation of new jobs [11].

The *Europe 2020* economic objective states that at a EU level the employment rate should be of 75% of the population, and the social objective plans to reduce the number of people exposed to risk of poverty by 25% as presented in the table below.

Table No. 1  
Basic objectives of the *Europe 2020* Strategy,  
by nature

Objective	Objectives Nature	Main Provisions
Employment rate	- economic	- employment rate should be 75% of the EU population (age range 20-64 y.o)
Decrease the number of people at risk of poverty	-social	- decrease the number of people exposed to the risk of poverty by 20 million (25%)

		of the EU population)
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Source: Author’s conception, based on [2], p.32.

Achieving an economic growth generates earnings of the EU citizens, with an immediate impact and decreasing poverty, thus generating high levels of social inclusion. However, if using alternative methods poverty is being reduced (for instance through autonomous growth of social assistance), increases consumer demand but also labour supply from the population. Therefore, analyzing the two goals (economic and social) an indirect proportionality can be observed and their creation is not contradictory [3].

In Romania, the national target was set according to the *Europe 2020* Strategy, under two conditions: first to take into account the starting point in early 2011 and second, the existence of bottlenecks or other restrictions on the performance target. These targets were also determined based on the realistic scenario approved by the Romanian Government and by 2020, our country expects a men’s employment rate of 74.8%, women’s employment rate of 65,5% from the total of Romanian population, which means a total employment rate of 70% of workers aged 20-64 [3]. The fact that our country does not deliver 100% of this objective will not worsen the EU situation, it still delivers 93,3% of it, however, it has no active contribution to the creation of new jobs and increasing the employment rate.

Analysing the Romanian economy and labour market illustrates the reason why these final data were proposed, preventing more ambitious targets. First, there is a moral hazard generated by high and not judiciously public benefits on social assistance, which reduces the opportunity cost of giving up work and leads to a reduced attractiveness of employment, thus affecting the patterns of job search. Second, the mechanism of the collective agreement at national level (established through primary legislation) brings nominal rigidities at economic level, reducing labour market flexibility and preventing rapid and effective redeployment and the restructuring of employment. Third, an important share of the national economy

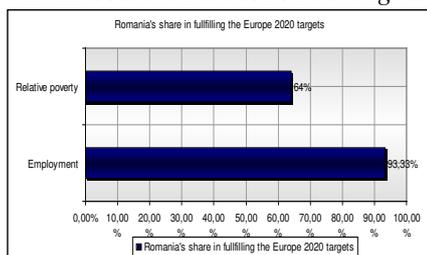
belongs to the black market, therefore, an important part of the actual employment, which is not recored at an official level, remains inconspicuous in terms of the government. The natural consequence of this aspect is that the employment rate of workers reported to the official government institutions is lower than the actual employment rate. On a medium and long term, the government’s lack of ability to solve this issue at an administrative level would maintain a high level of low skilled workers, thereby reducing the effect of increasing employment submitted on labour productivity, reduces the positive correlation between the inclusive growth (affected by the employment rate) and sustainable growth (affected by labour productivity). Fourth, for the ellabouration of curricula for the secondary and tertiary level, there is little anticipation of the labour market demand, therefore, a high rate of inadequacy in the supply of skills is generated. The consequence is that the graduates are rejected on the labour market and a pressure for retraining or upgrading skills through training programmes throughout the working life, is created [3].

The speed for increasing the employment rate in Romania, for workers aged 20-64 y.o is higher compared to the average speed of increasing the same rate at EU<sub>27</sub> level, which means that our country will not generate bottlenecks for achieving the *Europe 2020* target.

In Romania, the target regarding reducing poverty was set at the level of reducing the number of persons that are relatively poor and the Romanian Government approved the pesimistic scnario, which stated that our country could decrease the relative poverty rate by 16.01%, meaning, that for the decade 2011-2020 only 580,000 persons will not experience poverty and social exclusion. These data correspond to 64% from the EU target.

The figure below represents Romania’s performance in fullfilling *Europe 2020* Strategy targets, at a social and economic level.

Figure No. 1  
Romania's share in fulfilling the  
Europe 2020 social and economic targets



Source: Author's conception, based on [2], p. 84.

In Romania, the employment rate had, over the "Lisbon decade" (2000 - 2010) a descending trend, the lowest level of the employment rate was registered in 2002 (63,3%), the national average for this period of time being of 65.975. In 2006 the employment rate grew up to 64.8%. The financial and economic crisis influenced also the Romanian employment rate: by 2009 this was 63.5% and in 2010 its' value was 63.3%, the standard deviation was 3,075 and the variation 9.459.

As a member state, Romania began to modify the laws of employment, in 2011 elaborating a new Labour Code, according to EU's standards. Romania's main challenges are regarding the legal requirements concerning full or partial work, employers having to adapt themselves to difficult economic conditions, which represented a way to overcome the financial and economic crisis.

#### 4. Conclusions

The results obtained by the Lisbon Strategy were modest, and the new *Europe 2020* Strategy aims to answer to the question "Where did Lisbon Strategy go wrong?". This new strategy is optimistically oriented towards the future decade. Close to other documents, that were initially rejected, then redefined and readjusted, also the Lisbon Strategy has its' natural sequel, represented by the *Europe 2020* Strategy, which maintains alive the main objective of the LS, but brings out more realistic deadlines, gives up on an overloaded agenda and conflicting priorities, while enhancing coordination between member states[13]. The main target of the *Europe 2020* Strategy is to create better jobs, welfare and is

concentrating itself to generate a smart, sustainable and inclusive growth in order to offer a new direction for action for the member states[11].

Romania's performances in the economic and social area of this strategy, as a member state, can be improved, by correlating the EU processes to the national ones, that exist simultaneously to these flagship initiatives.

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## Common Agricultural Policy Post-2013: Scenarios Regarding Romanian Agriculture

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### Abstract

*Common Agricultural Policy (CAP), the centerpiece of the European integration, has been considered the strongest common policy of the European Union. However, due to its long history, it has been reformed several times, the most important being McSharry Reform in 1992 and Fischler Reform in 2003.*

*The paper aims to analyze the CAP after 2013 in the view of big European think-tanks as well as the position of the European Commission regarding a new EU agricultural policy. The objectives of the CAP reform are deeply connected to the “EU 2020 Strategy”.*

*The analyze of the Romanian agriculture using different scenarios reveals the fact that the development of the middle, family farm sector is a solution for the convergence with the European model of agriculture and for the development of this important economic branch.*

**Keywords:** CAP, reform, think-tank, agriculture, scenarios

**JEL Codes:** Q18, Q13, F59

### 1. Introduction

CAP has been the most analyzed, debated and controversial European policy. Through its long history of over 50 years, it has been reformed many times (1992, 2000, 2003, 2008).

Despite of that, a new reform post-2013 is compulsory having in view that Health Check is already a matter of past.

In this context, the analyze of Romanian agriculture reveals the fact that it is less developed in comparison to the agriculture of other EU countries and has a dual character

which can be considered an odd feature for a modern European member state.

### 2. Literature review

The paper is related to the national and international research that analyzed these aspects of one of the most important EU policies. The opportunity of a new agricultural policy and the need to carry on the reform has been deeply debated by different member states as well as by Romanian Center for European Policies, Centre for European Policy Studies, big European think-tanks, the European Commission and European Commissioner for Agriculture and Rural Development Dacian Cioloș.

### 3. Research method

The research methodology consists in collecting and analyzing of internal and international data. In order to analyze the Romanian agriculture after 2013 I used the method of scenarios.

### 4. The results of the research

Nowadays, new economic, social and environmental challenges need to be addressed in Europe, agriculture being in the front line for these challenges. This dynamic policy, reformed on many occasions, resulted in a multi-functional policy; though, it has been often criticized for its efficiency in achieving its objectives. The initial objectives have remained unchanged but the importance given to different objectives and instruments used for its achievement have changed radically. Intervention prices are set at low levels, whereas direct payments combined with cross-compliance contribute to

providing basic public goods, delivered through sustainable farming. CAP is facing challenges like: food safety, environment and climate changes and territorial balance. Although CAP has developed, many changes are still needed in order to answer to new challenges like: improving of the sustainable management of natural resources (water, biodiversity, soil), maintenance of competitive spirit in the conditions of globalization growth, recovery of the diversity of agricultural structures and output in EU, strengthening the territorial and social cohesion in the rural areas of EU, increasing the support of CAP for member states, farmers and active farmers. Responding to these challenges, CAP will also contribute to the “EU 2020 Strategy” concerning:

- **smart growth** (by increasing resource efficiency and improving competitiveness through technological knowledge and innovation, developing high value added and quality products, developing green technologies and using information and communication technology, investing in training, providing incentives for social innovation in rural areas and improving uptake of research);
- **sustainable growth** (by maintaining the food, feed and renewable production base, ensuring sustainable land management, providing environmental public goods, addressing biodiversity loss, promoting renewable energies, fostering animal and plant health, increasing resource efficiency through technological development and using results of research, further reducing emissions, enhancing carbon stocks and fully developing the potential of rural areas);
- **inclusive growth** (by unlocking economic potential in rural areas, developing local markets and jobs, accompanying the restructuring of agriculture and supporting farmers’ income to maintain a sustainable agriculture throughout Europe [5])

The Commission’s Communication on the “CAP toward 2020” recommends the following strategic aims: to guarantee long-term food security for European citizens and to contribute to growing world food demand; to provide European citizens with high quality and diversified products, in line with the requirements of natural resources and public health; to maintain viable rural communities, contributing to employment and to territorial balance, the increase of CAP support of member states, farmers and active farmers. Based on these aims, the Commission has formulated three objectives for the future CAP: viable food production, sustainable management of natural resources and climate action and balanced territorial development.

#### 4.1. Different views regarding CAP

In June 2009, at the informal Council in Brno (Czech Republic), in the debate regarding the future of Europe, several European think-tanks were involved, with interests ranging from commercial and international affairs to land use and food security with studies, reports and conferences.

Some of them expressed their position even before that moment, an example being Notre Europe which prepared some years ago several studies regarding the future of European agriculture.

*Groupe de Brouges* (reflection group regarding EU agriculture and sustainable development) launched in 2008 the paper “The dilemmas of globalization” that underlines the multifunctional role of agriculture as well as the fact that conserving landscapes and biodiversity requires public intervention in agricultural production. The core-business of farming is and should remain the sustainable production of food.

Food security and food sovereignty are important matters on Europe’s agenda and on the world’s having in view that the growth of the world’s population will probably be higher than the growth of rate of food production. In a report of a workshop held in Athens (Greece) in April 2011 it was stated that CAP must try and find a better balance of the differences between northern and southern countries, must try to find a way to make small farmers more competitive. There

is a lack of vision, strategy and policy concerning green development, new technologies should be available for all inhabitants of rural areas. There is still a big difference among EU countries to be competitive and market transparency must be improved. Other goals are: an increased quality of products, a safe environment, a sufficient income for farmers. More emphasis should be put on education both for farmers and consumers; policy must be aimed more at keeping young farmers in rural areas, especially in southern and Eastern Europe. There is a too much emphasis on Pillar I. That is why we should give more importance to quality of life issues (Pillar II). The real reform would be a reduction of direct payments/reduction of budget, a new way of thinking about competitiveness, agriculture and food sector. The competition on land is becoming an important issue. Utilized agricultural area represents an important percent, so that there is a lot of pressure on it, both from within the agricultural sector as from outside to use this cheap land for other uses such as housing, infrastructure, industry and recreation. The interconnection with other policy fields in order to increase competitiveness and sustainability is important as well as the role of farmers unions in order to increase horizontal integration of farmers and their role in the CAP. There is a lack of policy instruments within the CAP. We should first make an ex-post assessment of the current CAP measures (cross-compliance, agro-environmental schemes, farm modernization schemes); secondly, we should make an ex-ante assessment of reform proposals. From these assessments we should be able to say whether we need to improve current measures or develop new measures. Criteria to determine levels of sustainability are needed. We need to integrate the cultural dimension in the CAP reform and to find a way to bring an integrate model defined as a integrated strategy (economic, ecological, cultural, educational, etc.). Regarding the territorial balance, its multidimensional character has been provided by geographical mobility, the resulting disequilibrium within an area may be caused by the movement of its population for various reasons. The negative trends within the less favored areas lead to a declining number of

farm holdings that are securing a subsistence level of living and to increasing levels of unemployment. The role of innovation has been of crucial importance for rural areas due to regional imbalances. Rural development activities can contribute to the promotion of innovation in various areas, the role of education and research being stressed in this respect.

*L’Institut Francais pour les Relations Internationales* (reflection centre regarding international affairs) organized in 2008 a seminar regarding CAP, the conclusion being that it represents an appropriate response to the complexity of challenges that agriculture is facing. In September 2011, at the international conference held in Brussels, it was stated that CAP post-2013 should improve the sustainability and long-term competitiveness in the agro-food sector.

*Land Use Policy Group* launched in 2009 its own acknowledgement regarding CAP, focusing on rewarding the environmental services resulting from land management. The new policy should ensure the addressing of climate changes, promote the sustainable use of natural resources, the preservation of biodiversity, the use of new and smarter technologies with a positive impact for the environment, the integration of land management in the economic and social policies, the monitoring of these objectives and the support of the entire land management system; it should avoid the export of environmental problems by developing high international standards.

In June 2010, *SAF Agriculteurs de France*, a French agricultural think-tank, recommended the replacing of single farm payment with an agreement built around an European agricultural contract based on two elements: food security and environmental conservation. This contract will be supplemented by a system of “specific contracts” for those who wish to undertake new measures for environmental conservation. These contracts will be elaborated and negotiated after consulting all of the stakeholders. This fundamental change offers a new chance to the relation between society and farmers through clarifying public spending, to farmers as suppliers of services, to political actors who will find a new action field.

*European Centre for International Political Economy (ECIPE)* had an interesting contribution through its study regarding the winners and losers from CAP reform. The study argues the phasing out of single farm payment and proposes the replacing of the existing structure of CAP based on 2 pillars, with another one containing a public goods pillar (containing all efficient policies to be preserved) and a discretionary pillar (containing all inefficient policies to be removed over time). The paper also assesses the criteria likely to guide future allocation of CAP payments, such as GDP per capita, agricultural and forest areas, areas with Natura 2000 status and estimates the share of member states in total CAP payments under different post-2013 scenarios. This reveals differences between the negotiating positions that countries adopt and the payment receipts they can expect from the reform.

The conservative scenario assumes that two third of the funds should be allocated according to the procedure till 2013 and one third according to the size of agricultural area and to the size of GDP/capita. The progressive scenario reverses these percentages, being less addicted to the past. The scenarios differ through the importance given to the GDP/capita related to the agricultural area. Allocations are equally influenced both by the past and by the combination area/GDP but GDP/capita has a higher contribution in the case of scenario based on a high GDP.

The study with the highest impact - Bureau and Mahe / **Notre Europe** proposes a new vision regarding direct payments, by introducing an integrated system of contractual payments consisting in three levels:

- decoupled payments with a view to maintain the agricultural area;
- payments connected to the natural handicapped areas ( concerning less favored areas);
- "green points" payments for areas which adopt certain production techniques.

It is expected that the redistribution of payments on this basis would allow farms located in areas with a particular social value and in environmentally sensitive zones to be sustainable, to provide the expected

identified public services and to contribute to food diversity. This contractual payment scheme would develop a set of incentives for the delivery of positive externalities on the environment.

The suggestions are made in the way that agriculture should become more competitive, the current payment schemes must be replaced with a simplified and smaller one, public intervention must be maintained to guarantee a floor price (safety net).

On **October 12<sup>th</sup>, 2011**, the Commission presented a set of **legal proposals** designed to make the CAP a more effective, efficient and understandable policy for a more competitive and sustainable agriculture and vibrant rural areas in order to help the farming sector to become more competitive and to deal with the economic crisis and increasingly unstable farm-gate prices. The proposals aim to strengthen the competitiveness and the sustainability of agriculture and maintain its presence in all regions, in order to guarantee European citizens healthy and quality food production, to preserve the environment and to help the development of rural areas. Following a debate in the European Parliament and the Council, the approval of the different regulations and implementing acts is expected by the end of 2013, with a view to having the CAP reform in place on January 1<sup>st</sup>, 2014. The involvement of the Parliament in the process of taking decisions will better respond to the expectations of farmers, inhabitants in rural areas, European citizens in general.

Different points of view recommended, among the main objectives, to preserve the food production potential through the territory of EU in order to guarantee the long term food safety for the European citizens in terms of crisis and to contribute to the growing food demand at global level as well to support the farmers communities that supply the European citizens with quality and diverse food in terms of sustainability, according to the environmental demand.

**Dacian Ciolos**, the Commissioner for Agriculture and Rural Development, underlined in his speech the statements on the key points: better targeted income support, tools to address crisis management which are more responsive and better suited, a “green” payment for preserving long-term

productivity, additional investment in research and innovation, a more competitive and balanced food chain, encouraging agro-environmental initiatives, facilitating the establishment of young farmers, stimulating rural development and entrepreneurship, better addressing sensitive areas, a simpler and more efficient CAP.

#### **4.2. Scenarios for the development of the Romanian agriculture in the period 2014-2020**

##### ***Development of large agricultural holdings***

Subsistence farms disappear gradually in favor of competitive, large commercial farms leading to a significant increase of the middle agricultural area utilized per farm, agricultural activity being focused in the favorable areas for agriculture while the number of less favored areas decrease and might disappear.

*Consequences:* an increase of the agricultural output, a decrease of the population employed in agriculture; the fertile land is intensively exploited, an increase of GHG emissions.

##### ***Development of middle, family farms***

The utilized agricultural area cultivated by farmers representing agricultural holdings between 10-50 hectares increase, supplying local and national markets. Large farms become more market-oriented at international level while small farms concentrate on direct sales, traditional products at national level. In this way, the convergence with the European model of agriculture can be obtained.

*Consequences:* increased agricultural output, a more developed rural area and a more sustainable agricultural sector, young farmers are encouraged to settle in the countryside.

##### ***Keeping the actual model***

The number of small farms remains high while an important part of the utilized agricultural area is cultivated by large commercial farms.

*Consequences:* the contribution of agriculture to the GDP decreases, low quality of the agricultural equipment, any improvement of the food chain, young people tend to migrate to urban area while the population in the rural area is represented by old farmers.

## **5. Conclusions**

Some adaptations appear necessary, in streaming and simplifying the actual instruments as well as introducing new policy elements with a view to a better functioning of the food chain. CAP should put in place instruments in order to protect farmers of extreme volatility.

CAP reform must continue in order to promote competitiveness, efficient use of resources, adoption of appropriate measures with a view to ensure food safety, social and territorial balance in the context of climate change, taking into account the limited budget resources and the economic crisis in agriculture. In this way, it will contribute to building a more sustainable, smarter and more inclusive growth for rural Europe.

For the Romanian agriculture, the development of the middle agricultural sector and the convergence with the European model of agriculture might represent a solution to modernize this important branch of the economy.

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## Romania’s Activity in Community Trademark Registration

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### Abstract

*In the current economy, the competition for attracting new customers on the Community market by gradually removing tariff and non tariff barriers became very strong. Since companies are no longer operating on a small national market, they must pay a particular interest to protect the intangible patrimony in order to be successful. The trademark, part of the intellectual capital of a company, makes products distinguish from each other depending on the manufacturer by using symbols, thus acting on the consumer and providing it with information in the selection process. Trademark registration in the Community system offers broad protection on the throughout the present Member states territory as well as its extension to countries that will subsequently accede the registration. This article aims to make an analysis based on empirical data of the way in which brand holders in Romania have applied for registration in the Community system, class structure, nature and comparison of this data with OHIM’s total activity data.*

**Keywords:** Community trademark, intellectual property, evolution, OHIM

**Jel Classification:** O34, M31

### 1. Introduction

The research subject is to analyse the activity of trademark holders in Romania of trademark protection in the Community system. EC Regulation 40/94 on Community trademark has introduced an unitary system of trademark protection throughout the Member states. The basic characteristics of Community trademark are:

- unitary characteristic – to register a Community trademark one shall submit a

single application; following the favorable settlement one can obtain a single title that offers protection throughout the European Union territory. Therefore, the decisions concerning trademark existence have a unitary characteristic.

- coexistence with the other two systems of protection – the national and the international systems; the protection of the Community trademark system is not compulsory and it exists independently of the national and international trademark systems, but there is certain correlation between the three.
- claiming the seniority of a national trademark by which the holder of an identical national or international trademark may invoke the age of that trademark.
- transforming Community trademark (CTM) into national brand – in order to be registered as a CTM, the acceptance of all national offices of the Member States is necessary, thus the refusal of one of them could lead to rejection. In this case the solution given to the holder to benefit from the filling date or claimed priority is submitting to the national offices that have not refused registration and so transforming the CTM into a national trademark. There are direct benefits, because the filling date and the protection of each country are not lost but the holder loses the trademark unity and the prestige in owning a Community trademark[4].

The system effectively started to function in 1996. Romania became an EU member in 2007 and there is sufficient empirical data to analyze how the trademark owners understood the importance of this system and have introduced it in the development strategy. It should be noted here that trademark proprietors from non-EU countries may require Community trademark

registration. The analysis of these applications may reveal the interest of countries worldwide in the Community market and the importance given by them to protect their own brands.

With the removal of tariff and non tariff barriers to trade, the free market with approximately 350 million customers from 27 Member States opened in front of the companies. Thus trade policy must be rethought. It is very important the way customers are attracted and made loyal. The trademark should be the foundation of this strategy and more precisely, in the context of current analysis, the Community trademark. With an extensive and unitary protection a strong brand can be developed and in the same time it provides the legal bases for economic development.

The way in which trademark proprietors from Romania acted to break into this market and have applied for trademark registration as well as time evolution of those applications will be analyzed below. The data are taken from the OHIM statistics and represent the status at 29.02.2012 [5].

## 2. The evolution of applications and registered trademarks

The applicants for Community trademark registration may be from Member States as well as beyond EU. Relevant for the analysis carried out is the evolution of the applications submitted by proprietors from Romania since the introduction of the system, in the last three years before the accession and the modifications produced after it when all previously registered Community trademarks extended their protection on Romania’s territory.

*Table no. 1. Submitted applications and registered Community trademarks*

Year	CTMs-Submitted applications	RegisteredCTMs
1996	1	-
1997	1	-
1998	5	1
1999	1	1
2000	4	2
2001	4	5
2002	8	4

2003	3	7
2004	29	2
2005	46	14
2006	129	37
2007	315	97
2008	285	189
2009	334	216
2010	411	398
2011	631	335
2012	98	63
	2305	1371

Source: <http://oami.europa.eu>

Data analysis regarding submitted applications for registering Community trademarks shows the following:

- from 1993 to 2003 applications to OHIM were sporadically submitted, up to 8 applications per year in 2002, showing little interest of holders from Romania for EU-wide protection of their trademarks.
- the period 2004-2006 is marked by a percentage rate of growth exceeding in some cases 100% of the number of applications. This is also due to the political changes, accession perspectives had an important role in the interest to apply a development strategy to overcome national borders and be a Community one.
- the post-accession period 2007-2011, except 2008, increases are recorded from year to year, the most significant one being in 2011 compared to 2010, from 411 applications to 631. After accession, Romania as part of EU came into direct contact with the Community system of protection and was more able to notice its benefits.

The number of applications for Community trademark registration gradually increased from year to year with one exception – seen as a percentage. Instead, in terms of volume, the total number of 2305 is low and shows the limited interest of Romania in protecting the trademarks at the EU level. Slovenia, Slovakia, Hungary, Cyprus, Bulgaria are countries with which we can compare our number of applications. As culture of the intellectual property, Romania is an emerging market. Creating a Community trademark requires time, protection is the first step for a future asset

that can bring considerable income. The trademark is inherently an element of trust conveying information within a short period of time through symbols that determine the customer to make the choice.

Globally, intellectual property assets share in the total company value have dramatically increased because of its promotion policy based on strong brands.

There is a difference of 934 between the submitted applications and the registered Community trademarks. This difference has two sources:

- the time required to follow the registration procedure from the time of application pending the decision
- refusal received by some submitted applications after their analysis

### 3. Class structure and number of applications by classes

A trademark can be registered for at least one class and at most 45 classes, according to Nice Classification. The 2305 application filled by Romanian proprietors requested protection for a total of 6676 classes, representing an average of 2,90 classes/application submitted. This can be explained by the fact that the standard tariff for a trademark registration allows applying for three classes, for each class beginning with the fourth one must pay an additional cost.

*Table no. 2. Top 10 classes with the most applications submitted by the proprietors from Romania*

1-35. Advertising, business management, business administration, office functions.	1127
2-30. coffee, tea, cocoa and coffee substitutes, rice, tapioca, sago, flour and preparations made from cereals, bread, pastry and confectionery, ice cream, sugar, honey, treacle, yeast, baking powder, salt, mustard, vinegar, sauces(condiments), spices, ice.	410
3-39. Transportation, packaging and storage of goods; travel	406
4-29. Meat, fish, poultry and game, meat extracts, canned, frozen, dried and cooked fruits and vegetables; jellies, jams, compotes, eggs, milk and dairy	404

products, oils and fats.	
5-42. Scientific and technological services as well as research and design services relating thereto; industrial analysis and research services; creation and development of computer hardware and software.	354
6-32. Beers, mineral and aerated waters and other nonalcoholic drinks; fruit drinks and fruit juices, syrups and other preparations for making beverages.	337
7-41. Education, training, entertainment, sporting and cultural activities.	294
8-9. Scientific, nautical, surveying, photographic, cinematographic, optical, weighing, measuring, signaling, checking (supervision), safety(rescue) and teaching equipment and instruments; devices and instruments for conducting, distributing, transforming, accumulating, regulating or controlling electricity; devices for recording, transmission or reproduction of sound or images, magnetic recording media, discs; compact discs, DVDs and other digital recording media, mechanisms for coin-operated apparatus; cash registers, calculating machines, data processing equipment and computers; computer software, fire extinguishers.	242
9-33. Alcoholic beverages (except beers).	239
10-43. Services for providing food; temporary accommodation services.	225

Source: <http://oami.europa.eu>

Making a top10 most frequently used classes to it can be noticed that 5 of them are service classes. From this fact emerges the idea that services can have a greater degree of delocalization and a much faster territorial expansion with not a very high cost. The first place is by far occupied by class 35 with 1127 applications. Because the market it is still at its beginnings, the first who understood the importance of Community trademarks were the proprietors activating in advertising industry, business management, business administration. From the total applications, this class occupies the second place with 213.853 applications. One may notice a difference that is more than double between the share of this class in Romania

and its total share which shows the early stage in which our country with a larger share of class 35 applications.

There is another group in the top 10 of 4 classes (30, 29, 32, 33) grouped two by two – they are complementary: the first two are related with food products and the following with nonalcoholic and alcoholic beverages. All this shows that Romanian producers of food products and beverages want to protect their own brands in the European Union. This condition is explained due to Romania’s potential in these sectors of activity and the high quality products of some brands. Protection on an extended territory combined with an adequate quality can be profitable.

*Table no. 3. Top 10 classes with the most applications submitted by total and the situation for Romania*

No	Clas	Total applications submitted	% from total	Top no.	% from total
1	09	279,474	10.04	8	3.62
2	35	213,853	7.68	1	16.88
3	42	195,507	7.02	5	5.3
4	41	150,507	5.41	7	4.4
5	16	149,348	5.36	13	2.74
6	25	128,047	4.60	15	2.41
7	05	97,890	3.52	11	3.16
8	38	95,648	3.44	17	2.35
9	03	85,810	3.08	18	1.91
10	36	77,408	2.78	16	2.35

Source: <http://oami.europa.eu>

Class 9, which is on first place by total with 279.474 applications, occupies in Romania eight place with 242 applications submitted. This class is for equipment and scientific measuring instruments, and includes brands of products incorporating high added value and so the density value is high. Only eight place in Romania, with a share of 3.62 compared to a total of 10.04 shows that the producers from our country either do not have strong brands in order to be protected by Community registration or this industry is too little developed in Romania and protection on the Community market would not bring significant future benefits due to high competition.

*Table no. 4 . Applications submitted by the CTMs nature- Romania*

CTMs nature	Number of applications	%
Figurative	1,367	59.31%
Verbal	921	39.96%
3D	11	0.48%
Others	5	0.22%
Colour	1	0.04%
Total	2,305	100.00%

Source: <http://oami.europa.eu>

*Table no. 5. Applications submitted by the CTMs nature -Total*

CTMs nature	Number of applications	%
Verbal	627,947	60.89
Figurative	394,789	38.28
3D	6,708	0.65
Colour	866	0.08
Others	839	0.08
Sound	162	0.02
Holograms	9	0.00
Olfactory	7	0.00
Total	1,031,327	100.00

Source: <http://oami.europa.eu>

By the CTMs nature, Romania has the largest number of figurative trademarks, 1367, with a share of 59.31% of total applications. This situation can be explained in two ways: mainly Romanian proprietors address to the internal market, but with expanding perspectives to the Community. For a marketing strategy that uses such an approach, the figurative trademark is the most appropriate because it overcomes the linguistic barriers of perception and understanding, considering the markets desired for competing and the language differences between them. On total, the situation between the figurative and the verbal trademarks is the opposite from that of Romania. In OHIM’s statistics, the main types of trademark are the figurative and the verbal ones, both overall and in Romania, with 99% share; the other types of trademarks have below 1%.

#### 4. Conclusions

The trademark is the most important mean of legally recognized business reputation. The way in which proprietors from Romania applied for protection throughout the EU shows a growing interest but at a lower level compared with the other countries. A valuable trademark is built in time which means a development strategy perspective spread on several years. A small number of CTMs show that Romania is more a sale market for products of the other states than a producer that can compete with strong brands. Romania registered the most CTMs in the class of advertising, business management, business administration, office functions, being more than double of the total applications submitted – in percentage terms. The number of applications grew with the accession indicating that the accession to the Union had a direct influence upon the trademark protection strategy. The benefits of extended protection throughout all the Member States provided by the Community trademark system had effect on the evolution of the number of applications submitted by the holders from Romania. The benefits of CTM system are creating a legal framework for development strategies in the EU market and in the future for the countries that will join later.

#### 5. Acknowledgements

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# The Status of Road Transport Companies. Aspects of the Direct Application of Community Rules

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## Abstract

*Road transport liberalization implied a reconsideration of the conditions for carrying out the activities in this field. Ensuring open and non-discriminatory access to the road transport market implies the existence of national regulations that allow the direct application of European regulations for carrying out the activity of road transport operator.*

**Keywords:** road transport, liberalization, transport operator, company

**J.E.L. Classification:** K 10 - General

## 1. Introduction

The need to directly apply Community rules and, consequently, to implement the conditions required at European level for road transport activities entailed a further review of the existing legislation in this field. The importance of road transport activities in the national economy and the need to ensure the general principle that any transport company should comply with several requirements led to the harmonization of regulations on the fulfillment of road transport activities in conditions that ensure free market access and control at the Community level. Therefore, the field of road transport knows, at present, a new regulation by the provisions of G.O. no.27/2011 on road transports (published in the Official Gazette no. 625/2011), which meets European requirements.

At present, this new regulation allows the fulfillment of road transport activities of goods and passengers, in accordance with the EU regulations transposed into the national law. The reassessment of the road transport legislation targeted the status of transport companies which, usually, can not fully fall

in the categories classified in the common law, since they follow a set of derogatory rules imposed by their activities.

## 2. The Access to the Road Transport Activity

Establishing the conditions of the road transport activity involves, primarily, the fundamental distinction between public transport, own account transport and transport in own interest.

The selection criterion in this case is represented by the pursued social interest. Thus, any natural or legal person can carry out road transport activities in order to move persons or goods for personal gain. Also, any legal person, any company can carry out road transport activities of goods or persons in order to achieve its purpose. However, public transport can be performed only by those persons who meet the legal requirements for the conduct of this activity.

Related to the commercial nature of the activity, road transports may be carried out on payment, by road transport operators in “non-discriminatory access conditions for third parties, under a contract of transport”<sup>[1]</sup> and own account road transports may be carried out by road transport companies for moving goods or persons in own interest.

The legal framework for carrying out road transport activities establishes the rules and limits under which these activities can be carried out, activities which should be circumscribed to several requirements of good repute and financial and professional standing, certified by the registration in specific registers. In addition, any own account road transport operator or company should hold a document which allows the fulfillment of a certain type of road transport.

In accordance with the laws in force, the road transport of goods or persons may be

carried out only by companies authorized to access the occupation of road transport operator.

The term company, within the meaning of the European regulations, refers to any natural or legal person engaged in the occupation of transporting persons or goods for commercial purposes (see the provisions of article 2, section 4 of the Regulation (EC) no. 1071/2009 establishing the common rules on conditions to be complied for the occupation of road transport operator, directly applicable in accordance with the dispositions of article 3, section 19 of G.O. no.27/2011 pct.19). Regarding the road transport activity, it should be noted that the legislator does not use the generic name of company, but makes a distinction between road transport on payment and own account road transport. Thus, for the road transport activity on payment the term “company” is equivalent to the one of road transport operator, the latter referring to the work performed "by collecting a fee or the equivalent in kind or in services" (see article 3, section 40 of G.O. no.27/2011). However, for own account road transport, the term “company” is kept, complete with the indication that this is a company of own account road transport. In both cases, the road transport companies with headquarters in Romania, whether as road transport operators or road transport companies, should comply with the rules set by the relevant European regulations.

In the following, using the generic name “company”, and given the above distinctions, we will identify the conditions that allow the fulfillment of road transport activities.

The analysis of directly applicable Community provisions in national law reveals that a company may be authorized to carry out road transport activities of goods or passengers on payment, subject to the requirements for the admission to the occupation of road transport operator.

According to Article 7 of the Methodological Standards for applying the provisions on the organization and performance of road transports and of their related activities established by G.O. no.27/2011 on road transports (approved by the Order of the Minister of Transports and Infrastructure no.980/2011, published in the Official Gazette no. 854 bis/2011, hereinafter

the Standards), the access to the occupation of road transport operator is obtained under the provisions of article 3 paragraph 1 of the Regulation (EC) no.1071/2009.

Firstly, the company’s real and stable head office should be established on the territory of a European Union Member State. According to Article 9 of the Standards, for this condition to be fulfilled, it is not enough for the company concerned to have its head office established under the deeds of incorporation or under the status in Romania.

The specificity of the activities entails other adjacent requirements. On the one hand, it concerns the possibility to control the activity, in the sense that the head office of the company should correspond to the place it keeps the documents which may be verified by the public authorities empowered in this field (controls are made by the inspectors of the State Inspectorate for Road Transport Control, abbreviated I.S.C.T.R). On the other hand, it is worth noting that the company must have a fleet of vehicles registered in Romania, regardless of the form in which they are held, and maintained in proper technical conditions, in activity centers established in Romania.

Secondly, the company must meet the requirement of good repute. The good reputation is a condition designed to ensure that both the company and the person who will coordinate its activities enjoy the necessary integrity and morality. This condition is in accordance with the provisions of article 6, paragraph 1 of Regulation (EC) no.1071/2009 in conjunction with article 10 of the Standards, in that the company or its manager were not convicted or punished for breach of the national provisions in force. In this case, the legislator refers not only strictly to the company's business activity in Romania and in the EU Member States, but also considers other types of illicit acts (human trafficking, drugs).

Thirdly, the company must have financial capacity. An essential feature of the principle of free trade is represented by the right of any person to engage in a commercial activity [2]. In this context, the subordination of the exercise of road transport activities to a financial condition could be seen as an exception to the above mentioned principle. In order to meet the condition related to the

financial capacity, within the meaning of article 14, paragraph 1 of the Standards, the company should to prove that it has a certain amount both for the commonly used vehicles and for the supplementary used vehicles. The proof of its financial capacity is made through the annual accounts certified by accredited persons or through certificates certifying a bank guarantee or insurance (see article 14, paragraph 2 of the Standards in conjunction with article 7, paragraph 2 of the Regulation (EC) no .1071/2009).

Such a restriction could be explained by the legislator's desire to ensure the access to this occupation only to those companies which can prove that they have the funds necessary to ensure qualitative services, with high reliability.

The last condition regards the manager's professional competence, demonstrated by a relevant certificate (article 15, paragraph 1 of the Standards). The company's transport activity must be coordinated by persons who hold certificates of vocational competence, obtained on the basis of their initial vocational training, which will be periodically updated by means of specialized courses (article 16 of G.O. no.27/2011).

### **3. Data Registration in Electronic Registers**

The statutory provisions also provide for the company's obligation to register its corresponding data in electronic Registers. These registers differ by the type of transport which will be made by the company.

For the road transport on payment, the road transport operator will record it in the electronic Register of road transport operators, provided that it has obtained the Community license.

The term “Community license” appears as a novelty in the current regulation of road transports (G.O. no.27/2011). In accordance with the provisions of G.E.O. no.109/2005 (repealed by G.O. no.27/2011), the fulfillment of road transports on payment was permitted under the transport license proving that the conditions of the access to the public transport, established by the national competent authority (Romanian Road Authority, abbreviated A.R.R) have been met. The standardization of the applicable rules and the exclusion of the existing

restrictions in the fulfillment of intra-Community road transports were achieved by new legislative changes. The harmonization of national and EU legislation also meant the obligation to carry out road transport activities on payment only under a document that permits free and non-discriminatory market access to the Community road transport market, and the control of these activities.

Carrying out road transports on payment only when there is a Community license is a consequence of the free movement of services, which, with the overall title, meant that "in order to operate throughout the European Union, it is enough for the companies in a Community country to hold the license to operate in the country of origin"[3].

It should be noted that the Community rules on the free movement of services have excluded from the benefit of their application the field of transports (article 58 of the Treaty on Functioning of the European Union/ the former Article 51 of the Treaty establishing the European Community), the latter being, from the very beginning, subject to separate regulations (articles 90-100 of the Treaty on the Functioning of the European Union/ articles 70-80 of the Treaty establishing the European Community). From a juridical point of view, this distinct regulation of the field that we refer to is explained by the features that distinguish transports from other services. Thus, transports, although have the legal nature of services, are different, in particular, from the category they belong to by the transport operator's main service and by the professionalism (article 3 of the Civil Code provides that there are considered professionals all those who operate a company, in that they systematically exercise an organized activity) involved by its activity, respectively the movement of goods or persons, as services available to the public [4]. Economically, the special regulation, as sector policy, is explained by the influence of transport activities on other economic sectors [5].

The Community license shall be granted only to those companies that carry out road transport activities on payment and which prove that the conditions relating to the access to this occupation have been met. The proof of the fulfillment of the admissibility

conditions is made by the documents attached to the application presented to the competent authority. If after the analysis of the documents filed under the law (article 21, paragraph 2 of the Standards) it is noted that the requirements have been met (article 7 of the Standards), the competent authority shall issue the Community license valid for 10 years. The compliance with the Community requirements, even after obtaining the Community license, is ensured by the mandatory control of the company. In this respect, article 23 of the Standards provides for the obligation of I.S.C.T.R to perform a control to the company's head office within 3 months after granting the Community license.

For own account road transport, the own account road transport company will be registered in the electronic Register of own account road transport companies, provided it has obtained an own account road transport certificate (article 47 of G.O. no.27/2011, in conjunction with article 3 of the Standards).

The own account transport certificate is the document that allows the company to make such transports and it is obtained under conditions similar to those imposed on road transport operators. Compared to the activity of road transport operators, own account road transport companies are exempt from the requirement of financial capacity, being enough to meet only the requirements of good repute and financial competence (article 3, paragraph 1, letter b of the Regulation (EC) no .1071/2009).

Getting the Community license or, where applicable, the own account transport certificate, is a necessary but not sufficient condition for the free access to the road transport market. The harmonization and control of such activities at the Community level require the advertising of data on the providers of such services. This is done by the competent authorities by entering the appropriate data for own account road transport operators and companies in the national electronic Register of road transport operators and in the national electronic Register of own-account road transport companies. In Romania, the competent authorities for the registration, management and updating of the data entered in those registers are the Romanian Road Authority

(ARR) and the State Inspectorate for Control in Road Transportation (I.S.C.T.R).

The company's application for the registration in the electronic Register corresponding to the activity it holds may be legally qualified as an attribute for the identification of the service provider company required by law, in relation with the nature of the activity, within the meaning of article 230 of the Civil Code.

The specificity of road transport services is also characterized by the fact that the exchange of information at the Community level is very complex.

From this point of view, the data recorded in the electronic Records can be grouped into three categories.

The first category of data concerns the identification elements of any professional, i.e. name, legal form, seat (article 4, letter a, b of the Standards; see the Civil Code and articles 225-227 of the Civil Code).

The second category of data refers to documents attesting the company's right to perform road transport activities. The electronic Register will record the number and the series of the Community license, or, where applicable, of the certificate of own account transport and the type of the transport to be performed by the company, respectively the road transport of goods or passengers. The accessibility to the actual fulfillment of road transports requires the existence of several documents on board of the used vehicle. Under the legal provisions (see articles 19, 29 of the Standards, articles 24, 47 of G.O. no.27/2011), the road transport on payment and the own account road transport can be carried out only with vehicles for which certified copies have been issued, customized with the registration marks of the Community license or of the own account transport certificate held by the company. The numbers and series of the certified copies and the registration marks of the vehicles for which they have been issued, will also be entered into the electronic Registers (Article 4, letter e of the Standards).

The last category of data regards the company management and the compliance with the conditions for the exercise of specific activities. In this respect, the name of the manager and any penalties imposed on him/her or on the company (Article 4, letters

c, f, g, h) are entered in the electronic Register.

The implementation of the Community measures concerning the conditions of access to the road transport market, which outlines the status of service provider companies, and the ways in which the electronic Records ensure the exchange of information with other EU Member States, are regularly reported by the competent authorities, to the European Commission (see article 6 of the Standards, in conjunction with article 26 of the Regulation (EC) no.1071/2009).

#### **4. Conclusions**

The need for national regulations in full compliance with the EU legislation has imposed a reassessment of the existing legal provisions in the field of road transports. The new changes have aimed, among others, to provide the legal framework for the direct application of Community rules regarding the fulfillment of road transport activities and the access to the market in this area.

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## Considerations on the Legal Status of the Forwarding of Goods. Regulations in the New Civil Code

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### Abstract

*The efficient fulfillment of transports, from an economic and legal point of view, involves, in most cases, the existence of an intermediary between the owner of the goods and their transport operator. The intermediary's activity, traditionally assimilated to the commissioner's, knows a special regulation once with the entry into force of the New Civil Code.*

**Keywords:** transport, forwarding, commission, warrant

**J.E.L. Classification:** K 10-General

### 1. Introductory Aspects

Moving goods by using various means of transport is a complex process, in whose execution an important role is played by the intermediation activity.

The intermediation activity, as an independent activity in organizing and carrying out transports, known as the forwarding of goods, aims to "ensure the circuit of goods by the expeditionary, for the benefit of its client (sender)" [1].

From a legal perspective, the forwarding activity is analyzed as an intermediation operation, similar to the commission, which facilitates, mainly, the fulfillment of transport related activities.

The intermediation activity involves the representation, by the intermediary, of the person for whom he/she works. As a technical and legal process, the representation is translated into the operation by means of which any person appointed as representative concludes legal documents on behalf of another person named the represented person [2]. The representation may originate in a legal provision or it may

result from the agreement between the parties. In transports, the representation can only be voluntary, originating from the parties' agreement, their willingness to seek a means to achieve the contractual relations through another person, in order to provide safety and expediency.

In this respect, most often, in international transports, there are used the services of a specialist undertaker. Because the work it performs, the intermediary in this area is called the "architect of international transports", which shows that it recommends to its client the best achievement solution [3].

The representation may be direct or indirect. For the direct representation, the representative concludes the legal document on behalf of, and at, the represented person. For the transport activity, the representation is usually indirect, in that the representative (the intermediary) concludes the legal documents with third parties on its own behalf but on the represented person's account [4].

### 2. The General Framework for the Organization and Performance of the Forwarding of Goods

The intermediation operations in the field of transports are performed on the basis of the legal instrument known as the forwarding contract.

Prior to the adoption and entry into force of the New Civil Code, the forwarding contract did not benefit from a special regulation. The only direct reference to this activity was in the definition of the transport contract (articles 413 of the Commercial Code - now repealed), which referred not only to the carrier, but also to the person "who makes any object to be transported". In the absence of express provisions, the forwarding activity was equated to the trade

commission, which aimed at "the handling of the commercial business by the commission agent in the account of the principal" (article 405 of the Commercial Code - now repealed). The classification of this activity in a legal structure was imposed particularly in the transports of a certain complexity, where there is the need for specialist advice in organizing the required transport.

The entry into force of the New Civil Code widened the field of special civil contracts. On the one hand, the new Civil Code governs the contracts usually reserved for professionals. On the other hand, as a novelty, the Civil Code gives a special regulation to some varieties of these contracts.

The forwarding contract is currently experiencing a special regulation, as a subdivision of the contract of mandate without representation (articles 2064-2071 of the Civil Code). These provisions can be completed, where applicable, with the provisions regarding the mandate and the commission. Also, in practice, there are used standard conventional rules (the General USER Conditions, the General Conditions of the F.I.A.T.A expeditionary).

### **3. The Characteristics of the Forwarding Contract**

Under article 2064 of the Civil Code, the object of the forwarding contract is the conclusion of a transport contract and the fulfillment of several operations ancillary to the transport, by the sender, on its own behalf and on the principal's account.

Similarly to the mandate without representation (article 2039 of the Civil Code), the object of the forwarding contract is to conclude a legal document (the transport contract) by the sender, on its own behalf, without representing the principal, but on the latter's account, directly committing itself to third parties.

In addition, the forwarding contract is similar to the forwarding agent, its object being also to provide for transport related operations, for a remuneration called commission (article 2043 of the Civil Code). This similarity of the work performed by the sender with the one performed by the commissioner has made possible the application of the provisions governing the

trade commission (articles 405-412 of the Commercial Code - now repealed) in a special field.

In the context of the new special regulation, the forwarding contract is concluded between the sender and the principal. The name "expeditionary", commonly attributed to the person whom is transferred the possibility to take all decisions necessary to move the goods to their destination, was abandoned and replaced by the legislator with the one of "sender". The one who takes this position is a *del credere* commission-agent because he/she commits himself/herself to his/her client to ensure that goods reach their destination [5], namely to exercise due diligence to achieve the desired results.

Replacing the name of "expeditionary", with the one of "sender" can create however some confusion.

Typically, the other contracting-party of the transport operator in the contract for the transport of goods is the sender. Usually, this quality belongs to the person who disposes of the goods and who directly concludes the contract of transport. In connection with the current regulations, the intermediary, who works on his/her own, but at the expense of the principal, although in reality the goods belong to another person, may be a party in the transport contract. In this situation, the intermediary, designated by the term "sender", also holds the quality of party to the contract concluded with the transport operator, until the final execution of the obligations under this contract. In any case, the client (principal) must be the owner of the goods or, at least, he/she must have the authority to act on behalf of the owner.

Typically, by concluding the forwarding contract, the sender assumes only the transport organization. There are also exceptions from this rule, meaning that the sender can make the so-called transport. In the latter case, the sender will have the additional rights and duties of the transport operator (see article 2070 of the Civil Code).

The forwarding activity should be authorized (article 22, paragraph 1 of G.O. no.19/1997 on transports, republished with subsequent amendments). For this reason, we believe that the sender (intermediary) must be a professional within the meaning of Article 3 of the Civil Code, as it is pursuing a

professional activity of intermediation, as a company. Moreover, in international transports, the quality of expeditionary is held by international forwarding companies, authorized to exercise this profession.

The contracting party of the sender is normally the person interested in the movement of goods, designated by the term “principal”. The quality of principal belongs to the natural or legal person that has the right to require the organization of the transport fulfillment (see also the provisions of article I, section 2 of the General USER Conditions).

The valid conclusion of the forwarding contract requires, like any other agreement, the fulfillment of the conditions of substance and form prescribed by the law.

In practice, the rule is that the conclusion of the forwarding contract is equivalent to the mere adherence of the client to the conditions pre-established by the forwarding company, the order made by the principal in this sense being sufficient (Chapter I, points 3 and 4, USER Conditions). This is completed, at present, with a special requirement. In accordance with the dispositions of article 2065 of the Civil Code, the forwarding contract can be considered concluded only when the forwarding order can not be revoked anymore. This moment coincides with the conclusion moment of the contract of transport for the benefit of the principal.

Under the principle of mutual consent, the mere agreement of the manifested wills creates the contract. However, the forwarding contract shall take the *ad probationem* written form (Chapter I, point 4, USERS).

The valid conclusion of the forwarding contract gives rise to rights and obligations on the contracting parties and their breach attracts the parties' liability.

The sender's main obligation is to advise the principal on the best way of moving the goods. The failure to do so shall entail the transport operator's liability, irrespective of the type of guilt (see the provisions of article 2068, paragraph 1 of the Civil Code referring to "negligence in fulfilling the forwarding").

When choosing the route, the means and the modes of transport, the sender will take into account any instructions given by the principal. In the absence of these instructions, the sender will work in the principal's interest (article 2067, paragraph 1 of the Civil

Code). Compared to the provisions in the field of the forwarding agent (article 2048 of the Civil Code) which clearly provides for the exceptions to the commission agent's obligation to exactly follow the principal's instructions, the sender may exceed the limits of the received empowerment only for good reasons. Without explaining what "reasonable grounds" mean, the legislator regulates the sender's liability for all damages caused to the principal by failure to respect the received instructions. Furthermore, the sender will be liable for fortuitous losses, unless it proves that this could have been produced even if it had followed the instructions.

The sender is obliged to exercise, at the request of the principal, the right to countermand, applicable to the transport contract (article 2066, of the Civil Code). The right to countermand is represented by the possibility recognized under the law, for economic reasons, of the person who holds the goods, to unilaterally modify the transport contract. Legally, the possibility to unilaterally change the transport contract is an exception to the principle of the binding force of the *pacta sunt servanda* contract, provided for in article 1270, paragraph 1 of the Civil Code. The right to countermand (article 1969) falls under the category of "cases authorized under the law" (article 1270, paragraph 2) which allows the unilateral modification of the original agreement.

The sender may also have the obligation to ensure the goods, if the principal instructed it to do so (in this respect, see article 2067, paragraph 3 of the Civil Code).

Although the special regulations governing the field of the forwarding contract do not expressly provide it, we believe that, in case of non-fulfillment or improper fulfillment of the obligations assumed by the sender, the principal can choose between terminating the contract with recovery of damages and performing the contract on the sender's account. The second alternative is equivalent to an indirect enforcement, in nature, of the burden which rests on the sender (article 1528, paragraph 1 of the Civil Code, in conjunction with article 1530 of the Civil Code).

The principal's main obligation is to pay for the services rendered by the sender

(commissions), including the additional expenses incurred by it. The commission may be provided for in the contract or it may be determined in accordance with the professional fees of the specialized freight forwarding or left to the court's assessment, in accordance with the operations done by the sender (article 2069 of the Civil Code).

Compared to the situation of the commission-agent who benefits from a lien on the principal's goods (article 2053 of the Civil Code), which assures the recovery of fees and other amounts payable by the latter, for the sender the new regulations do not provide for this possibility. Even in the absence of special provisions in the Civil Code, this guarantee could be invoked by the sender by applying the standard contractual clauses concerning the right of pledge and retention of the assets belonging to the principal, found in its possession (see Chapter VIII, USER).

The actions resulting from the execution of the forwarding contact are extinctive prescriptible. For these actions, article 2071 of the Civil Code establishes two special prescription periods. Thus, for the organization and transportation in the EU, the period is one year reckoned from the date of rendering of goods at their destination or from the day when their rendering should have been made. For forwarding contracts covering the organization and carrying out of transports which begin or terminate outside the European Union, the prescription period is 18 months.

#### 4. Conclusions

Internally, the forwarding contract must follow the rules set by the new provisions of the Civil Code. The forwarding contract may not be completely separated from other legal instruments which facilitate intermediation operations.

The new regulation thus appears as a common law of the forwarding contract, which, together with the commercial usage, will provide solutions to the participants in transport activities.

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## The Impact of Post-Enlargement on the Romanian Labour Market

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### Abstract

*One of the fundamental principle of the European Union is the free movement of workers. The liberalization of labor force movement to Europe increases the migration towards the developed countries and this phenomenon affects the economic growth. The labor market of European Union is influenced by migration and immigration of the workers from one country to another one. EU enlargement had a significant impact on migration flows from Romania to old member states. Migration contributes to growth prospects of the EU. They are restrictions some countries but they did not stop migrants from coming. The result is the change of the composition of the immigrants and a change in the structure of our national labour market.*

**Key words:** labour market, migration, European funds

**J.E.L. classification:** J01, J6

### 1. Introduction

EU enlargement was a turning point in Romanian migration history with the implication in Romanian labour market.

There are specific circumstances which explain partly the sensitivity of migration issue among the general public as well as policy makers across Europe, who feared economic, social, cultural and political consequences of free east-west migration in the EU: the population size of the acceding countries was large, the differences in income between the old EU member states and the EU8 and EU2 were major, the new member states underwent a complex process

of societal transformation to a free society and a market-based economy before their EU accession. [1]

The 2005 Act of Accession of Romania and Bulgaria to the EU allows the EU-25 Member States to temporarily restrict free access of Bulgarian and Romanian workers to their labor markets in countries providing these restrictions in their legislation. Despite restrictions imposed by the transitional arrangements, a Member State must always give priority to Romanian and Bulgarian workers in front of workers from non-EU countries, in the priority of access to employment. No restrictions apply to workers from EU-2 (Romania and Bulgaria) in the Member States of the EU-2.

The seven years' transitional period is separated into three distinct stages („2+3+2”). The first two years following accession, the access to the labour markets of the incumbent depends on their national law and policies; national measures may be extended for a further period of three years and could continue for a further two years, but only if there are serious disruptions in the respective receiving labour market. [1]

The paper is structured as follows. The first section provides an overview of statistical evidence of labour market in Romania. The second section presents the effects of EU Funds on Romanian labour market

The last section concludes.

### 2. EU Enlargement, migration process and Romanian labour market

Migratory movements are the result of disequilibrium on the labour market. The workers don't have jobs and they go abroad

to find something better for them and to have better living conditions.

The post accession East -West migration in European Union significantly altered the migration landscape and was dubbed “one of the most spectacular migratory movements in contemporary European history” [2]

There is a new profile of migrant after the post-enlargement of Romania into the EU. There is a change in the typical characteristics of people leaving the country in the 1990s and 2007. [1] [2]. The pre-enlargement migrants were typically middle-aged with vocational education and previous work experience and the post-accession migrants were predominantly young people with tertiary education. [3].

The structure of Romanian labour market after European Union Enlargement is changed. We propose to study some structural changes of employed population and employment rate between 1990-2009.

The detailed structure of the total employed population in Romania, gender and area (urban / rural), 1999-2009 is presented in Table 1. We note that employment declined during 1999-2009 period, the lowest value recorded in 2008 (2029 thousand less in 2008 compared to 1999). After Romania joined member of European Union the employment population was lower. The borders were open for the workers and they left the country to work mostly in Spain and Italy.

Table 1. Employed population structure of Romania during 1999-2009 (thousands of persons)

Employed population	1999	2000	2001	2002	2003	2006	2007	2008	2009
Total	10776	10764	10697	9234	9223	9313	9353	8747	9243
Gender:									
Male	5799	5772	5719	5031	5057	5074	5116	4703	5100
Female	4977	4992	4978	4203	4166	4239	4237	4044	4143
Area:									
Urban	5098	5039	5019	4607	4662	5115	5072	5101	5032
Rural	5678	5725	5678	4627	4561	4198	4281	4268	4211

Source: Household Labour Force Survey (AMIGO), Statistical Yearbook of Romania, pag. 89 and INSSE.

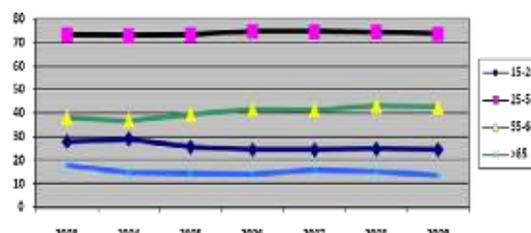
**Employment rate** dropped in Romania from 59.6% in 1998 to 51.0% in 2003 increase to 59% in 2008, and dropping in 2009 to 58,6%, amongst demographic decline amid Romania's population combined

with continued restructuring of the industrial sector in our country, loss of breadth and depth vary from one region to another, from one district to another.

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Figure 1 highlights the evolution of the employment rate of population aged 15 and over, by age over, by age group for 2003-2009

Figure 1: Evolution of the employment rate of population aged 15 and over, by age group, 2003-2009



Source: INSSE, Tempo-Online database

The employment rate of working age population (15-64 years) in 2009 was 58.6%, down from the previous year (-0.4 percentage points). This indicator has, as in previous years, higher values for men (65.2% vs. 52.0% for women) and people in rural areas (60.7% versus 57.1% in rural urban). The employment rate of young people (15-24 years) was 24.5%. The employment rate of older people (55-64 years) was 42.6%.

If the cumulative percentage share of group 65 + with the share of group 55-64 years and the 35-49 years group in total employment one would conclude that the active population in Romania is characterized by increased aging. It is a negative phenomenon with major implications on the future development and economic growth. Installation of the active aging phenomenon extending to old age, accompanied by the low representation of young people on the labor market leads to lower labor vitality and its aging. Increased participation of older persons (65 years) for female employment is

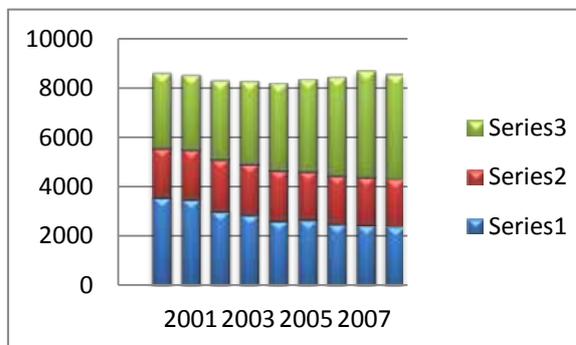
even stronger than in male employment, meaningful situation if we consider that the retirement age for women is lower than men's retirement age.

Analyzing the employment rate of Romania's population for 2009 we notice that the highest employment rate for people of increased working age was in the higher education graduates (84.1%). As the level of education decreases, employment decreases as well. Thus, 62.2% of the people with medium level of education were employed and only 42.0% of those with low education.

**Gender based structure** of the employed population of Romania showed an increase in the share of total employment in the male population in 2002, 2003, 2008 2009 compared to the year 1999 as a result of the higher retirement age for men, from 60 to 65 years. A higher share of male employment in total employment is due to a smaller number of men compared to women registered in Romania on the one hand, and can be explained by the still existing labor market discrimination of women in our country, together with the female's traditional household role - deeply impregnated in mass psychology, particularly in rural areas, and on the other hand with a higher active lifespan of men compared to women (an extra five years).

**Employment structure by sector of activity in Romania** highlights the phenomenon of de-industrialization and restructuring of the country's economy, without finding any real progress in the services sector.

Figure 2. Employment structure by sector of activity, 2000-2008



\*Data source: INSSE, Tempo-Online database  
Note: Agricultural activities include hunting, forestry and fishing. Industry includes mining, oil extraction, production of electricity, gas water. Services include construction, trade, restaurants hotels, transport,

storage and communications, financial, insurance and stock, real estate and other services, public administration and defense, education, health other activities of the national economy.

There is a decrease in the number of people employed in agriculture, given that households have on average small areas of farmland. Employment rate in agriculture decreased from 41.39% in 2000 to 28.17% in 2008. Since the beginning of transition in Romania, job losses occurred in industries less than in services. Since 2000 employment in industry increased slightly until 2006 when the occupancy rate was 23.26%, amounting in 2008 to 22.36% in services employment was an upward trend. In services during the survey period one would notice an increase in the share of employment in this sector, the employment rate increased from 35.37% in 2000 to 49.45 in 2008.

From the analysis of employment by sector of Romania's population one would notice highlighted a growing trend in the share of population employed in services, share exceeding 50% of the employed population in industrialized countries, aging and the feminization of of the population employed in agriculture.

After 1990 the evolution of employment in Romania the been influenced by several factors such as decrease in the country's total population, the emergence of foreign investment flows that generated new jobs, extend the working life from 57 years to 60 years for women and 60 to 65 years for men, small and medium enterprise development and the expectation to have that will make a positive contribution to increasing employment, especially in terms of non-wage labor. Restructuring and privatization process started after 1990, but permanent pressure on employment generated by the wave of layoffs hit the economy of Romania. Despite real economic growth in post-communist Romania, the job market remains relatively tight, mainly due to the structure by age and profession of the unemployed, not correlated with the applications of the Romanian economy. For these reasons currently particular attention is payed to retraining and reconversion of the workforce. [4]

### 3. European Funds as a solution for the dynamization of labor market in Romania

HRD priorities were established in line with the Lisbon objectives: full employment (overall employment rate increased to 70%, increase the employment rate among women at 60% and increase the employment rate among the elderly to 50%), increasing quality and labor productivity, increase social cohesion and inclusion. Romania, as EU Member State, implement the revised Lisbon Strategy, the implementing the National Reform Programme 2007-2010 (NRP)

HRD contributes to the implementation measures set for 2009-2010 in the NRP, the following activities:

Improving student assessment systems and the acquisition of key competences;

Curricular reform;

- Facilitate transition from school to active life;

Training for staff continues to enhance the adaptability workers and enterprises;

- Ensure health and safety at work of employees;

Strengthening the administrative capacity of public employment;

Development of tools and methods to analyze and anticipate the changes labor market;

Increase the chances of labor market integration of young people by implementing ESF funding projects;

Active employment measures for disadvantaged workers, particularly disadvantaged and with disabilities and long-term unemployed, including those in rural areas;

Development of social economy

Given that almost all financial allocation by the ESF for the period 2007-2013 (93%), distributed HRD priority axis, is sustain the goals Lisbon can evaluate participation HRD to achieving this strategy, the end of 2010, the following data:

ESF contribution to the value of the contract for projects implemented in the Axis 1 "Education and training in support of growth and development company based on knowledge "was 885,696,140.80 euros, representing 111.01% of allocation 2007-2013;

ESF contribution to the value of the contract for projects implemented in the PA 2 "Linking life long learning with labor market" was 470,822,997.40 euros

representing 51.62% of allocation 2007-2013;

ESF contribution to the value of the contract for projects implemented under PA 3 " Increasing adaptability of workers and enterprises "was 494,770,002.40 euros representing 109.90% of allocation 2007-2013;

ESF contribution to the value of the contract for projects implemented in the AP 4 "Modernising public employment services" was 65,214,828.41 euros, representing 36.91% of allocation 2007-2013;

ESF contribution to the value of the contract for projects implemented in the AP 5 "Promoting active employment measures" was 362,358,745.50 euros, representing 76.06% of allocation 2007-2013;

ESF contribution to the value of the contract for projects implemented in the AP 6 "Promoting social inclusion" was EUR 393,852,684.60, representing 72.95% of 2007-2013 allocation.

European Commission sent last country-specific recommendations in 2009. Module the measures supported by ESF contributed to the implementation of recommendations of country formulated by the European Commission presented the Annual Report MASOPHRD Implementation for 2009. Year 2010 was a year of transition to EU 2020 and therefore were not Country recommendations made by the European Commission. Romania submits the European Union, in 2010, the draft Programme National Reform 2011-2013, which transposes the national objectives of Europe In 2020. European Commission will make its first recommendation on Country Program 2011-2013 National Reform in the months June-July 2011.

#### **4. Conclusion**

Although Romania's labor market progressed a lot in the years following the EU integration, there a still structural and operational issues to be addressed. The EU Funds contributes to the achievement of the goals of Lisbon Strategy, but difficulties still persist.

#### **5. Acknowledgement**

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## Present and Future of European Normative Constructions: *Societas Europaea* and *Societas Privata Europaea*

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### Abstract

*The European normative framework in company matters was adopted with the purpose of harmonization of national laws in the context of international affairs development, in order to integrate the supranational business forms on the Single Market. Yet, in the present economic context, regulating the European company, form of organization of the activity involving a major capital concentration, appears as insufficient, compared to the necessity of adopting specific European norms for the development of small and medium sized companies, the European Union profiling proposals concerning the regulation of the European private company.*

**Keywords:** European Union, *Societas Europaea*, *Societas Privata Europaea*, supranational business forms.

**JEL Classification:** F23, K22.

### 1. Introduction

The legal framework within which is constituted the *Societas Europaea* (SE) is given by the Regulation (EC) no. 2157/2001 on the statute of the European private company (OJ L 294, 10.11.2001), altered by means of the Regulation (EC) no. 885/2004 of the Council on the 26th of April 2004 (L 168, 1.5.2004) and the Regulation (EC) no. 1791/2006 of the Council on the 20th of November 2006 (L 363, 20.12.2006).

The reason of the conception of a new business form at a communitarian scale was that of adjusting the production structures at the dimension imposed by the accomplishment of the internal market, on the purpose of eliminating the barriers on the commerce's way and by that, the development of the European economy.

What expresses the occurrence of the present analysis is yet the possibility of a conceptual integration of this partnership in the international economical conscience, psychologically yet objectively submitted, the actual circumstances of development, in a Europe hit by a system crisis, in which the economies of the Member States gear together, and by that, the indirect and direct investments.

Even more than that, is it imposed an analysis of the European company as a form of accomplishment of certain purposes of the international affairs, as long as it can be foreshadowed the exacerbation of an economical context within which, though unstated, the existent capitals are imposed to concentrate, in order to survive the potential economical shocks hitting the world economy.

The economical context of the last few years delineated the projection of a new form of accomplishment of the legal framework of unreelment of economic relationships, by promoting a more relaxing manner of organizing international affairs financially speaking, in the sense of proposing for enactment the “*Societas Privata Europaea*” (SPE), which is first of all a business form still outside the incipient status of regulation.

## 2. The Societas Europaea Regime

As long as the accomplishment of the European Union's objectives imposed the necessity of creating a company of an European dimension, free of the obstacles resulting from the differences and the limited applicability of the national company law, it has been imposed the elaboration of a legislative basis which should regulate the statute of the European private company. Thus, according to the Council's regulation (EC) no. 2157/2001 this is a partnership, similar to the share company, conducting a commercial activity, with the participation of private companies governed by different national laws.[1]

Pursuant to articles 1.1 of the regulation, a European private company can be set up on the territory of the Community only under the form of a share company. The minimum subscribed capital shall be inferior to 120 000 euros. A European private company can only be constituted by public or private companies from different Member States, and not by private individuals.

However, the regulation enlists four ways of set up: by merger, when at least two of the companies involved are governed by different national laws; by constitution of a holding if at least two of the promoting companies are governed by different national laws or they have a subsidiary under a distinct jurisdiction for at least two years; the incorporation of a subsidiary SE company, when at least two of the founding partners belong to distinct jurisdictions or they own a subsidiary in another state for at least two years; or by transformation, when the company submitted to transformation has a subsidiary under a distinct jurisdiction for at least two years.[2]

Generally speaking, on the grounds of a technique reference, the European private company is conceived following the model of the company on shares and its memorandum of association contains compatible provisions with this form. In such sense, the European Regulation traces exactly the form of the company template represented by this type of European company. There are profiled provisions regarding the attributes of identification – head office, name – constitution and the minimum value of the social capital, the type of liability assigned

for the shareholders for the company's obligations, organization and functioning.

In what concerns the head office, the European company can be set up exclusively on the territory of the Union, under the jurisdiction of any of the Member States, under the conditions of the European Regulation. The European private company with the head office in Romania is constituted according to art. 5 of Law no. 31/1990, by means of memorandum and articles of association or by means of a single entry, and shall comprise the elements stipulated in Art.8 of the same law.

Ulterior to the constitution of the European private company, the head office can be transferred from one Member State to another, according to the procedure instituted by regulation, so that this transfer does not lead to the dissolution of the company and the constitution of a new legal entity.[3]

As in the case of national companies, the European company acquires juridical personality since the date of its registration in the appointed national register. In such sense, pursuant to art. 16 para. 1 from the Regulation, the European private company acquires juridical personality since the date of its registration in the register provided by the legislation of the Member State on which territory it establishes its head office.

As for the European company with the head office settled in Romania, it acquires juridical personality exactly the day of its incorporation and registration to the Registrar of Companies. It should be noticed the fact that the company can be incorporated to the Registrar only after signing an agreement regarding the involvement of the shareholders in the activity of the company, under the circumstance established by G.D. no. 187/2007 which started from the Council's directive no. 2001/86/EC of completion of the European private company statute in what concerns the implication of the agents.[4]

By means of the European private company statute can also be adopted a monist or dualist system of organization. The dualist system involves the existence of the following authorities inside the European company: a General Meeting of the Shareholders, which competences can be established by a regulation and the legislation of the Member State on which territory the

company has its head office; an executive authority, responsible of the management of the company. Its members are appointed and dismissed by the supervisory board. In the same time, internal law of the Member State on which territory the European Company has its head office can provide the possibility of appointment and dismissal to the General Meeting of the Shareholders of the executive authority; a supervisory board controlling the activity of the executive body. In the same time, it is worth mentioned the fact that the surveillance body does not have the competence to ensure the management of the company.

In exchange, the adoption of the monist system of organization of the European company determines the existence of the following two authorities: a General Meeting of the Shareholders, which competences are established by regulation and the legislation of the Member state on which territory the company has its head office; an administrative authority ensuring the management of the company.

The regulation does not comprise provisions referring to the functioning of the European company, since the dispositions of art.9 para. 1 letter c). are incident. According to them, the non-regulated aspects enter under the incidence of the legal provisions adopted by the Member State on the territory of which the respective European company has its head office. Consequently, legal internal provisions are to be applied in priority to the community measures regarding European companies, and in the absence, to those applicable of share companies constituted in the respective State.

A special provision is comprised in Art. 61. The text of law makes a reference to the law of the Member State on which territory the European company has its head office in order to regulate the issue of annual accounts, the report of, the audit, as well as the disclosure of the respective accounts.

### 3. Societas Privata Europaea

Because small and medium sized enterprises represent the proven foundation of the economic development during periods of crisis when large capital decentralize, the European idea of creating an institutional

framework for their development turned out to be forecasting.

Furthermore, since 2000, European preoccupation in matter took shape in the setting up of a Paper of small enterprises, and in 2003, the European Commission concluded on the necessity of awarding a new perspective to the process of harmonization of European law in matters of company.

The European Commission's communication for the Council and the European Parliament entitled “Modernising Company Law and Enhancing Corporate Governance in the European Union – A plan to move forward, 21 May 2003, COM (2003)” put the regulatory basis of this legal provision of institutionalization of the SPE, unfortunately not yet entered into force, but of maximum interest from the point of view of the capital's flexibility in terms of interest for investments.

Such new supranational form of deployment of international affairs facilitates the spirit of competition, its advantages rising higher, when compared to lower costs of implementation of the investments on the Single Market, but also to the regulatory unification of the establishing rules.

At the beginning of the global crisis, as long as these desiderata were defined, the European Commission presented the First Draft Regulation of the SPE statute, on the 25<sup>th</sup> of May 2008 (European Commission, First Draft Regulation of the SPE statute, June 25th in 2008).

SPE is conceived either as an act of will of a single entity, or a partnership of private individuals and/or legal entities (with or without juridical personality, private or public), inclusively SE, SCE, GEIE or another SPE, constituting in a form of private limited company, with juridical personality, in which fractions of capital (named “shares”) are not transactional.

SPE can be set up either *ex nihilo*, under the Regulation, or by the transformation (without dissolution or loss of the juridical personality), division or merger of certain existent companies (regulated by the applicable national law), with the condition that the head office and central administration is on the territory of one of the Member States.

The Commission had in view the Decision *Centros* of the ECJ, thus statuting that the head office and the central administration or the main office of the SPE can be on the territory of different states, the head office can be moved in another state, by means of agreement of the shareholders. [5].

The juridical personality of the SPE is achieved in the moment of consenting the constitution in the register designated by national law of the Member State where is the head office. In the circumstance of merger by absorption, the absorbent company becomes SPE in the moment of registering the merger, and in the circumstances of division, the beneficiary company becomes SPE in the moment the division is registered.

What rises the interest in this Draft Regulation is the new conception regarding the protection of creditors, thus being eliminated the traditional demand of the existence of a minimal capital of protection. [6].

Consequently, the limit of the capital does no longer represent, in the opinion of the Commission, the essence of the creditors' guarantee, as there are accepted the aspects derived from practice, which are the confidence of the creditors on other patrimonial elements, (such as cash flow). In conclusion, the SPE can be constituted with a symbolic capital of 1 euro.

The social capital can be subscribed by contributions in cash or in nature, full payments not being compulsory for the constitution. The exoneration of the obligation to make payments in full can intervene exclusively in the situation in which, as a consequence of the non-submission of the contribution, it is decided the decrease of the social capital.

The protection of the creditors against excessive distributions to the shareholders is circumstantiated by the report on the active/passive assets inside the SPE, so that the Draft Regulation do not allow the distributions after which the passive assets are superior to active assets. Before the distribution, the shareholders can ask the management of the SPE to issue a certificate of solvency, attesting the company's possibility to cover the short-term liabilities, before the maturity date, but in a maximum term of one year since the date of distribution of benefits, which certificate is disclosed.

The registration of the SPE enjoys a maximum flexibility, yet censored by the principles of the outlined disclosure of the Directive 2009/101/EC.

The draft provides one single verification of the legality, alternative, either by checking the legality of the documents and items of information of a SPE by an administrative or judicial authority, or by Notary certification, at the moment of the SPE registration.

Owning fractions of capital confers a higher level of freedom inside the SPE, while adapting to company tendencies, doubled by the principles of corporate governing, (ulteriorly adopted expressly by the Green Paper – Corporate governance framework of the European Union, 2011), allowing the shareholders to statute by means of the memorandum of association, the respective rights, included those regarding the transfer of shares and the protection of the minority shareholders' interests.

Thus, the Draft Regulation does not provide the shareholders' right to force the minority shareholders to sell their shares (“squeeze-out”) and does not force the majoritarian shareholders or the SPE to buy shares from the minority shareholders (“sell-out”), yet the provisions referring to such right can be established by will of shareholders, in the memorandum of association [7].

Inside the SPE, the decisions are adopted by the shareholders (it is noticeable that a SPE does not know the idea of institutionalization of the General Meeting), as a rule, with the observance of the principle of majority, decided upon by means of the memorandum of association or, in certain circumstances, imperatively qualified (2/3), by means of the Draft Regulation.

Thus, the qualified majority is imposed for the decisions having as object the alteration of the shareholders' rights, the exclusion, the withdrawal of a shareholder, the decrease of the social capital, the transfer of the head office to another Member State, the transformation of the SPE, the merger, the division or the dissolution of the SPE.

The Draft Regulation contains, in annexe, the orientative model of the memorandum of association, by indicating the compulsory clauses of the articles of incorporation.

Despite all these, though in appearance such form or organization of the investments

seems enough regulated, it is obvious that there are imposed certain modifications of the SPE statute, demanded by the business market.

As a consequence, there are outlined a series of legal draw backs concerning the regulation of the national applicable limits of encroachment, since it is noticeable the necessity of decreasing them as much as possible during the functioning of the SPE.

However, although it offers flexibility to the European regime of investments, the Draft Regulation should ensure an increased protection for the creditors' rights, left almost in full charge of the principle of good faith of the shareholders, who, in a capital world, it is plenty of times defeated.

The almost total report to the company theory brings also a decrease of the shareholders' protection, especially the minority shareholders – without excluding yet the abuse of minority position. As a consequence, it is imposed a certain normative limitations of the manner of decision making inside a SPE, so that any partnership should not become a manner of compulsion.

Such arguments come to justify why, for more than four years, the European Commission has not reached a form that should be adopted.

Yet, this normative framework should not be neglected, because it may represent a future basis of development of economic relationships, which should be enough convincing.

#### 4. Conclusions

The way that it is statuted in the European legislation, the purpose of creating a European company was that of allowing the insertions of concentrated capital on the Single Market, by setting up companies at European dimensions, aiming to eliminate the barriers imposed by national laws, such form already being adopted by a series of companies among which we mention Allianz. The main argument in favour of a specific form of regulation for the international affairs' development of small and medium sized enterprises is represented by its particularities by comparison to the European company, with the advantages given by the

flexibility of setting up and the inexistence of capital limits.

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## Research on Result Indicators in the Implementation of European Funds in Romania in the Period 2007-2013

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### Abstract

*From the analysis of annual reports as a result of implementation in the period 2007-2011 to include indicators on the lines of funding varies depending on the duration of the implementation of the project, the project level to reimbursement payments, the overall level of reimbursement. Indicators give us information about the results obtained through the fulfillment of the objectives of the financing applications, about equal opportunities, sustainable development, closing the partnerships. The level of reimbursement and achievement indicators and finally determine the absorption of European funds.*

**Key word :** optimization indicators FSE

**J.E.L. Classification:** L 66, Q13.

### 1. Introduction

Through this research study I watched to identify factors that determine trends adapting human resources involved in implementing projects with European funding, as well as optimizing absorption of European funds. The conclusions of the research say that in order to optimize the implementation of European projects are required to be undertaken the following: conducting trainings with the beneficiaries or host institutions of projects to prepare teams of management and implementation of projects, devising a coherent legislative framework, fluent, flexible for streamlining financial repayments, providing for the

dissemination of the results of meetings and a experience gained, the establishment of national and regional formations of coordination of tutoring in terms of legislative regulations subject to readiness and opportunity. In the present work we quantify the actions recorded and I estimated possibilities of future action for maximum efficiency.

Studies shows that the availability of financial resources is occurring at a pace very slowly due to the following aspects: the beneficiaries of the proposed and approved projects are insufficiently prepared for the absorption of funds grants and social environment, adapt to hard and is reluctant to request the legislative and regulations imposed by the European Union, as well as the requirements submitted by the managing authority of the existing projects at national level the trend of change in mentality and training for streamlining activities is very little developed, the lack of solutions for the deployment. State institutions-municipalities and banks involved in the management of European funds, insufficient financial resources at the national level in order to support the financing of projects, the lack of confidence in trade due to the delays in the registration of transactions, the evolution of management teams and implementation of projects in a very slow pace in comparison with their capacity for organization, mobilization and motivation, a positive trend in terms of innovation and creativity, orientation towards short-term strategies, medium-and long-term prospects of development, technology transfer, partnership. It is noted that the number of ten

dices coercion are larger than the tendency to support innovative activities in the regions studied.

## 2. Material and method

Use of funds from the ESF in accordance with article 34 (2) of Regulation (EC) No 1083/2006 watching the performance indicators: increase in the value of cumulative physical completed in 2010 from the cumulated at the end of 2009, the share value made in late 2010 in the value-target scheduled for 2010. Thus, in the year 2010 achievements have been recorded for the following characteristic indicators: the number of long-term unemployed participants in integrated programmes, of which women/young – increase of 14.8 times, i.e. 25.7/35.6 times, the number of participants in integrated rural programmes – increased 3.8 times. Insignificant progress in achieving the targets set for 2010 were recorded for the pointer to the share of participants in those rural areas where integrated programmes, which had obtained a job. In the year 2010 have been posted for progress: the number of long-term unemployed participants in integrated programmes and number of participants 24,32% in rural areas from integrated programs, 2-22%. Insignificant progress in attaining the indicators have been found: the share of participants in those rural areas within the integrated programmes which have obtained a job with target 1.89 by 15%.

## 3. Results and discussions

Achievements on financial indicators show that the amount of ESF funding grants for projects contracted was 362,5 million, representing an increase of 8.4 times over the figure recorded at the end of 2009. In signatures and all projects are implemented, the principle of equal treatment between women and men has been promoted, both as regards members of the deployment team and with regard to the target group. In accordance with the financial and technical reports of the total transmitted 27024 people in the target group in the period reported, 11946 (44.2%) are men and women are 15078( 55,80%).

From the analysis of the persons involved in the training activities shall observe the highest number that is occupied by the total

number of inactive persons, followed by qualification/requalification occupied and the inactive in education and training. A considerable number of people about the unemployed. The lowest level was registered by the long-term unemployed and liberii professionals.

Figure 1 - Labour market status

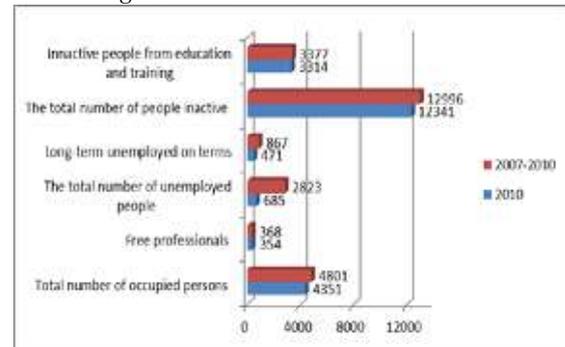
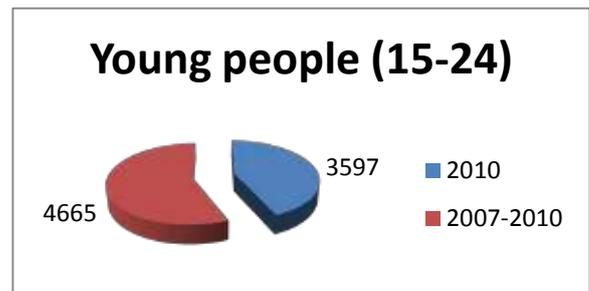
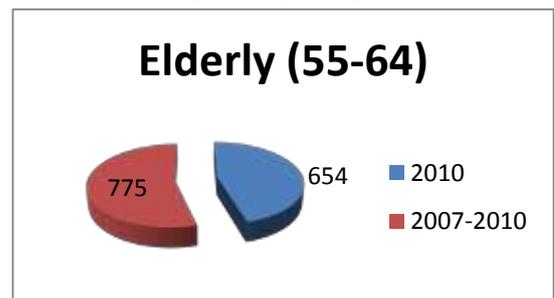
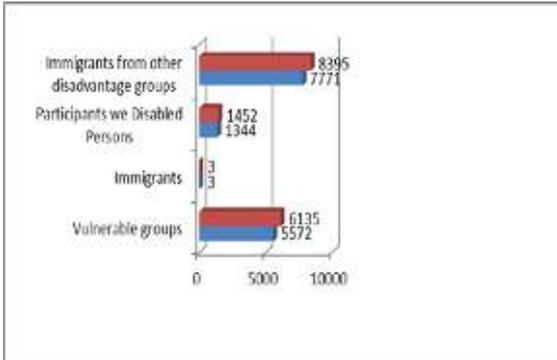


Figure 2 - Breakdown of participants depending on age



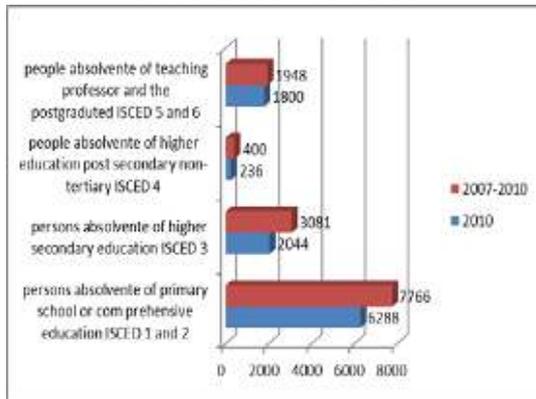
As regards the involvement of the target group members according to age, there is a greater participation of young people aged 15-24 years-84,61-85,75%, and a little more participation of senior citizens aged between 55-64 years-14,25-15,39%.

Figure 3 - Breakdown of participants depending on the vulnerable groups



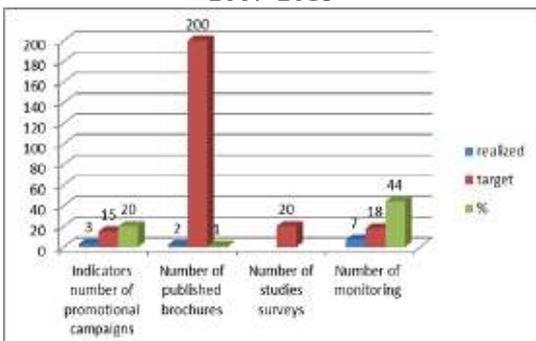
In figure 3 it appears that the highest level is occupied by immigrants and other disadvantaged categories, followed by the vulnerable group of people. The lowest level is occupied by immigrants.

Fig.4 - Breakdown of participants depending on the educational level



In terms of category of people in the target group according to the level of training school that most mulțe people are those that have graduated the school whether primary or secondary ISCED 1 and 2, then people who have graduated high school ISCED 3. Lowest share was occupied by persons with higher education and post-secondary course and nontertiary ISCED 4.

Fig.5 - Indicators to include in the period 2007-2013



In terms of promotion and advertising materials must be noted that the highest share was recorded in the number of published brochures, then monitorizari, and finally the number of promotional campaigns. The main obstacles encountered in the implementation of projects OI ANOFM were related to: - unable to attract the necessary human resources projects: implemneting;

-number of servants which may provide implementing of projects in the institution is insufficient. For solving problems has made reconciliation management teams and finding a viable solution for the continued of the signed contracts.

-attraction of external specialists is hampered by the lack of a legislative framework to be expressly stipulated mode of engagement conclusions.

#### 4 Conclusions

For efficiency the activities of projects financed from EU funds can be taken a number of actions, such as

-using a touch screen computer system to provide people without jobs a database with job vacancy, condițiile employment, address and contact details of potential employers, industries;

-the use of Job clubs by employers and employees, as a tool for access to new occupational opportunities;

-the development of an innovative electronic tool and evidences of management and professional skills of the initial, intermediate and final target group, to identify individual training needs and their subsequent integration of the labour market, competence in the diagnosis of deficit and to identify a professional development plan.

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# For and Against a New Framework for Banking Supervision

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## Abstract

*Offering a critical perspective, this paper presents the new strategy in European Union’s banking supervision as response to the financial market tensions, describing the results of this redefinition process on different areas: the revision of supervision institution and international banking standards and the strengthening of corporate governance in banking.*

*The cooperation between macro and micro prudential authorities represents a solution for sustaining the financial stability in the euro area. The paper also analyzes the newly implemented capital standards - Basel III, a way for assuring a better management of systemic risk.*

*The efficiency and success of this reform in banking are subjects of doubts and strongly debated in the current context. and problems concerning its independence attract adverse opinions.*

*Far from being on one side or the other, this paper gives a full description of the process, leaving its advantages and disadvantages an open subject.*

**Keywords:** banks, supervision, crisis, new framework

**JEL classification:** D78, E44, E52, E58.

## 1. Introduction

The current financial crisis has shown the deficiencies of banking supervision at European level revealing a fragmented way of control and risk management. It has sent a resonating wake-up call throughout the European Union urging all stakeholders to address the growing inconsistencies between Europe’s (fragmented) regulatory and supervisory approaches and the realities of growing financial market integration.[13].

The national model of the banking authorities could not keep up with the financial globalisation process, based on international institutions with worldwide activity. It has become imperative in this unbalanced world, the need of a process of redefining the framework of supervision, both microprudentially, and macroprudentially. At a microeconomic level, the attention focused on structural elements, using specific instruments such as on-site and off-site supervision. Macroprudentially, it was necessary to limit the possibility of the financial system to break down as response to systemic risk, being compulsory an aggregate treatment of risks.

Taking into account the importance of the european financial system in the world’s banking system, the new framework for banking supervision appeared with the primary purpose to ensure common supervision standards.

All the disfunctionalities of the existing institutional structures created the need to build structures capable to internalize the negative externalities [14].Internalization in this context would require centralization of regulation and supervision in the EU, meaning establishing cooperative and coordinated decision-making processes.

Starting from the idea that a perfect internalization needs a good centralization of supervision rules, the European Union answered to the financial crisis by establishing a new institutional framework.

## 2. The redefinition process of banking supervision

Analysing at the changes in the european banking system due to the challenges of the present crisis, it appears that these changes generated the development of some new structures for banking supervision, in a

process of redefinition for the whole banking system.

This redefinition process can be analysed through different aspects:

- the revision of the architecture of financial supervision;
- the reform of international capital standards;
- the strengthening of corporate governance.

The first aspect of the reform process, meaning the change of the supervision's architecture is the result of 2009 Larosiere Report (“Report of the High Level Group on Supervision”) and presumes the existence of an architectural package in which the microeconomic supervision components mix with the macroeconomic ones in order to create the financial stability.

The supervision revision process can be understood from two points of view: an institutional side and a practical side of stress testing resistance of the European banks.

Institutionally, the paper European Economic Governance issued by the primevicegovernor of the National Bank of Romania presents the new architecture which has become operational since the 1st of January 2011. This new architecture is represented by *The European system for Financial Supervision* with its different substructures: *The European Council for Systemic Risk* - responsible for the macroprudential supervision at european level, *The European Supervision Authorities* which include: *The European Banking Authority*, *The European Insurance and Occupational Pensions Authority*, *The European Security and Markets Authority*, *the Common Committee of European Supervision Authority* and *the National Supervision Authorities*.

When it comes to the different roles and responsibilities of these structures, the macroprudential and microprudential roles are very well deserved by the substructures of the system [3]. *The European Council for Systemic Risk* has duties concerning the analysis of relevant information in order to identify, monitor and evaluate the threats and potential risks for the financial stability of the European Union. It also gives warnings to the supervisors, makes recommendations and monitors the measures taken by the responsible authorities. *The European*

*Supervision Authorities* are responsible for the microprudential part of supervision. Their role is clearly stated and means consistent applications of EU rules and regulations in case of breaking down the european standards and legislation, ensuring a coordinate response to crisis. *The European Banking Authority* is a distinct entity in this new framework having an important role in compliance with the european standards, standards that once respected maintain the whole sistem's stability.

The role of national authorities is not lost in this new framework. They are still responsible for everyday supervision of individual banking institutions. That is why this new system still keeps decentralization elements through the presence of the National Authorities in their area of competence.

*The Common Committee of ESA* is a linking structure having a particular role in increasing the cooperation and consistent supervision approaches, in coordinate the exchange of information and to ensure a common culture of supervision and also to collect microprudential data from national supervisors.

All these bodies constitute an overarching framework for financial supervision combined with expertise of local microprudential supervisory bodies closest to the institutions operating in their jurisdictions[6].

This process could not have been done only on theoretical basis. The practical aspect meant the stress test of the main european banks, through an exercise that studied the influence of the stress factors over a number of 91 banks. The test was needed in order to evaluate the state of the financial system and in order to adapt the necessary measures to the real situation.

The results showed a strong resistance of the european banking system, revealed by the positive results of the study. It was a step forward in the convergence policy of the european banking system as all the stress testing practices were convergent. This stress test was a significant tool for ongoing supervision.

The new framework of banking supervision intended to remove the limits of Basel II Capital Standards Agreement, limits that were obvious during the financial crisis. there were many aspects that questioned the

viability of Basel II Capital Standards Agreement [2]. First of all the importance of systemic risk was underestimated and in this context the apparent diversification of risks through securitization facilitated the development of important channels of contagion. There was also overestimated the capacity of credit institutions to precisely assess major risks. There has been identified a model risk caused by structural factors (the lack of the macroprudential component) and by the calibration failure of the internal mechanism for risk measurement that generated the unsustainable risk exposure compared to the capital basis. There also has been overestimated the true nature of the assessments made by the rating agencies under the circumstances of the lack of some minimum professional standards and supervision of them. Towards the liquidity risk, concerning the financing component and the one of assets recovery, it was not properly reflected in prudential reports.

The reform of international capital standards brought as a solution the new Capital Agreement Basel III, issued by The Basel Committee from The Bank of International Settlements. Both the theoretical approach and the reports of the Bank for International Settlements reflect a series of advantages of the new agreement comparing to the former[24][25][26][27]:

- the quality, consistency, and transparency of the capital base will be raised (Tier 1 capital: the predominant form of Tier 1 capital must be common shares and retained earnings; Tier 2 capital instruments will be harmonised; Tier 3 capital will be eliminated);
  - the risk coverage of the capital framework will be strengthened by: strengthening the capital requirements for counterparty credit exposures arising from banks' derivatives, repo and securities financing transactions; promote more integrated management of market and counterparty credit risk; add the CVA (credit valuation adjustment)-risk due to deterioration in counterparty's credit rating;
  - introducing a leverage ratio requirement that is intended to achieve the following objectives: put a floor under the build-up of leverage in the banking sector;
- introduce additional safeguards against model risk and measurement error by supplementing the risk based measure with a simpler measure that is based on gross exposures;
  - introducing a series of measures to promote the build up of capital buffers in good times that can be drawn upon in periods of stress;
  - introducing a global minimum liquidity standard for internationally active banks that includes a 30-day liquidity coverage ratio requirement underpinned by a longer-term structural liquidity ratio called the Net Stable Funding Ratio.

A third aspect that was redefined at european level was the corporate governance of the financial banking system. At the european Banking Federation, the romanian professionals, the Bank for International Settlements reflect the same idea which is the need to improve the corporate governance especially in banking field, illustrating at the same time the malfunctions and their effects during the crisis.

It was a necessity to take into account in the new framework some elements:

- elements linked with the activity of the The Board of Directors; within the new framework it has to clearly understand its role, to have the necessary competence for its responsibilities, to establish the main directions for the activity, to respect the corporate values, to ensure that the supervision process is coordinated to the commercial and risk policies, to prove a good knowledge of all the operational structures and markets on which the bank operates;
- the revision of remuneration policies of the executive board [17]; for this reason the motivational process through bonuses must be dependent on the medium term results, not on the annual financial results which can overestimate the effective performance. The guaranteed bonuses are not consistent with a rigorous policy of risk administration and potential earnings must be adjusted with the cost and the volume of the liquidity risk. At the same time, the temporal scheme of remuneration must be consistent with the time horizon of potential risks and only a small part of

them must be offered in cash. The largest part must be offered as shares which cannot be sold for a period of at least three years, or as options of buying a part of banks' shares, at a higher price (10 percent higher) than its usual price.

The global financial crisis has increased the focus on the compensation policies of financial institutions.

Moreover, banks agree that measures should be taken to correct any existing misaligned incentives due to remuneration policies. They believe that their risk management should be aligned with their long-term objectives. Remuneration must not be excluded from the scope of risk management.

At European level these new standards were applied in different financial fields. A study issued by the European Banking Federation revealed the fact that at all staff levels in the European institutions not only in banks has been implemented a process of coordination between risks and revenues.

This process of change at European level has been a natural response to the financial crisis. The crisis has emphasized the role of systemic risk, this type of risk being a global problem, on the conditions of an international financial system. Under these circumstances, the measurement and monitoring of risks must have an international dimension, if we do not want to give up the advantages of globalization and turn back to a system with only a national function for markets and institutions. It has appeared even the idea of an international risk map. This concept was introduced by Stephen G. Cecchetti, Ingo Fender, Patrick McGuire in their study *Towards a global risk map* [1], and concerns the necessity of international exchange of information and of a larger framework for statistical reporting for the same purpose of data exchange process.

The events which took place during the crisis revealed lacks and disfunctionalities not only in banking supervision systems, but also in the use of intervention tools. The actions taken for solving the problems of the institutions with crossborder activity had been ad-hoc actions, not coordinated. That is why the need is for a crossborder cooperation during the crisis, avoiding great dimensions shocks and international contagion. Even the European Commission admits that financial

stability is not any more a problem of national interest, but a European problem. [19].

### 3. Controversies

There are different problems that appear when we refer to the new framework for banking supervision. One problem is whether such a great institutional change is not „too big to fail”, and this is the idea developed in the study of *Dr. Elaine Fahey*. Grand institutional reforms, may prove the paradox of being “too big to fail” [6].

The EBA (European Banking Authority) is subject to most of the controversies, mostly by reason of its high-profile status, its functionally-singular activity and its direct role as to the banking and finance industry.

Another problem refers to the independence of the new authorities. That is because of the fact that functioning within the borders of European Union the rules and regulations are issued after a collective decisional process between the European Council, The European Commission and The European Parliament. Once again, especially EBA is questioned when it comes to independence.

The Authority's institutional independence can be challenged on four grounds [8]:

- First, by the presence of national supervisors on its board considering that they will be recipients of its decisions;
- Second, by the lack of specification of the grounds for dismissal of its head. The regulation only mentions that the ultimate decision belongs to the powers of the European parliament following a decision of the board.
- Third, the arrangements for legal immunity for its staff – they will have the same statute as staff working under the EU Treaty – might be insufficient, taking into account that the Authority has the power to investigate alleged incorrect or insufficient application of Union law obligations by national authorities and to adopt decisions that affect individual banks.
- Finally, the presence of the EU Commission on the board – albeit without voting power – raises the issue of potential political interference on the

policy decisions.

On the other hand, the exchange of information attracts diverse opinions as it is not done directly from one credit institution to another, but through national supervision bodies.

There is another problem linked with the independence that refers to the funds of these new authorities. The Authorities funding mainly comes from the general EU budget and obligatory contributions from national supervisory authorities. These institutions do not have their own budget, they are bounded by the national agency budgets, whose contributions are made in accordance with a formula based on the weighting of their votes in the board, limiting the Authorities budgetary independence.

Continuing with the critiques to the new system, we selected one of the negative opinions came from an American economist Barry Eichengreen, who considers the new framework cumbersome and unworkable because of the national interest which are contradictory [16]. As a solution this economist propose that The European Central Bank should become the banking regulator for the euro area. He also considers that a common view could be obtained by a faster admission of members in the euro area and the exclusion of the ones that do not want to be part of this group (as an example Great Britain). There are voices against this proposal, one of them from the IMF, considering the fact that additional power for the European Central Bank would harm their own interests and purposes.

#### 4. Conclusions

The establishment of the new European Framework for Banking Supervision is certainly a significant step on the road towards fully internalizing the potential negative externalities that result from the existing decentralised national supervisory frameworks in an integrated financial market.

The objective of changing the look of supervision in the European Union was based on three pillars [20]:

- an improved and harmonised set of preventative and resolution tools;
- clearly defined roles of authorities at the national level accompanied by balanced coordination mechanisms at EU level;

- financing arrangements that limit reliance on public budgets to future crises.

If we take into consideration the fact that at the origins of the crisis there were the banks and that they all benefited from financial aids then, they had the obligation to conform to rules and regulations and to accept a closer monitoring [16].

By this new supervision environment the European Union ensured a concrete set of measures for the financial stability of the whole Union, assuring the same technical standards in order to identify the systemic risk in an early period for better action in emergency situations and solving the disagreements between the supervision authorities. The EU clearly needed better tools to address the problems in banks more effectively.

The maintenance of a stable and reliable financial system are the essential prerequisites to keep the confidence and consistency in the European banking environment.

These exceptional and bold measures have helped to sustain financial intermediation in the euro area and have been instrumental in maintaining the availability of credit for households and companies, while remaining fully consistent with the ECB's primary mandate of ensuring price stability in the euro area over the medium term [20].

However, the operation and success of such authorities may bring stability, global cohesion and popular confidence in respect of European regulatory powers.

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# The Evolution of Banking Competition under the Influence of European Union Regulations

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## Abstract

*The European directives are a challenge to the study of competition in banking and financial industry. Many regulations were implemented in the last 20 years in European countries by the need to obtain the level of harmonization required for develop a single competitive financial market. The purpose of this study is to underline the influences of regulations from European banking framework on banking competition. What are the main influences of the banking directives on competition? What are the changes appeared in the European banking field after the implementation of integration policy? Those are some questions that I tried to answer. In this study section 1 analyses the competition regulatory framework in European Union. The second section presents the European directives and investigates their impact on banking competition and the third one concludes.*

**Keywords:** European integration, banking competition, regulatory framework, financial market, European directives

**J.E.L. Classification:** E44, F15, G18

## 1. Introduction

During the last years, the banking consolidation process from Europe determined the evolution and the development of the European banks in national economies more than cross border, despite the encouragement of European regulations considering the EU banking expansion thorough a common regulation of the banking system and other financial services and by removing barriers between banking system, the insurance and capital market.

The bases for the existence of a European common market were created by the Treaty of Rome. The main interest of national players belonging of the Single Market is to grow during the next period by expanding into foreign markets. One of the reasons that created this trend is that internal expansion opportunities have entered into a slowdown phase.

Despite the measures taken over the time considering the increasing of financial integration, the European Union continues to be characterized by fragmentation due to technical, regulatory or administrative barriers in different national financial systems. The euro introduction and the measures adopted by the Financial Services Action Plan (FSAP) contributed to the increasing of financial integration, but the specificity of each national economy and the legislative diversity delayed the full integration of financial markets.

The Financial Services Action Plan of European Union launched in 1999-2005 period, had as main objective to create a single market for financial services specifically designed for industrial consumers based on a single legal framework for securities markets and derivatives, for mergers and acquisitions and in the same time to provide access to all consumers at a European financial market for individual consumers, which would imply a reduction of differences considering the rates between EU countries the harmonization of prudential regulations, especially in insurance and reinsurance fields. The regulatory areas included European investment company statute, tax savings, banking privacy, pension funds, and acquisitions, financial services' distance communication.

Europe 2020 strategy for smart, sustainable and inclusive economy and its sustaining represents one of the main

challenges for the competition policy, considering the strong global competition and the financial crisis (European Commission, ec.europa.eu/europe2020/reaching-the-goals/targets/index\_ro.htm accessed on 13.02.2012).

The competition policy and the strengthen competition reforms are an important part of economic governance. It has the ability and the influence to make an important contribution, is an essential factor for a proper function of the markets through efficient allocation of resources

It has the ability and the influence to make such a contribution is an essential factor for proper functioning of markets through efficient allocation of resources and increasing productivity and innovation. This policy supports the competitiveness of the European Union, which is becoming increasingly important to maintain the economic and financial stability.

## **2. Analysis of the competition regulatory framework in European Union**

Competition is the key element to stimulating the competitiveness of European industry considering the demanding goals set in Lisbon Strategy. New approach of the competition policy entered into force on 1<sup>st</sup> May 2004, coinciding with the accession of ten New Member States. This was described by the European Commission as pro-active and is characterized by:

- To promote an intense economic activity with impact in increasing the results, a wide diffusion of knowledge, better conditions for consumers and efficient economic restructuring all over the internal market requires an improvement of the competition regulatory framework;

- To stimulate competition are necessary steps in eliminating entry barriers and the obstacles appeared during the process (Stoica and Palma Martos, 2009).

Since 1990, the Commission followed a dual strategy: developed and strengthen bilateral relations with major trading partners and made important investments in multilateral bodies such as OECD (Organisation for Economic Cooperation Development) or Internal Network Competition (INC).

During the first half of the twentieth

century, the authorities from many European countries had a much more tolerant view about monopoly and restrictive practices than those from USA. Since the Second World War there was a gradual strengthen consolidation of the antitrust legislation in Europe. Ironically, since the beginning of the 21<sup>st</sup> century the European approach can be characterized as stricter than the one from USA considering various aspects. Many European governments had a hostile view about non-interventionist approach, approach that has been dominant started with the eighties. They also had being sceptical that the market should select the most efficient firms, unless it is provide otherwise.

The main objective of The European Union's competition policy is to promote this approach in the European Single Market. Main pillars of EU competition policy are represented by 81 and 82 articles from the Treaty of Amsterdam, which was developed in 1999. These two articles incorporate the 85 and 86 articles from the Treaty of Rome. In accordance with the subsidiarity principle, the scope of 81 and 82 articles is limited to the companies with the headquarters in EU's member states, which are developing commercial operations in other EU's countries.

Article 81 refers to restrictive practices, which prohibit agreements between the banks from EU's member states which prevent or restrict competition. The interdiction refers both at the vertical agreements and also to the horizontal ones.

Article 83 regulates the potential abuses due to the existence of the monopoly, such as monopoly prices, unfair pricing and price discrimination. A bank is considered to be market dominant if it can prevent competition, acts independently of its competitors and exercises control over production and prices. In practice, is developed an investigation in the case when a single bank has 40% market share. Pricing or technical development in customers detriments, the refusal to work with certain clients and restrictions or unfair terms imposing are forms recognized as dominant position abuse.

European Commission, together with national authorities impose the rules that govern competition in EU, namely the 101 to 109 articles of the Treaty of European Union,

considering a better functioning of the markets and providing a framework where banks compete equally and fairly. These regulations benefit consumers, banks and European economy as a whole. In European Commission, the General Directorate for Competition is mainly responsible for direct application of these regulations.

The articles mentioned below, but especially Articles 101 and 102 (previous articles 81 and 82 from the Treaty of EU) (<http://eur-lex.europa.eu/en/treaties> accessed on 11.02.2012) have as main direction of regulation the following:

- Article 101 of the Treaty prohibits anti-competitive agreements between banks (e.g. market sharing). Often, the cartel cases start with a tolerance request of a bank, with the main objective of obtaining a lenient treatment;

- Article 102 prohibits abusive comportment of the banks with a dominant position on the market, for example, that force the consumers to buy a package of products that could be sold separately by the competitors or influencing the exit of competitors from the market by signing exclusive agreements. If a bank has a market share less than 40% is unlikely to be dominant.

New regulations on anti-trust procedures were introduced by Regulation (EC) no. 1/2003 and were designed for a more effective enforcement of competition rules in European Union and to operate in interests of consumers and banks and in the same time to reduce the administrative burden ([http://europa.eu/legislation\\_summaries/competition](http://europa.eu/legislation_summaries/competition) accessed on 11.02.2012). The competition rules will be applied decentralized and together with closer retrospective monitoring applied through this regulation, the Commission's administrative workload will be eased, which will result in a concentration of its resources considering the monitoring of the worst violations of competition. Also, through this regulation, the role of competition authorities and national courts in implementing de EU's competition legislation and its effective and uniform application will increase.

Mergers are governed by Regulation no. 139/2004, which entered into force in May 2004 and refers to mergers and acquisitions. This regulation was amended by regulation

no. 1033/2008 (Official Journal L279, 22.10.2008, pp. 3-12, European Commission, <http://eurlex.europa.eu/LexUriServ/LexUriServ.do>, accessed on 02.10.2012). A horizontal merger is taken into consideration only if it has a significant impact on European Union's competition. Through Article 30 of the Regulation no. 139/2004 "European Commission is responsible for transparency and effective advice provided to Member States and for the information of the third parties interested in full compliance of the procedure" (Regulation no. 139 of the European Council, 2004).

The main goal is to simplify and to improve the merger investigations' transparency; this is an essential thing in a growing and cross-border expanding market of the Member States. Also, this regulation contains the main lines in evaluating the concentration degree resulted from mergers, based on economic indicators, as well as for rights of the banks in the case of an unauthorized merger.

The involvement and the help of the state is still an important component of the EU competition policy, governed by Articles 86 and 87 of the Treaty. Through the Article 86 is established that a Member State has the right to deliver public services, but in the same time provides that the suppliers of the public services to be the object of the same rules about collusion and market power abuses like the companies from the private sector. Article 87 refers to the implementation of one rule that restricts the state aid and the subsidies if the competition is distorted, but in the same time it offers exemptions in a number of cases where the state intervention is necessary to maintain good functioning of the economy.

EU's capital requirements for credit institutions and investment firms aimed as main objective the implementation of a comprehensive and sensitive at risk framework and in the same time to encourage a good management of the consolidated risk between financial institutions. This will maximize the efficiency of the capital standards and the continuity of the financial stability, maintaining in the same time the confidence in financial institutions and consumer protection (European Commission, [ec.europa.eu](http://ec.europa.eu), accessed on 29.01.2012).

European competition policy should

contribute simultaneously for the benefit of the consumers and for the commercial interests through the merger process. Concentration degree brings some competition limitations, but in the same time it improves the efficiency. (Stoica and Palma Martos, 2009). The financial system of the countries from South-East Europe is characterized by the dominant role of the banking sector. Capital market segment for long-term funding is illiquid and in some cases even underdeveloped, and the non-bank financial intermediaries such as insurance companies and private pension funds are in early stages of development. European Commission is empowered by the Treaty of EU to apply the limitation rules. From May 2004, all national competition authorities are empowered to fully apply the Treaty provisions to ensure that it won't be a distortion or restriction of the competition (European Commission, 2011).

### **3. European directives and their impact on banking competition**

Number of the European directives appeared to regulate the banking system increased, countries in integration process and Member States must harmonize nation legislation step by step, and institutional structure to meet the EU's conditions. The technology transforms the products offered by banks and computing platforms, and the regulations transform banking services markets. This was also underlined by the recent financial crisis, on an integrated financial market the propagation and “contamination” risks threatening the financial stability (De Larosiere Report, 2009).

Treaties – cooperation based on democratic principles. Main treaties that helped and governed the formation of the European Union are: the European Coal and Steel Community (1952), Treaties of Rome: the European Economic Community (1958), the European Atomic Energy Community Treaty (1958), the Single European Act: Single Market (1987), the European Union Treaty – Maastricht (1993), Amsterdam Treaty (1999), Treaty of Nice (2003) and the Treaty of Lisbon (2009) ([www.europa.eu](http://www.europa.eu) accessed on 30.01.2012). EU Treaty is the base for euro system; this is the reason that it

has an important role in prudential supervision and financial stability.

Harmonization in banking and finance began with Directive 77/88/EEC from 12 December 1977 – First Banking Directive, which coordinates the laws, regulations and administrative acts related to the access and monitoring of the credit institutions. A credit institution is defined as a business with an activity consists in receiving deposits or other repayable funds and in providing loans on their own (Article 1, First Directive). Through this regulation was intended to increase cross-border competition, access and conduct of the business on banking markets of the EU's members in the same way as on the national markets. Harmonization of legislation at European level would facilitate the penetration and the cross-border activities. This directive is governing the fair competition between comparable categories of the credit institutions. To have a fair banking competition which can be followed by all participating banks as an example at the national transactions, but also at cross-border ones was absolutely necessary that at the directives base to have the principle of fair competition.

Another important pillar in the European banking regulations is the second banking Directive entered into force on December 15, 1989 which harmonises the authorization rules. This establishes the existence of a single operating license all over European Community – a bank authorized to operate in EU country can operate in any Member State without requiring a local authorization. This directive has a direct impact on competition; national banks were forced to modify their strategies regarding offers, costs and cross-border products. The impact of foreign offers is positive for competition, because the national players will improve their final costs for consumers to stay in the game.

In order to complete the framework for a good development of the activity, other directives were adopted: Own Funds Directive (89/299/EEC of 17 April 1989) which is in strong connection with Solvency Ratio Directive (89/647/CEE of 18 December 1989). The first Directive establishes conceptual equity standard, which Member States have to use it in the moment of enforcement of the European Economic Community and the second one sets the

minimum solvency ratio which has to be maintain by the credit institutions.

Comparing USA and Europe, in terms of transformation, the first seems to be more advanced in deregulation process – not only because of the market segmentation regarding the currency, but also because of the European Single Market Directives, substantial only on paper, they haven't been until now as efficient as on the paper (Danthine, J. and Giavazzi, F., 2000).

A step forward in integration process is represented by SEPA (Single European Payment Area), which was established especially to reduce cross-border costs. The main objective of SEPA is to eliminate all the existing barriers between national payment markets. Using technical and commercial standards, SEPA will improve the payments industry and in the same time will bring competitiveness on the market. Promoting the new payment instruments, SEPA will conduct to a single efficient market. This infrastructure consolidation will stimulate the competition and one of the main consequences will be the fact that banks will negotiate in a better way the settlement costs.

The main directive from the banking sector is the one of the capital requirement, composed by two directives: Directive 2006/48/EC of the European Parliament and Council from 14 June 2006 about acquisition and tracking of the credit institutions business model and Directive 2006/49/EC of the European Parliament and Council from 14 June 2006 about capital adaptation for investment firms and credit institutions (ec.europa.eu, accessed on 29.09.2011).

The main direction on banking evolution will be international consolidation. The players form national field will build their strategies taking into consideration the local and foreign competitors. In the same time, the competition policy will play an important role in monitoring the activities development and when necessary will restructure the inefficient banks.

#### 4. Conclusions

The interest of the national players from Euro Zone to foreign markets will probably grow in the next period and one of the reasons is that the intern growing opportunities will pass by a slowdown

period.

In Europe there are still some fears from banks to involve in mergers and acquisitions on other national markets because of political interference and national protectionism of the banking systems.

The European directives appeared to regulate this sector are more numerous, nevertheless the countries in integration process or member states have to harmonize their legislation and institutional structure step by step to meet the conditions imposed by those.

The European financial integration is an important problem, both from regional and global implications. One of the main objectives of the European Union is to create a single market for financial services. Considering that banking system is important in resources allocation and on the basis of evolution, innovation, performance and efficiency is competition, a single banking market with transparent and easy regulations to all the players can offer to clients products and services of high quality and low costs. A single European banking market with a cross-border competition leads to economic growth, based on efficient allocation of the resources, not an economic growth based on excessive consumption, both on national and European Union level.

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## Economic and Social Cohesion, Determinant of Human Development

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### Abstract

*Economic and social cohesion has been addressed in the official documents concerning the welfare of European citizens: the Treaty of Rome (1958), Single European Act (1986), Lisbon European Council (2000), Treaty of Nice (2001), Renewed Sustainable Development (2006), Treaty of Lisbon (2007). The concept was discussed as a determinant of human development and therefore sustainable development.*

*This article deals with social evolution "tools" for measuring: Human Development Index, calculated for the first time in 1990 and the Human Poverty Index, calculated by ONU. Also, there is presented the comparison of HDI for Romania and other European countries.*

**Keywords:** human development, social cohesion, sustainable development, human development index

**J.E.L.Classification:** O15, I15, I25, I30, J 16

### 1. Introduction

Economic and social cohesion is presented on the official site of the European Union as an "expression of solidarity between Member States and EU regions. EU goal is balanced development by reducing disparities between regions and promoting equal opportunities for all. "

Economic and social cohesion policy is the amount of public initiatives and actions taken towards reducing economic and social development disparities between regions and proximity to the living of their inhabitants, through actions aimed at increasing the competitiveness of these regions and creating new jobs better paid for the inhabitants of these regions for incorporation of sustainable development objectives as defined in the

Lisbon European Council (March 2000) and Gothenburg (June, 2001).[1]

Economic and social cohesion was promoted in the text of the Single European Act by inserting a new Title (XIV<sup>th</sup> of the Treaty on European Union, became the XVII<sup>th</sup> in consolidated Treaty), entitled "Economic and Social Cohesion", developed in the text of the Union Treaty European Union (Maastricht Treaty).

The concept of social inclusion incorporates multidimensional set of measures and actions in social protection, employment, housing, education, health, information and communication, mobility, security, justice and culture, to combat social exclusion.[2]

Social exclusion includes not only lack of material resources, but also the inability to actively participate in social, economic, political and cultural society.

Aiming to achieve sustainable development, each country aims to overcome gaps of other European Union member states on three pillars: social, economic, environmental.

Based on the definition contained in the Brundtland Report on sustainable development and objectives of the European Strategy of Sustainable Development can be drawn definitions of sustainable economic development (economic development as providing satisfaction to the consumer without compromising or prejudicing those of future generations) and sustainable human development in a knowledge society characterized by healthy, social cohesion, opportunities for education and employment, unpolluted environment.

In the Treaty of Nice, in February 2001, it has been revealed that "people are the most valuable asset of the European Union, investments in people will be at highly important for the wellbeing and place they will occupy in the economy of the future." [3]

Human Capital is an important determinant of economic development through its participation in the production process, helping the growth rate of added value through its innovative capacity.

A high level of employment and quality jobs are the link between economic and social dimension of sustainable development and can be quantified by GDP and employment levels, the primary macroeconomic indicators, but also the health of the population index - regarded as reservoir long-term labor [4]

Human development is an intrinsic part of sustainable development component that defines the purpose and outcome of its.[5]

Human development involves enabling people to live along and healthy life, access to education, participation in social and political life of society, freedom of speech. Fighting poverty, education and health and gender equality are central concerns of human development, focusing on six of the eight Millennium Development Goals: eradicating extreme poverty and hunger, universal access to primary education, promoting gender equality, reducing child mortality, improving maternal health, combating HIV/AIDS, malaria and other diseases. Restriction poverty is unanimously regarded as the aim of developing a fair and impact on poverty is a major criteria for assessing the quality of growth..

## 2. Human development index

Human development index is a measurement tool of social evolution in terms of health, education and income.

It was calculated for the first time in 1990 by combining indicators of life expectancy at birth, GDP per capita and level of education (literacy, school enrollment level of school-age population).

Variable *Life expectancy at birth* is the basis for calculating the HDI, taking into account so far. Since 1991, it was introduced a new variable to calculate the HDI, namely *The average amount of schooling* that with *Adult literacy rate* is used to determine the *education index*. The year 2010 brought changes in the variables used. Thus, the education variables were replaced *Gross enrollment rate in education* and *Adult literacy rate* variables average *schooling*

*period* and *The expected period of enrollment*. In terms of variable income, *per capita GDP* was replaced by *Nation gross income per capita*.

Specific index for each dimension of human development in part is calculated as follows:

$$S_i = \frac{\text{Real}_v - \text{Min}_v}{\text{Max}_v - \text{Min}_v}$$

where

$S_i$  = specific index,  $\text{Real}_v$  = real value,  $\text{max}_v$  = maximum value,  $\text{Min}_v$  = minimum value .

Minimum and maximum values have changed over time, in accordance with developments globally.

Table 1 Minimum and maximum values

Variables	Um	1995-2009		2010	
		Min	Max	Min	Max
Life expectancy at birth	years	25	85	20	83,2
Adult literacy rate	Percent	0	100	-	-
Gross enrollment ratio	Percent	0	100	-	-
Mean years of schooling	years	-	-	0	13,2
Expected years of schooling	years	-	-	0	20,6
Gross Domestic Product (GDP) per capita	Purchasing power parity(\$)	100	40000	-	-
Gross national Income (GNI) per capita	Purchasing power parity(\$)	-	-	163	108211

Source: Mirela Lazar, Cornel Lazar, *Human Development in Romania in the Context of the New Methodological Approaches*, Review of research and social intervention, 2011, vol33, p.144

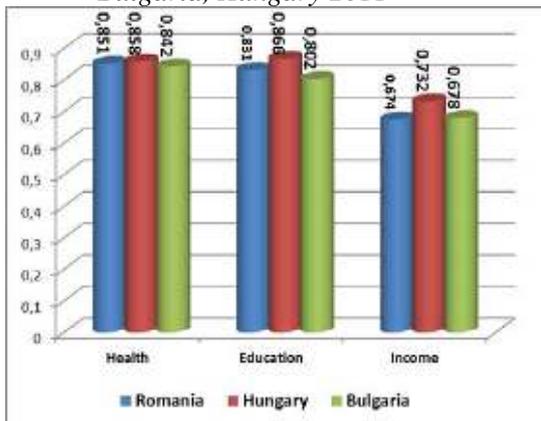
According to the Annual Human Development Reports based on HDI,

countries were classified for 2009-2010 as follows:

- ✓ very high human development: 0,788 – 1;
- ✓ high human development: 0,677 – 0,784;
- ✓ medium human development: 0,488 – 0,669;
- ✓ low human development: 0 – 0,470

European Union is a community of countries with high and very high human development, so in 2011 Romania was classified 3<sup>rd</sup> in the category of countries with high human development with an index value of 0,781, positioning us 50<sup>th</sup> of 187 countries ranked. Health factor has recorded 0,85 value, education was 0,83 value and revenues have amounted to 0.67. Hungary, EU member in 2004, classified 38<sup>th</sup> in 2011, is one of the countries with high level of human development, while Bulgaria, EU member from 2007, as Romania, is classified in countries with high human development.

Figure no 1 Comparison of HDI Romania, Bulgaria, Hungary 2011



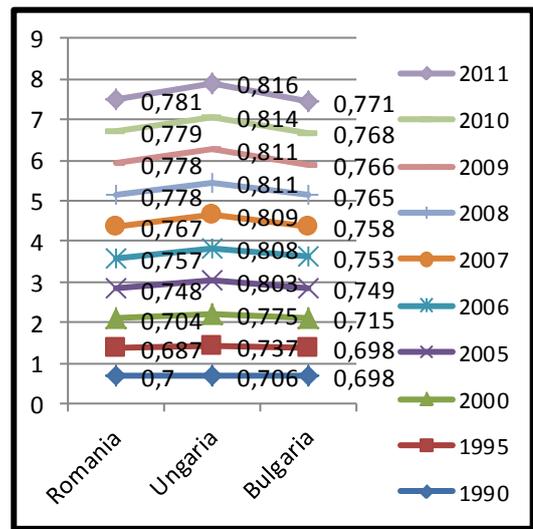
Source:

<http://hdrstats.undp.org/en/countries/profiles.html>

Romania recorded increases in human development from the value reached 0,704 in 2000 to now, the biggest jump was in 2005 when HDI reached 0,748. Rise of the index of human development is welcome, but must be considered the gap still existing between Romania and other EU countries.

By comparing the development index for the period 1990-2011 between Romania and EU neighboring countries, Hungary and Bulgaria, there is advance what we have to close the gap with Hungary and Bulgaria, the country ranked in those with high level of development.

Figure no 2 Evolution of HDI 1990-2011 Romania, Bulgaria, Hungary



Source:

<http://hdrstats.undp.org/en/countries/profiles.html>

Spending on health and education are investments in human capital accumulation and avoid providing its depreciation. In health, public expenditure in Romania during 2005-2009 were 3.8 percent of GDP, under 5 years mortality rate for 2009 recorded 12 percent, down from 34 for 1980, 32 for 1990, 22 for 2000, 18 for 2005, 15 for 2007 and 13 in 2008, average life expected was 74, based on the value of 69,6 for 1980. Average expenditure for Bulgarian citizens health was 4.3 percent of GDP for 2005-2009, while the Hungarian government covered the expenses of 5,55 percent of GDP. The largest proportion of spending was for Norway, namely 7,45 of GDP and EU member country with the highest value is Germany with 8,07 percent of GDP.

Education plays an important role in sustainable development being an objective of the strategy. Education level is measured by combining data on literacy rate, accounting for two thirds and combined proportion enrolled in various forms of education in accounting for one third. Expenditure on education in Romania has grown from 2,9 percent of GDP for 2000 to 3,5 percent for 2005 and 4,3 percent for 2007, keeping the value for 2009. In the period 2000-2009, Hungary spent 5,11 percent of GDP for education and Bulgaria spent 4,26 percent, while Sweden has

reached the highest values by 7,21 percent of budget spending.

By 2010, GDP per capita income was the size indicator, the highest value of our country was \$ 11,780 (PPP) for 2008 which led to the achievement of income of 0,682 index. For 2011, GNI per capita was 11,046, up to 2010 when it reached 10,863.

Although countries signed the Treaty of Lisbon are aware of their obligations to eliminate poverty population in terms of exposure to poverty risk indicator, countries like Hungary, Slovakia, Slovenia, Spain, Portugal, Malta, Latvia, Lithuania, Greece, France, Finland, Denmark, Czech Republic, Belgium suffered an increase in population at risk living in poverty. Fortunately for Romania, Luxembourg, Italy, Germany, Estonia, Bulgaria, Austria, is the percentage decrease in 2008-2010. However, in 2010 Romania has the highest percentage of poor population in the EU, socially excluded, 41,4 percent with a decrease of 1,7% compared to 2009.[6]

A percentage of 0,5 romanian people had the day income 1.2 dollars for the period 2000-2009 [7]

With an increase in national income per capita of only 1 percent per year, time to eliminate absolute poverty could also spread the next century. If, however, the objective is to ensure that the world is on the road to sustainable development by early next century, it is necessary to follow a minimum of 3 percent of national income per capita. Thus, the number of years required to bring down the poverty rate from 50 to 10 percent range from:

- 18-24 years if per capita income grows at 3 percent,
- 26-36 years if grow this achieved at 2 percent,
- 51-70 years, if it gets only 1 percent [8].

In the Treaty of Lisbon in December 2007, the emphasis is on respect her rights citizens' Member States in a society in which pluralism, non - discrimination, tolerance, justice, solidarity and equality between women and men. It shall combat social exclusion and discrimination and promote social justice and protection, equality between women and men, solidarity between generations, promote economic, social and territorial. [9]

Gender inequality index value for 2011 was 0,333, as Romania was ranked 55<sup>th</sup>.

In 2009, labor market participation rate for women was 45,4 percent and males 60% [8]

In the fifth cohesion report was presented Human Poverty Index (HPI) calculated by the UN for all EU regions based on a probability at birth of no reaching age 65, in the risk of poverty rate, unemployment long term the proportion of people aged between 25 and 64 years with only a primary education.[10]

The highest levels of human poverty, according to these measurements, were recorded in southern Spain, Greece, southern Italy and Portugal. The lowest levels were observed in highly developed Member States, those with moderate growth and the least developed - in the Czech Republic, Germany, Slovakia, Slovenia and Sweden.

### 3. Conclusions

Human welfare is measured using the Human Development Index which reflects the health, education and income. Since the Single European Act was intended that member countries should be characterized by economic and social cohesion. Romania is in the category of countries with high human development index value taking a rise from year to year.

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## The PIIGS Group under the Pressure of Sovereign Debt

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### Abstract

*Under the impact of all the tensions generated by the global financial crisis that degenerated into an economic crisis, the EU is subject to new tests of strength, due to increased risk of sovereign debt of the countries belonging to the PIIGS Group. The year 2011 had a maximum strength for the EU and mainly for the Eurozone countries, the macroeconomic imbalances influencing many of them, and the EU leaders admitted the lack of some legal levers that could determine the guilty countries respond for the situation created. Moreover, the legislative lack, by which the European countries are forced to correct the budget imbalance and to meet the imposed macroeconomic convergence criteria, led to a deep sovereign debt crisis in the EU. Basically, the Eurozone initially created as an area of macroeconomic stability has become a region full of uncertainties and subject to risk collapse.*

**Key-words:** unemployment; GDP; sovereign debt; creditors; crisis

**J.E.L. Classification:** E60; F36;

### 1. Introduction

The PIIGS countries (Portugal, Italy, Ireland, Greece, Spain) are mainly responsible for the sovereign debt crisis in the Eurozone, and now, they are an increasing threat to the economic stability of the EU. Therefore, analysts recommend that they leave the euro area before it is too late. The compliance with the budget deficit target of 4.5% of GDP imposed by *Portugal*, in agreement with the IMF, seriously affects the

country's economy, according to an IMF report. Despite the economic recovery measures taken in *Italy*, the country went into recession after seeing a contraction of 0.7% of its GDP in the last quarter of 2011. *Ireland* re-entered recession and its economy shrank by 0.2% in Q4 of 2011 and by 1.1% in Q3 [1], in spite of all the reform efforts made and praised by Mario Draghi, Chairman of ECB. In *Greece* tensions continue after obtaining the second financial aid from the EU and the IMF and after it managed to successfully restructure a part of the state private debt. Greece represented an important challenge for the European leaders, although it is a country with a small economy. *Spain* launched its first emission of bonds, and the verdict for the budget was unfortunately not favorable. The demand was weak, the prices went down and the yield for securities with maturity at 10 years reached only 5.7%. The government in Madrid launched another emission of bonds with maturity at 10 years in April 2012, wanting to get 5.5 billion euros. Unfortunately, Spain is back in recession in the first quarter of 2012. The domestic demand is weak, and unemployment reached 22.85% in January 2012. [2]

### 2. The PIIGS countries under the pressure of sovereign debt

Table 1. Debt of the PIIGS countries in 2011

	Portugal	Ireland	Italy	Greece	Spain

<b>GDP</b>	200 billion euro (0,2 tn)	200 billion euro (0,2 tn)	1200 billion euro (1,2 tn)	200 billion euro (0,2 tn)	700 billion euro (0,7 tn)
<b>External debt</b>	more than 400 billion euro ~ 251% of the GDP	1700 billion euro ~ 850% of the GDP	2000 billion euro ~ 166% of the GDP	more than 400 billion euro ~ 252% of the GDP	1,9 tn. euro ~ 272% of the GDP
<b>Public debt</b>	106% of the GDP	109% of the GDP	121% of the GDP	166% of the GDP	67% of the GDP
<b>External debt per capita</b>	38.081 euro	390.969 euro	32.875 euro	38.073 euro	41.366 euro

Source: <http://www.bbc.co.uk>

### 2.1. Portugal – a general perspective

In recent years, the Portuguese economy has undergone a difficult period, especially in terms of budget deficit considered to be too high. Divided into sectors of activity, *the GDP has the following structure: 72% services, 25% industry and 3% agriculture.*[3]

Foreign trade has a deep deficit, 72% of it being oriented to the EU. [4] *The main trading partners* are Germany, Spain and France, and the main creditors are: Spain (65.7 billion euro), Germany (26.6 billion euro) and France (19.1 billion euro).

Portugal recorded in the last decade, *the slowest economic growth in the euro area*, defined by an average annual rate of only 1%, due to some structural problems that have persisted in the economy. Therefore, Portugal has become *extremely vulnerable to the effects generated by the global economic crisis*, recording: a high budget deficit, an increasing debt and a high unemployment rate. The labor market presented *a trend of deterioration* in recent years, and in January 2012, the unemployment rate reached a record of 14%. [5]

In 2011, Portugal avoided the economic collapse, *receiving financial aid from the EU and IMF*. They have imposed *strict*

*conditions* to the Portuguese government: *a reduction of the budget deficit to 5.9% of the GDP in 2011, as compared to 8.6% registered in 2010, and to 3% of the GDP by 2013.* [6]

According to previsions made by the European Commission, the realization of the current plan for fiscal consolidation depends both on *the materialization of the ambitious targets regarding the budget expenditures and the avoidance of a more accentuated decrease in the real GDP.*

### 2.2. Ireland – a general perspective

After joining the EU, Ireland has turned from a predominantly agricultural country, into a modern, technologically advanced country, entitled the “Celtic tiger”. It is the country which, in the last two decades, has recorded *the highest growth rate of industrial production* of nearly 10% per year. *Foreign trade* is in surplus and 74% is export-oriented and 60% is EU import-oriented. [7] *The main trading partners* are: the UK, the USA and Germany, and *the main creditors* are: the United Kingdom (104.5 billion euro); Germany (82 billion euro), U.S. (39.8 billion euro). Divided into sectors of activity, *the GDP has the following structure: 70% services, 27% agriculture and 3% industry.*[8]

In the crisis that rocked the world since 2008, the Celtic Tiger is the second Eurozone country after Greece, which asked for the common support of the European Commission and the IMF to save its money found at great risk. After the massive growth between ‘90-‘03, Ireland has not administered money well, which led to *huge imbalances in the financial system and economy*, by increasing the budget deficit and the external debt. Much of the losses were determined by the real estate developers whose properties have been seriously affected when the speculative real estate bubble burst. *Ireland’s problems* are related to the banking system that has a high debt and a high unemployment rate of 14.3% in March 2012. [9]

### 2.3. Italy – a general perspective

Italy is a dual country with a developed and diversified economy in the north and

with large backlogs in the south. The northern regions are among the richest areas in Europe, but the country's economy is weak from a competitive point of view, the production is low, the legislation is ineffective, and the investors have low interests.

*The GDP has the following structure: 70% services, 27% agriculture and 3% industry. Foreign trade registers deficits and 59% of it is oriented to the EU. [10] Germany, France and the Netherlands are the most important trading partners, and France (309 billion euro), Germany (120 billion euro) and the UK (54.7 billion euro) are the main creditors.*

Italy has a very large debt, but it is a relatively rich country in comparison with Greece or Portugal. The doubts regarding the possibilities of the Italian political class to manage the crisis and the fears that the debt could grow to such a level that the economy can not sustain it have caused panic on the markets. France is the most exposed to Italy's debt. The annual growth rate is 0.75%, lower than the rate paid for the debt, and the economy could not sustain it. In the past, this has not become real due to the high inflation, which produced income from the collected taxes.

The global economic crisis deepened the economic problems of this country, which has faced some structural weaknesses for a long time. The IMF estimates, for Italy, an increase of 1.3% in 2012, but the reality shows that they face a huge public debt and the austerity program imposed by the government and the precarious situation of the labor market *could negatively affect private consumption and the investment in fixed assets and influence the estimations.*

However, *Italy's problems* are major as the country has one of the highest rates of GDP debt in the euro area (121%). Besides, considering that its economy is double the size of that of Greece, Ireland and Portugal put together, a package of financial support would generate too high costs.

#### **2.4. Greece – a general perspective**

For Greece, 2010 was the second consecutive year of absolute reduction rate of the GDP and a year of severe austerity measures necessary *to consolidate the fiscal*

*system and reduce the budget deficit and level of the public debt.* [11]

Greece's economy entered a severe decline within the global economic crisis and the difficulties in identifying the sources to finance public expenses.

Greece's unemployment rate climbed to 21.8% in January 2012, which was double in comparison with the euro area average, and unemployment among young people exceeds the number of those with jobs. [12] According to the estimations, the economy shrank by about one fifth since 2008, when it entered the strongest recession since World War II. Nearly 600,000 jobs, more than one tenth of the total, were eliminated in this period.

Although the Greek economy is not an important player in the vortex of the debt crisis, the disaster it might cause to the other countries in the euro area is extreme, mainly because of the fear to touch larger countries such as Italy.

Divided into sectors of activity, *the GDP has the following structure: 71% services, 23% industry and 6% agriculture. Over 50% of the Greek industry is concentrated around Athens and the country's main economic sectors are agriculture, tourism, construction and shipping. Foreign trade has a chronically deficit balance and 65% of it is directed towards the EU. [13] The main trading partners are Germany, Italy, the United Kingdom, and the main creditors are: France (41.4 billion euro), Germany (15.9 billion euro), Britain (9.4 billion euro).*

The perspective of future development is not very encouraging, because of the poor competitiveness of the Greek products on the international market.

#### **2.5. Spain – a general perspective**

Since joining the EU (in 1986) the Spanish economy has experienced a rapid growth and diversification, *the engine* being represented by the foreign direct investment and consumer demand. *The GDP has the following structure: 67% services, 30% industry and 3% agriculture.* [14]

Foreign trade is weak and is directed 70% to exports and 59% to imports from the EU. [15] *The main trading partners are: France, Germany, Portugal, and the main creditors are Germany (131.7 billion euros), France*

(112 billion euros), and the United Kingdom (74.9 billion euros). Trade in services recorded a surplus, in exports, tourism is to be noticed (54%), and in imports, services of communication, information and commerce (45%). Spain is traditionally *the second European tourist destination* after France. 2011, amid social revolts in the Arab countries, has turned the Canary Islands into the main Spanish tourist destination.

For Spain, the years 2010 and 2011 marked a period of *large structural reforms* after *the biggest economic recession registered in 2008 and 2009*, considered to be unique by experts. Basically, the economic boom made housing and construction sector push Spain into a deeper recession than many other European countries.

In 2008-2010, Spain was *the country with the highest unemployment rate in the EU*, and in January 2012 it reached 22.85%. [16] Basically, in 2010 *Spain's unemployment rate was double the average in the euro zone*. [17] Moreover, *the public debt exceeded 60% of the GDP*, and *the budget deficit*, although it decreased as compared to the previous year, *was the third largest*, after Ireland and Greece, and *work productivity* continues to be lower than the EU average.

### 3. Conclusions

After Greece, Ireland and Portugal *have received financial assistance* from the EU and the IMF, the investors' attention was drawn by Italy and Spain. Financing costs for these two countries reached record levels for the euro area. However, unlike Greece, a possible payment incapacity of Italy, *the third euro zone economy*, or of Spain, *the fourth largest economy*, would produce a real shock in the European economy and on the financial markets.

Taxation in Spain is *lower than* in other EU countries, which allows *freedom of action* in order to achieve the fiscal targets set by government. *Fiscal consolidation* appears to be essential in order to increase confidence among national and foreign investors and, on a short-term, it slows down the economic recovery which is so necessary in generating new jobs. Over time, scientists have found that *price stability* is the way to maximum sustainable economic growth. [18]

*The perspective of the PIIGS countries* continues to remain under a fairly high degree of uncertainty and the perspective of the euro area is strongly influenced by their economic development. Considering the current state of production, labor productivity and unemployment, at a high historical level, one may take into account the scenario in which the PIIGS countries could go out of the monetary union, but if one leaves the euro area, it can create a chain reaction that would involve other countries, too. Even if Greece has not started the process of dismantling this area, Spain and Italy, two major economies, will be able to generate major problems, and the crisis of confidence could lead to the recognition of the vulnerability on the “Old Continent”.

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**Section I**  
**International Affairs and European Integration**

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**Subsection 3**  
**Regional Development Strategies**

# The Development of the Romanian Agriculture by Adopting a New Type of Rural Economy

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## Abstract

*The development of the Romanian agriculture also depends on the development of a new type of village economy that requires in addition to the agricultural development the development of the non-agricultural activities, the development of industry, services and infrastructure in the rural areas. Starting from the realities of the Romanian village, the paper presents the elements necessary to develop a modern rural economy in Romania.*

**Key words:** rural economy, agriculture in Romania, agriculture development

**J.E.L Classification:** Q15, Q18

## 1. Introduction

Agriculture is an important area for Romania, considering having a large number of agricultural lands and the size of the population employed in agriculture.

In many specialized studies the development of this sector is considered an opportunity for Romania's progress, agriculture being an important area that can be exploited for qualitative transformation of the Romanian economy.

On the other hand, the quality of Romania's European Union membership implies Romanian farmers adapting to the requirements of the European and world agriculture. In this respect the existing gaps should be eliminated both in the level of development of agriculture and in the one of the village.

The specialized Romanian literature by the studies of some authors such as Păun I. Otiman, Dinu Gavrilescu, Cristian Hera, Gheorghe Zaman present the importance of

developing a healthy rural environment, by training of professionals by developing infrastructure and services.

It is paid particular importance to the development of the rural area at the level of the European Union, through various policies and regulations, especially through the Common Agricultural Policy.

Thus, the rural development is one of the most complex contemporary economic concern because it involves balancing the requirement of preserving the rural, economic, environmental and cultural areas of a country on the one hand and the trend of modernization of the rural life on the other hand.

This study aims to capture some aspects of Romanian rural economic development, and finally propose some means of action for the development of a modern rural economy in Romania.

## 2. The rural economy in România

In the context of the social change in the Romanian society registered in the last two decades, the rural environment goes through a sinuous phase of redefining, determined by a number of socio-economic processes, such as: the re-allotment, restructuring the economy, the migratory urban-rural movement, the external migration, the intensive development of towns located near the major cities and the depopulation of the isolated villages. All these put their imprint on the type of farming applied, on the type of farmer, on the level of rural development and on the quality of life in the countryside.

The economic and social dynamics of all countries has shown that important changes occur constantly in the economic structure of regions. The structural changes caused by the rural economic life raise questions relating

to: local and regional development, integration strategies in regional and cross-border development programs and economic reconversion of regions and labour.

For Romania, which is in the process of economic reform, the dynamics of the sector, regional and local restructuring is much more accentuated. The reconversion-restructuring programs have some features determined by the transition from one type of employment to another one, from one branch to another, from specialized activities to multiple activities or from a focused activity to other territorially dispersed ones.

The rural agriculture and development in Romania are cardinal components of the evolution of the Romanian economy.

The Romanian village faces problems related to agriculture – such as the existence of the subsistence agriculture, increased uncultivated land, the shortage of spaces for production and storage, the loss of the genetic potential of animals, desertification of areas, but also problems related to the aging of the rural population, the reduction of qualified labour force, increased poverty, underdeveloped infrastructure.

These imbalances have shown that the reform process in agriculture and the rural development are challenging and require a slow evolution. Therefore, the Romanian agriculture can not be compared in terms of yield and level of development with the agriculture of the EU countries.

Romania still has a subsistence agriculture, 35% of the farmland being owned by small and very small farms that have less than 5 hectares and the work in agriculture is predominantly family-type and and it involves the production of goods for self consumption. The products of these households are excluded from the market because they do not meet the demands of the *acquis communautaire* regarding trading. They were attracted into the economic circuit through association and cooperation on a contractual basis to become viable and the sector of the market-oriented family holdings is still underdeveloped.

Statistics show a downward trend of the active population in agriculture and also an aging workforce, half of which is over 45 years. This trend will continue, according to the demographic forecasts, due to the decrease of birth rates and increased aging of

the Romanian population and amplification of migration. These phenomena influence the degree of openness to innovation, occupational mobility, retraining.

Even if the employment recorded in the Romanian agriculture has a high level, the qualified agricultural workforce has a low share. In this respect the agricultural legislation has not yet introduced the certified agricultural producer and has not set up structures and mechanisms to promote it. At the same time, the banking and financial law does not link the loans for farmers also to their skill level (similar to the EU farmers` green certificate), but only according to material collaterals system.

On the other hand, the small and medium rural businesses corresponding to the upstream and downstream industries and services of agriculture have created few jobs requiring skilled labour, with low absorption capacity of the available workforce in the rural areas.

The agricultural product processing industries are largely obsolete technologically, with low technical and economic performance, to the limit or, most often below the limit of profitability. Many of these companies without the financial capacity to upgrade or the attractiveness for privatization are on the verge of bankruptcy, liquidation and closure, generating further rural unemployment.

The efficient private family agricultural holding is not sufficiently developed because of the inadequate technical facilities and low investment capacity. Eventually the agricultural area`s profitability and efficiency do not depend so much on its size, but rather on the quality of production, farm management, agricultural exploitation as company and its participation in the market competition.

Even if, in terms of economic structure in the rural area the agricultural activities occupy the largest areas, the development of services is also very important, especially the agro-touristic ones in the development of the Romanian countryside.

Job losses from the agricultural activities can be reallocated in the industrial, social and services activities in the rural areas. A series of non-agricultural activities have developed harmoniously in the countries where there have been applied specific policies to keep

the population become non-agricultural in the rural areas. They should be complementary to the agricultural activities.

The Romanian rural non-farm economy (industrial enterprises, in services or rural tourism) has a low share.

Unlike the EU, where the non-agricultural rural economy is almost 60% of total rural economy, in Romania it accounts for about three times lower (21.8%).

The non-agricultural rural economic development contributes to gross value added growth by processing the non-agricultural and raw materials from the local resources, but also to the creation of jobs by using and stabilizing the local workforce (rural), to the revitalization of the rural communities, particularly those in the disadvantaged and peripheral areas.

### 3. A new type of rural economy

The quality of the Romanian agricultural area is the natural premise of the competitiveness of the Romanian agriculture. Thus, the Romanian village should be removed from the closed natural economy and introduced into the business environment. The rural economy should be transformed gradually from subsistence economy to commercial economy.

Romania needs a multi-functional and competitive agriculture complementary to the other European countries' agriculture. It is necessary *to change the agriculture which is dominated by subsistence household with an agriculture made up of commercial private-family farms* that are technically, economically and financially efficient.

It is also necessary a modern infrastructure correlated with the current needs of the rural life and with a complex rural economic activity in the Romanian rural area.

Creating and maintaining an adequate infrastructure is essential for the economic and social development of the rural areas and for achieving a balanced regional development.

Romania presents major discrepancies between the urban and rural area both in terms of physical infrastructure, as well as the social one.

The infrastructure for transport services, telecommunications, electricity, water and waste management is essential for business

development and attracting investment in the rural areas. An improved public infrastructure could serve as a basis for creating new economic activities and in turn could generate new jobs.

The human capital is crucial for the economic development potential of a region. The diversification of the rural economy also depends on the level of education, skills and qualifications of the rural workforce.

The modern European vision on agriculture gives an important role to the modern farmer, which is defined by the Frenchman Bertrand Hervieu (former president of the Institute for Agricultural Research in France) as being a farmer who practices a job of synthesis that is specialized and complex. This job requires new skills that are not inherited, but rather are learned. From this point of view, the farmer is a modern entrepreneur. The rural development, the improvement of life quality and the diversification of the rural economy depend on the modern farmer. All the requirements and obligations imposed on the new type of farmer converge towards achieving a higher level of professionalism. This requires a systematic, continuous and multidisciplinary education from the farmer.

The professional sphere of the modern farmer must exceed the field of agriculture which he needs to master in depth; he must also know the environment, both in terms of its conservation and current challenges regarding global climate change.

The specialists' continuous education and training in the agricultural sector provide the foundation for the long-term sustainable agricultural development

On the other hand it should be sought both the stimulation of investments in the development of agricultural activities and also the non-agricultural ones, so as to contribute to the development of the rural economy.

It is also very important the attraction of European funds, but the changing of the Romanian agriculture and of the rural background can not be done only through the support from the European funds. The internal factors' effort is the one that can change the current state of our country's agriculture.

Thus, a new type of modern rural economy (village) requires measures aimed at the following actions:

- developing activities and promoting competitive agricultural products,
- better regulation of the rural markets,
- compatibilizing the rural economy with the one of the European Union,
- implementing some projects based on public-private partnership,
- developing rural education, developing the access to training,
- participating in continuing vocational training,
- developing the services in agriculture (both services for agriculture and industrial services and services for the rural population),
- upgrading for agriculture,
- supporting research and innovation in agriculture,
- better funding of the field, especially by attracting European funds;
- training for the information society by connecting the rural school to the Internet and multimedia equipment,
- developing leading industries targeting ecological agricultural products, rural tourism, creating alternative energy sources.

These actions will support the improvement of agricultural holdings, increase the quality of agricultural products, increase farmers' income, reduce agricultural depopulation, improve working and living in the rural areas.

#### 4. Conclusions

Romanian rural economy is in a very large extent dominated by agriculture, whose prominent feature is the large proportion of subsistence farms, which produce mainly for own consumption. Given the dominance of agriculture, the rural economy remains very poorly integrated in the market economy. In addition, the subsistence farms accede very difficult to other sources of income and therefore the welfare of a significant part of the rural population depends solely on the level of profitability of farms.

On the other hand, we are facing a great compatibility dilemma, between the new Common Agricultural Policy (CAP), adapted to the present situation of agriculture in the European Union (high technical

performance, increasingly high technical performance, increasing higher material consumptions and costs, presence of large stocks of agricultural products with significant economic consequences upon the farm economy) and the Romanian agriculture situation, which should target other objectives (deep farm restructuring and farm consolidation, massive support for increasing the EU market).

The functional implementation of the Common Agricultural Policy involves the following: increase of agricultural production contractualization level, diminution of underground market and fiscalization increase in agriculture, as well as the improvement of the agri-food chain operation by promoting the agriculture based on harvest contracting.

Therefore their efforts to develop programs, strategies and projects viable and integrated in the European context are extensive and very important for the development of the Romanian rural areas.

#### 5. Acknowledgement

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## Features of the Regional Development and Decentralization in Romania. A Comparative Analysis of the Regions of Romania

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### Abstract

*Nowadays, global economy has to face some difficulties, especially since the financial crisis is still a present factor in our economy. This research paper emphasizes the importance of adopting, especially during instability periods, coherent measures by all those who have the power of decision in terms of local budgetary revenue collection and expenditure destination. It is necessary that the regional development dimensions to be conceived according to the diversity of nations, their historical background, but also the cultural, economic and social development discrepancies. We have also underlined the connection between regional development, local autonomy and decentralization, mainly the administrative decentralization, as these concepts define the transfer of responsibilities for the planning, financing and management of certain public functions from the central Government to subordinate units or regional and local authorities. The article focuses on the Global Index of Development and its specific indicators which reveal region's social-economic and financial performance.*

**Key words:** regional development, local autonomy, decentralization, local needs

**J.E.L. Classification:** H71, H72, R58

### 1. Introduction

Perhaps nothing has sparked more divergence among economists than the relationship between state and individuals or the relationship between state and economy.

Concepts concerning liberalism, free market, state intervention, or, more recently, local autonomy, fiscal decentralization and regional development have generated

ambiguity and conflicts in certain time periods. In the past years, the dispute between economists is frequently related to, on the one hand, the failure of the market – how serious it is, and, on the other hand, the failure of governance – how effective or ineffective public policies have proven to be.

Regional development is a relatively new concept that aims at stimulating and diversifying economic activities, stimulating investments, helping to reduce unemployment and, eventually, lead to an improvement in the standard of living.

Another important concept presented in this paper is the regional development policy, a concept that describes a set of measures planned and promoted by local and central public administration authorities, in partnership with various actors (public, private), in order to ensure a dynamic and sustainable economic growth, through maximizing the regional and local potential, in order to improve living conditions. The main areas which may be affected by regional policies are: enterprise development, labour market, investment attraction, transfer of technology, improving infrastructure and the quality of the environment, rural development, health, education, culture.

The daily political discussion about decentralization and local development in Romania frequently brought about disagreement between the central government and the elected local authorities. For instance, local governments complain about having autonomy in virtually all local affairs except for financial ones. The central government, in turn, refers to numerous laws and decrees that establish local autonomy in expenditure and revenue and deplores the fact that local governments do not make sufficient use of their legal rights (1).

This research explores the meaning of financial autonomy from the regional point of

view, the major contribution being that of offering a structured overview of factors that may potentially diminish the freedom of local and regional authorities with regard of their budget decisions.

The article has two main parts. The first one describes some features of the Romanian regions and the difficulties they face, making some comparisons in terms of local development with the other EU regions and taking into account the most relevant policies concerning the local public sector. The last part of the paper includes a more pragmatic approach, as it analyzes the indicators of the Global Index of Development both for each region, but also for the whole country. Finally, the conclusions and proposals present measures we found appropriate to be taken by those responsible for the economic development of the regions in order to cope with the lack of resources, the financial crisis and, why not, the global economy challenges.

## **2. Stage research and research methodology**

Starting from the assumption that the relationship between decentralization and regional development may guarantee the stability of a real democracy, we came to the conclusion that it does not present a unified approach in the specific literature, aspect that creates practical obstacles in defining it.

One of the multiple mistakes made consists in simply understanding what the term “region” refers to. It does not show only the national area regionally marked, but it also defines multinational regions of neighbouring countries which are bounded by commercial transactions, economic partnerships or by common culture and traditions (2). The region is a territory which forms, from a geographical point of view, a distinct unity or a similar assembly of areas characterized by continuity, in which the population possesses certain common elements and is dominated by the desire of keeping their individuality and develop it in the future, with the purpose of stimulating the cultural, social and economic process.

In fact, one definition refers to the regional development as the provision of aid and other assistance to the less economically developed regions. Regional development may be domestic or international in nature.

Therefore, a correct understanding of regions might identify more precisely the regional development implications because these vary according to the definition of regions and the way a region and its boundaries are perceived internally and externally.

By analyzing the specific literature, we noticed that many studies focus on finding the financial resources needed to sustain the development of the regions. Firstly, financial decisions are the expression of financial policies pursued by central or local authorities (3). Secondly, local or regional public financial management became an important matter of concern especially in the context of decentralization (4). As a result, two other authors (5) stated that there are at least two targets to achieve: a balanced, sustainable system, able to provide local and regional delivery of qualitative services for citizens and an increase of local government’s financial solvency in order to ensure an optimal development. During the financial crisis, some economists turned towards EU grants, which can contribute to overcoming the difficulties triggered by reduction of budgetary revenues (6).

Regardless the way chosen to fundraise, the purposes are unanimously recognized and very well specified by the Regional Development Agency (RDA) in the Regional Operational Program’s (ROP) general presentation. The most important issues considered are:

- developing and modernizing small and medium sized companies;
- creating and modernizing infrastructure;
- offering support for developing cities and villages in achieving their social policies and implementing technologies;
- promoting tourism.

Using Romanian and European statistical data offered by specialized institutions, information revealed in the specific literature and other sources, this research paper highlights some economic facts related to the regional disparities and to the absolute need to promote and apply jurisdictional strategies of development.

We used some of the indicators of the Global Index of Development in 2010 for Romania and for its regions. We retrieved information for this purpose mostly from the Romanian National Institute of Statistics.

### 3. The decentralization process and the regional economic development

In the public administration system, an important role is held by the connections established between the Government and local authorities, i.e. between the centre and the periphery of the system.

We often hear about the need for local and regional interest to obey the general interest. Hence, the administrative law doctrines (7) have established the types of relationship that exist between central and local governments.

In essence, there were two such relationships established: centralization and administrative decentralization, which are also principles of organizing the regional public administration.

Decentralization represents a system of organization that allows human communities and public services to manage themselves, but under state control and authority, giving them the necessary resources.

Decentralization is the transfer of administrative action and decision from the central government to the public authorities of the local governments (8).

At international level, decentralization is seen as a long-term gradual process (9) involving various components, such as political, technical, administrative, fiscal and financial decentralization.

Closely related to our study are the administrative decentralization and the financial decentralization. In a recent study, two authors (10) have defined the administrative decentralization as involving the transfer of the decision-making authority, as well as the resources for providing public services or functions to other levels of administration, local government agencies or offices. This means that local authorities can engage and dismiss its staff, without the intervention of the competent ministry.

Financial decentralization is an important component of decentralization because local authorities have the most complete information on which decisions regarding local financial resources can be better justified. It also involves the transfer of responsibilities to local authorities based on the principle of bringing public services closer to citizens and resources, the international practice using the custody/allocation method and the revenue

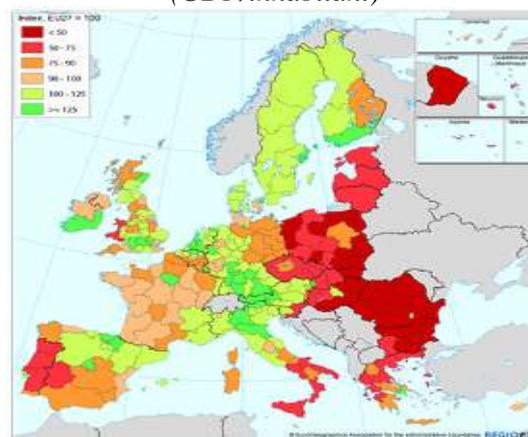
sharing method, under which a certain tax will be transferred to the authority that is able to administer and collect more efficient (11).

The financial and administrative decentralization are related. Local public administration authorities are invested with the right to establish and manage some taxes in order to provide the necessary resources to cover the expenses of the regions.

In Romania, the theme of decentralization has been increasingly invoked in the recent years. However, this economic, political and social objective failed to be efficiently implemented. Until now, our representatives could not identify clear solutions to respond promptly to the specific requirements of regional and local communities.

The European Commission is the institute that created and developed the concept of regional policy as being an investment policy. It supports competitiveness, economic growth, job creation, improved quality of life and sustainable development. These investments support the delivery of the Europe 2020 strategy. Regional policy is also the expression of the EU's solidarity with less developed countries and regions, concentrating funds on the areas where they can make the most difference, for example in the regions illustrated by red (index <50, EU27=100) in the following figure:

Figure 1. Regional Disparities across EU (GDP/inhabitant)



Source: European Commission website, available at <http://ec.europa.eu>

Their desire is to reduce the significant economic, social and territorial disparities that still exist between Europe's regions. Leaving these disparities in place would undermine some of the cornerstones of the EU, including its large single market and its currency, the euro.

During the period 2007-2013, the EU has invested and will invest a total of €347 billion in Europe's regions (12).

The funding helps, for example, to improve transport and internet links to remote regions, boost small and medium-sized enterprises in disadvantaged areas, invest in a cleaner environment and improve education and skills. EU funding is also invested in innovation, developing new products and production methods, energy efficiency and tackling climate changes.

All these contemporary international development dimensions are subject to globalization and integration, aspects that enforced countries to find homogenous ways to structure regions from different national areas. In Romania, we use the Nomenclature of Territorial Units for Statistics (NTUS) created by the EU Statistic Agency with the purpose of creating a unique classification guide for the regional statistics of the EU.

#### 4. Romania's regions and the economic and social disparities between regions

Accumulating the essential elements of the National Regional Development Strategy with the aim of reducing disparities between regions, 2007 – 2013 ROP approved a total budget of 19.2 billion euro from EU structural funds for our country. In addition, Romania benefited also of 10 billion euro from the national contributions of the state budget, local budget and private sector (13).

Romania is currently divided into 42 counties contributing to the state budget. Each county has in turn its own budget, just as cities and municipalities that are part of these districts have their own budgets. Local budgets are fed by local taxes, such as land tax, building tax, fees for advertising panels, but also by amounts transferred from the central government budget.

Such territorial division involves relatively high costs of all structures and it does not fulfil the efficiency requirements. Reforms of public administration need to be carried out to reduce public expenditure and to increase effectiveness and efficiency of some new and larger administrative divisions.

In addition, it encourages the relations of subordination between local and central authorities and, therefore, an excessive dependence. In this context, it is

understandable why the EU wanted a new territorial division. The new regions would be much larger and could handle more responsible the structural and cohesion funds.

In Romania, the institutions that have responsibilities in this area are:

- the National Council for Regional Development – a national partnership structure, with decision-making on development and implementation of regional development policy objectives;
- the European Integration Ministry - the institution that has powers towards developing, coordinating, implementing and monitoring policies and strategies of regional development;
- the Regional Development Council - a deliberative regional institution without legal personality, which functions in each region to coordinate different activities resulting from development policies;
- the Regional Development Agency - a non-profit, legal personality body, acting for regional development.

Currently, we are talking about dividing the territory - NTUS level I - into eight development regions - NTUS level II - where the policies to be applied.

Romania's territorial structure consists in 320 cities. These are basic administrative levels corresponding NTUS level IV. Municipalities, towns and villages are grouped into 41 counties, which, together with Bucharest, represent NTUS level III.

*Table 1. Levels of administrative organization in Romania*

NTUS	Unit	Number of units (July 1 <sup>st</sup> , 2011)
I	Romania	1
II	Regions	8
III	Counties	42
IV	Municipalities, towns and villages	3,179

*Source: <http://ro.wikipedia.org> – the administrative-territorial division of Romania*

The proposal about creating the eight regions became a fact in 1998. The regions are administrative-territorial units with no legal personality and were formed through the voluntarily association of counties. Institutional framework, objectives and instruments of regional development policy were revised in 2004, in the context of

negotiations on Chapter 21 "regional policy and structural instruments", by approving the regional development law in Romania (14).

Table 2. Total surface and population of each region

NTUS I	Region (NTUS II)	Total surface (km <sup>2</sup> )	Population - January 1 <sup>st</sup> , 2010
RO		238,391	21,462,186
	N-W	34,160	2,719,719
	Centre	34,100	2,524,418
	N-E	36,850	3,712,396
	S-E	35,762	2,811,218
	S	34,453	3,267,270
	B – Ilfov	1,821	2,261,698
	S-W	29,212	2,246,033
	W	32,033	1,919,434

Source: own adaptation after the Romanian National Institute of Statistics database

A more relevant analysis reveals the situation of some indicators of development at regional level.

Table 3. The analysis of regional development indicators in 2010

Region	Unemployment rate (%)	Percentage of urban population (%)	Infant mortality (no of persons)	Human pressure index
RO	7	55.07	9.8	0.6819
N-W	5.9	53.31	8.9	0.761
Centre	8	59.39	8.7	0.7533
N-E	7.8	43.15	11.2	0.572
S-E	8.1	55.08	12	0.8271
S	8.8	41.44	10.9	0.7464
B–Ilfov	2.4	91.97	6	0.0465
S-W	9.2	47.9	9.3	0.8011
W	5.9	63	10.4	0.9755

Source: own adaptation after the Romanian National Institute of Statistics database

All four indicators presented in the previous table are part of the 17 indicators taken into account when evaluating “the Global Index of Development”.

The region represented by Bucharest and Ilfov has the best results, except for the human pressure index which has a low value, aspect which shows that human activity has a strong impact upon natural resources (there is an average of 465 m<sup>2</sup> of agricultural area per inhabitant). The least significant pressure is in the W Region, as the average of agricultural area per inhabitant is of about 10,000 m<sup>2</sup>. Such differences between regions

are to be observed to all the regional development indicators evaluated.

In 2010, the unemployment rate was only 2.4% in Bucharest-Ilfov Region as compared to the national average (7%). Below the national average we find also W and N-W.

In terms of dividing the population between urban and rural areas, the regions present a quite balanced situation. As expected, Bucharest-Ilfov Region is an exception as almost 92% of the inhabitants live in the urban area. Rural population is more frequent in the S Region (about 59%), N-E (about 57%) and S-W (about 52%).

Infant mortality is of 6 persons per 1,000 live births in the case of Bucharest-Ilfov, while in the rest part of the country, the number is higher, ranging between 8.7 in Centre and 12 in S-E, so that, at country level, we obtained a percentage of almost 1% (i.e. 10 out of 1,000 children die early).

Although statistics show some variation over time, due to local factors, economic growth had a significant geographical component, the underdeveloped areas being concentrated in the N-E part of the country, on the border with Moldova, and South, along the Danube River. Underdevelopment appears to be strictly correlated with unemployment, rural activities and the inability to attract foreign direct investments.

The region situated in N-E suffers from its dependence on agriculture, as well as from its position near the border with Moldova and Ukraine. Western and central parts of Romania are closer to Western markets and are not so dependent on the primary sector.

These differences between regions, associated with fiscal policy mechanisms, led to increasing underdevelopment and disparities. Investments in deprived areas have decreased substantially due to a sharp drop in public expenditure caused by fiscal problems. This decline has affected investments in infrastructure and it prevented the modernization of key public utilities.

## 5. Conclusions and proposals

For this millennium, the World Bank experts consider the following trends: globalization, competitiveness and decentralization. All have a direct impact, but the last one requires multiple resources.

Decentralization is a process of

rationalization in the public administration, a sign of modernization. Regional organization and decentralization are not to be perceived as independent one from another; they are the product of the efficient functioning of the state. As a consequence, state control on a determined social and geographic area is more active if the territory is split into several administrative units.

Regional strategy has multiple purposes:

- the disparities between Bucharest-Ilfov Region and the other ones;
- the unbalanced development between regions, i.e. between N-E, S, S-W and W, N-W and Centre;
- the massive decline of small and medium towns, particularly mono-industrial cities, generated by the industrial restructuring;
- the degradation of the social-economic development of many large cities, contributing to the reduction of their role in developing the surrounding areas;
- low level of attractiveness for investors.

We consider that the overall objective of each institution should be the support and promotion of social and economic balance, the improvement of infrastructure, the encouragement of investments, especially in the areas where development delays are recorded. The main way to achieve all these would be an allocation of funds differentiated by region, according to their GDP/capita, so that the less developed regions to benefit from greater financial allocation.

The funds will provide resources for the implementation of projects which may produce a major impact for regional development: rehabilitation, modernization, education and health, transport infrastructure, improvement of the business environment, stimulation of entrepreneurship and opportunities for areas with growth potential.

Following the dynamics of regional disparities in Romania, the general objective of ROP

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# Poles of Competitiveness Policy of the European Union Member States

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## Abstract

*Both at micro, meso, macro or megaloeconomic intensity of competition coupled with the phenomena of globalisation of economy, fast technological changes, especially of computers and telecommunications, prograssive liberalisation of international trade are key elements that influence competitiveness on all levels. The complex determinants of competitiveness refers to: exploation of creative and innovative potential of regional/territorial/national, making connections to regional/territorial by stimulating the clusters/competitive clusters, national and cultural heritage, using innovative research potential. Competitive clusters shaping new roles to local authorities and governments because they represent the most effective way for a convergence between the companies, government agencies, educational institutions such as universities or academies, research centers and public authorities.*

**Cuvinte cheie:** competitiveness, competitive clusters, regional development, innovation, research-development

**Clasificare J.E.L.:** M21

## 1. Introduction

Recent developments, both in terms of public policy and the concepts of economic theory places the regions as centers of economic growth and improve living standards, governing key points, organize and decisions. The latest studies made in the European Union deepens further element of territoriality, emphasizing the role of cities and urban areas in general, the main source of economic competitiveness. Thus, it was concluded that the classical theories of

competitiveness, that absolute advantage theory of Adam Smith developed the theory of comparative advantage developed by David Ricardo and even the theory of endowment with production factors Heckscher-Ohlim-Samuelson (HOS) are no longer able to meet new specific problems have arisen. Thus, modern theories of competitiveness have emerged, highlighting the theory of competitive advantage by Michael Porter (1998) which suggests that obtaining such an advantage is not only natural resource endowment factors but the efforts of investment and capital formation and quality of these efforts prevail over their quantity.

Thus, countries with a weaker feature in inputs can find key sectors to stimulate investment and innovation, investing in infrastructure, research and development and creating supply highly qualified workforce. This task is mainly companies, but government can help to achieve them by creating a favorable business environment and investment climate to encourage firms to specialize and to become world leaders. The importance of knowledge, innovation and research is undoubtedly recognized for economic development.

## 2. Competitiveness poles in Europe and Regional Competitiveness

Regional competitiveness as a concept should include as a basic principle of territorial cooperation and strengthen coordination between sectoral, national and Community. An integrated inter-sectoral and inter-institutional territory is difficult to achieve but can generate endless possibilities for analysis and intervention measures default. Since the first EU report on competitiveness, which reported worrying trends in terms of competitive advantage both in global and local, to the current strategic directions of the Union, giving priority to

regional competitiveness, the key issue became subject to the formation of European policy.

New Lisbon Agenda requires that "the EU to mobilize all appropriate national and Community resources, including social cohesion" and argues that greater ownership of the Lisbon objectives is possible only by involving local and regional stakeholders and partners social (European Commission 2005). Lisbon Agenda was originally thought to help Europe to become "the most competitive knowledge-based economy" by 2010, but subsequently underwent a review by the emphasis has shifted to economic growth based on technological progress and employment. Also, the European Commission and Council have identified a set of indicators to monitor progress divided into six groups: economic environment, employment, innovation and research, economic reform, social cohesion and environment. Later, they added a spatial dimension, which integrated strategies for competitiveness and sustainability in the European Spatial Development Perspective.

Analysis of factors generating regional competitiveness is to provide a current in the European Union in dealing with spatial planning and new policies at European level aimed at reducing disparities and more appropriate distribution of development funds within the region. Determinants of competitiveness refers to: using creative and innovative potential of regional / territorial / national level, making connections to regional / territorial by stimulating the cluster, natural and cultural heritage, research and innovation potential use and improve accessibility.

Theory clusters / poles of competitiveness in countries such as France, Belgium, Portugal became visible after the paper's appearance M.Porter (1990), relies on the idea that competitiveness at regional level derives from the presence and dynamics of geographically localized activities, among which there fierce competition, benefiting from favorable conditions of production factors, the strong demand and strong and competitive sectors horizontally. The more localized the cluster / pole, the more intense interactions between these components of competitiveness and therefore the diamond region is more competitive.

### **3. France - promoter of competitiveness poles**

Emergence of poles of competitiveness / competitive clusters in Europe was a new stage in regional development of Member States that have implemented and put into practice these concepts as the main vectors: innovation, research and entrepreneurship - Governmental projects generated innovative, sustainable growth, new jobs, competitiveness and international visibility of businesses and local products.

Policy support French competitiveness poles was established in 2005. However, in 1987, long before the arrival of the pole term competitiveness, was an initiative in this regard. Through "Productifs Locaux Systemes", the French government supported the structural changes in regions affected by the decline of industrial sectors. The final beneficiary has not been a single company but a network of companies in a given field and in a certain region, called "local system of production-SLP".

The objectives of this program were increased competitiveness of SMEs, increase the attractiveness of the region and creating / maintaining jobs in sectors faced with problems.

Thus, this program has already established two important features of the pole of competitiveness: the geographical proximity and collaboration between member companies.

In over 20 years of the program (1987-2007), were held about 110 SLP. In 2005, France has shifted policy in local production systems, developing the first version of French policy in competitiveness poles.

Appropriate policy, the Ministry for Planning and the Ministry of Industry launched the poles of competitiveness, which was a pretty significant change in orientation from the traditional approach, by pro-growth approach. The objective of this program is to improve the innovative potential of French public by concentrating all efforts on the poles of competitiveness, create wealth and new jobs.

The operating principle of the pole of competitiveness lies in collaboration and key actors in the geographical concentration of

innovation more effective service by encouraging and supporting projects in order to access a leader in the field of France and internationally.

Each pole has its own legal personality, often form an association. Association has a team (permanent staff) who has a role in:

- Facilitating actors collaboration within the competitiveness pole design and implementation of joint projects;
- Coordination and selection of research projects offers that public funding is requested specific pole of competitiveness policy;
- Developing and implementing the overall strategy of the pole of competitiveness;
- Providing international communication;
- Ensuring communication with other police in France or other countries.

Poles of competitiveness strategies are established for a period of five years. Relations between the poles of competitiveness, state and local authorities involved are set in a framework contract.

Thus, in 2005-2008 the French government has provided funding of around 1.5 billion euros to finance research and development projects in the poles of competitiveness. In this period were financed:

- 544 R & D projects since 2005 (national funding) worth of 3.6 billion. Euro, involving 112.000 scholars;
- 1343 R & D projects funded by agencies, in 2006-2007.

In 2008, the French government-issued version 2 of poles of competitiveness policy. Corresponding new version were established axes of the second phase of funding, namely: new methods funding specifically for innovation platforms; building poles of competitiveness through performance contracts; creating an ecosystem of innovation and development notably through private funding.

For this second phase, the French government provided, 5 billion for 2009-2011. It was established at the French National Agency Cluster-CDIF, meant to coordinate the poles of competitiveness. This association brings together 60 poles of competitiveness and its mission is to facilitate mutual learning and sharing experience and providing information and training services. In addition, CDIF supports

the creation of new poles of competitiveness in France.

Currently in France are 71 competitiveness clusters (17 are international and 54 national), involving 5,000 enterprises, of which 80% are SMEs. These poles of competitiveness active in 16 sectors.

#### **4. The Belgian competitiveness poles**

As noted previously, we can say about France that is the promoter of the concept of "competitiveness poles" concept enjoys a success and has inspired other countries to adopt it. As is the case in Belgium, Portugal and Romania in the near future and the Operational Programme Increase of Economic Competitiveness will implement "Operation competitiveness poles".

And in Belgium, the poles of competitiveness means business partnerships, training centers and research units, public or private designed to create synergies in joint innovative projects within a geographical area (Wallonia). These partnerships allow: enterprises to connect to a high level of excellence, increasing individual awareness of each individual actor in Wallonia and therefore part of the cation part of the pole of competitiveness contributes to the increased visibility of Wallonia, the region and the economy in Europe and international gathering skills needed to launch and success of ambitious projects, innovation based on these skills together with their partners and thus improvement of workers.

Assists the world economy and is dominated by two phenomena, namely the internationalization of trade and production processes on the one hand and knowledge-based economy on the other side and their results based on exacerbated competition between companies. Thus, research and innovation are two new pillars to strengthen competitiveness.

Confronted with these developments, the Walloon region launched in 2000 a real strategic spatial development plan which was updated in 2005, a plan is built on four transverse planes. The Belgian government selected priority actions under the program including the creation and implementation lies competitiveness poles established a policy in Wallonia Development Strategy, this policy having a budget of 280 million

euros.

Implementation of this policy in the Walloon region is part of government approach that involved first of all identifying priority areas of performance. These are: aviation and space, agro-industry, mechanical engineering, health, transport and logistics, chemicals and sustainable materials. At the poles, is organized by a management council government.

For each field are working groups be created at the initiative of established business networks in the form of clusters, large companies have the initiative established areas or on the initiative sectoral federations. Each pole has a governance council made up of a president belonging to the domain industry, deputy scientist is required. Walloon Region is represented by two members appointed by the Walloon government. Government has established a procedure whereby annual competitiveness poles are monitored and evaluated. Also, an external agency makes a new assessment every two years the poles.

Funding competitiveness poles is committed by government to cover some operational costs of poles on the one hand and on the other hand deals with funding by regional projects initiated and undertaken by private firms in the poles.

## 5. Conclusions

Emergence of poles of competitiveness / competitive clusters in Europe was a new stage in regional development of Member States that have implemented and put into practice these concepts as the main vectors: innovation, research and entrepreneurship - Governmental projects generated innovative, sustainable growth, new jobs, competitiveness and international visibility of businesses and local products. The fundamental objectives of competitiveness poles that already funcționează some countries focused on:

- Realization of partnerships between stakeholders with expertise in competitiveness poles;
- Promoting a global environment conducive to innovation;
- Availability of strategic research and development projects that would benefit from government support.

European Union countries need strong industries, competitive and innovation-based competitiveness poles / cluster competitive recognized as key drivers of innovation and growth through development of collaborative and multi-sectoral approach. Poles of competitiveness and especially a policy attribute is their responsibility to policy makers at local, national and European and global crisis is proof it can be a catalyst for collaboration and motivation in an innovative and entrepreneurial company.

## 6. Acknowledgement

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# Romanian Entrepreneurship in the Years of Economic Crisis: a Regional Approach

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## Abstract

*The entrepreneurship spirit is a key element to ensure the dynamics of the economy and the society, both at worldwide and regional level.*

*The entrepreneurship activity has the potential to respond to the challenges of an environment in a continuous change and ensures both local and regional development.*

*The aims of our paper are to present in short the impact of the economic and financial crisis on the Romanian enterprises and to analyse its effects at the regional development level. A set of two hypotheses were tested and validated during our research by using the information provided by the National Trade Register Office. Our research shows, through the analysis of statistical data, a decrease of the interest for the entrepreneurial development and a dramatic fall in number of companies over the years 2008-2010, as a result of the economic crisis.*

**Key words:** entrepreneurship, entrepreneurial activity, regional development, economic and financial crisis, Romania

**J.E.L. Classification:** M19, O18, R12,

## 1. Introduction

One of the threats which the Romanian entrepreneurs confronts with during the present economic and financial crisis, are the growth of interest rates for loans granted by banks, foreign exchange rate volatility etc. [1]. Moreover, “the high level of investor’s aversion towards risks and the incertitude of economic perspective, together with administrative barriers negatively influenced the evolution, activity and performance of Romanian entrepreneurship” [2].

That is why “the majority of Romanian established entrepreneurs are also pessimistic in terms of starting a business, growing a business and in terms of perceived business opportunities” [3].

In Romania, entrepreneurship has become a key element both in the development of the market economy and revitalization of some underdeveloped regions after 1989. The consequences of the economic and financial crisis upon Romania’s entrepreneurship have been negative, but we still do not have an exact situation of those effects.

Having as a starting point the ideas mentioned above, two interconnected questions arise:

(1) Which was the impact of the economic crisis on the intention of starting a new business?

(2) Which was the impact on establishing new businesses in terms of regional location of the premises of the company?

To have an answer to these questions we used a methodological approach based on the existing statistical data at the National Trade Register Office for the years 2008, 2009 and 2010.

The structure of the present paper is the following: the introductory part which presents the two tested hypotheses using the information provided by NTRRO, the second chapter which presents the research methodology. The results of the research are analyzed and explained in the third chapter followed by the final conclusions.

## 2. Research Methodology

Starting from the objectives of the research, the author developed a set of two hypotheses, they are:

a. The lower the development level of a region is, the effects of the economic crisis on an entrepreneurial development are smaller.

b. The lower the development level of a region is, the number of bankruptcies is higher.

When developing the research, we did a statistical analysis of the data related to the number of companies newly registered and deregistered as they are recorded at The National Trade Register Office over the years 2008 – 2010. In order to obtain the necessary data for our paper, we submitted an application to The National Trade Register Office for this purpose. Eventually, the data were aggregated at region level and the information obtained were processed using Excel.

### 3. Entrepreneurial dynamics

#### 3.1. Companies newly registered at The National Trade Register Office

The first hypothesis shows the effects of the economic crisis on the development level of a region and starting up a new business. Considering 2008 as the year when the economic crisis began, we see that the crisis mainly affected the most developed regions. For instance, in Bucharest-Ilfov region they make half of Romania’s turnover figures (Burcea, et al. 2011) and the potential entrepreneurs were reluctant to start a business in a developed region such as Bucharest-Ilfov (see table 1).

Table 1.Number of newly registered firms as per regions, 2008-2010

Development region	2008	2009	2010
Bucharest - Ilfov	20.8	19.2	18.9
Centre	12.0	12.1	12.2
North-East	12.8	13.3	12.9
North - West	14.8	14.2	15.2
South Muntenia	13.6	14.1	13.8

South-East	9.7	10.1	9.9
South-West Oltenia	7.3	7.7	8.3
West	9.0	9.4	8.9
National	100	100	100
Total newly registered firms at national level	144222	116019	123022

Source: [4]

If we process the data presented in table 1 we can see that the rate of renewal of the economic environment (newly registered firms) is of 6.7 firms at 1,000 people. In 2009, the first year of economic recession, the value of this index goes down to 5.4, then in 2010 it slightly rose to 5.7. All over Romania, in all development regions, there was recorded a decline in the entrepreneurial intention in 2009 and 2010.

It was noticed that in the Bucharest-Ilfov region where the intention to start a business was two times higher than the national average, the percentage reached is 1.8. The intention diminished in poor regions, such as North-East and South West in Oltenia region where we have only 0.8% out of the average. The data obtained confirm the hypothesis about the stronger effects of the economic crisis upon more developed regions.

Practically, the economic crisis mainly affects regions with entrepreneurial potential, those connected to the global economy.

#### 3.2. Deregistered firms at The National Trade Register Office

A common phenomenon in a market economy is registration of new companies on one hand and bankruptcy on the other. What makes the difference is a positive economic climate and a negative one. Also the number of deregistered companies as they are recorded at the commerce register.

The analyzed period 2008-2010 is characterized by a significant reduction in number of the companies in Romania. The reasons for that are the economic crisis correlated with the government policy of rising taxes for companies. The introduction of the poll tax led to very many family firms being deregistered. In 2008 the number of registered firms were 661,702 (according to NTRO), in 2009 their number decreased by 10.8%, to 626,557. For the year 2010, although we do not have information about the number of existing firms nationwide, we estimate a high percentage as the number of deregistered firms rose compared to 2009 with 25%, and the newly registered firms with only 6%, resulting in an effective loss of 14% compared with 2008. So we have the measure of the economic crisis upon the economic environment in Romania (see table 2).

*Table 2. Relative distribution of deregistrations shown on development regions, 2008-2010*

Development region	2008	2009	2010
Bucharest - Ilfov	11.4	15.4	12.7
Centre	15.4	14.4	13.1
North-East	11.4	13.9	15.6
North -West	18.2	16.0	16.8
South Muntenia	11.1	11.2	12.9
South-East	12.5	12.2	11.0
South-West Oltenia	8.8	7.6	8.5
West	11.3	9.2	9.4
National	100	100	100
Total deregistered firms	58923	202203	252594

Source: Source: [4]

One can notice that the shock of the early days of the economic crisis was strongly felt in the most developed region in the country, Bucharest-Ilfov, as well as in the least developed region – North-East. The crisis continued in the North-East region.

The data confirm the hypothesis that the less developed the region is, the effects of the crisis are more powerful.

#### 4. Conclusions

The economic crisis impacted the potential entrepreneurs who can mainly be found in the developed regions and led to shut down a great number of businesses. In 2008 the difference in number between the registered and deregistered firms was positive resulting in 85,299 registered firms. In 2009 there was recorded a deficit. The most powerful effect of the economic crisis for the analyzed period was recorded in 2010: the difference between registered and deregistered firms was a negative one, at the end of 2010 there were recorded a number of 215,756 companies who were lost. If we take into account that at the end of 2009 a number of 626,557 companies submitted their balance sheets, we can state that one third of the Romanian firms had been lost!

The early stages of the crisis were felt by the most developed regions such as Bucharest-Ilfov and the least developed North-East. The only difference is that the poorest region increasingly sank in the crisis.

Nowadays, the government, the business associations and the NGOs have to help in building a new generation of entrepreneurs. Promoting and stimulation of the entrepreneurial spirit should constitute a valuable tool in challenging the economic and financial crisis.

Our research validated a set of two hypotheses. Firstly, the entrepreneurial intentions decreased in the years 2008-2010. Secondly, the great number of deregistered companies showed how strongly the crisis was felt especially in the poor regions. With a low entrepreneurial pool and poor attention given to the development and promotion of the entrepreneurial spirit, the poor regions become even poorer.

This research, limited by its scope, represents a strating point in the study of the effects of the crisis as a whole. The obtained

results can constitute work hypotheses for research of different sectors and residential environments.

## 5. Acknowledgment

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## The Problem Of Unemployment And Flexicurity Of The Labour Market In The EU Area. Romania Situation In Relation With EA 17\*

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### Abstract

*The workplace plays an important role in people's lives, not only because it provides a decent lifestyle, but also it is the place where they spend most of their time. Therefore a good job is a necessary condition in obtaining satisfaction and good quality of life. According to a study, it has been proven that most employees consider the ideal workplace, one that offers them the possibility to prove their intellectual skills. Unfortunately, the economical crisis has left a strong mark upon this environment leading to great disturbances in balance in many countries. Concerning the EU area, all the countries within have been affected, some more than others.. Countries like Spain and Greece are dealing with some real issues and as far as Romania is concerned it seems to be just below the European average. There are also some countries such as Germany where the situation is about to stabilize.*

**Keywords :** unemployment, flexicurity, Euro Zone, intellectual skills, satisfaction.

**J.E.L Codes.:** J2, J6, J8.

### 1. Introduction

Efficient and innovative companies need motivation and content employees. So, along the usual indicators of the workforce market, data concerning the quality of the job from the employee's point of view is taken more and more into consideration, due to various forms of employment. The quality aspects regarding jobs is being represented by seven dimensions: safety in the work place and

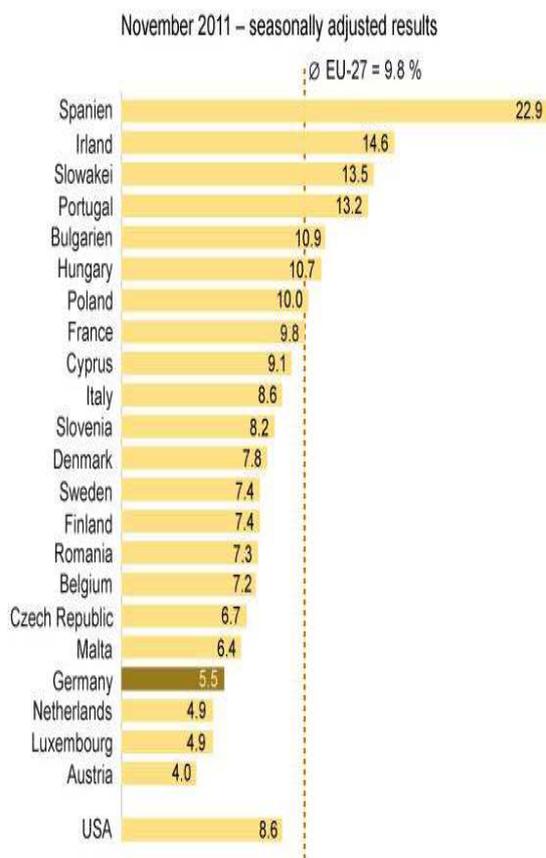
equality of chances; income and benefits; work schedule and the balance between work/life; the assurance of employment and social protection; social dialogue; skills and training; interpersonal relationships at the workplace and motivation towards work.

### 2. A current analysis of unemployment in the European Union. The problem of long term unemployment.

The crisis took a high social toll in Europe, with a high increase in unemployment. In 2008, unemployed represented 7% of the workforce of EU-27. By 2010, their numbers grew to 10% and with the perspective of maintaining a rate bigger than 9% until 2012.

The unemployment rates are especially high, over 12%, in Estonia, Ireland, Greece, Slovakia, Latvia, Lithuania and Spain. Long term unemployment - people that haven't had a job in over one year - has grown considerably and is currently approximately 40% of the total unemployment in the EU. This fact shows a considerable risk of a long term exclusion from the work force market. The rate of unemployment is especially high amidst the low qualified persons, immigrants and young people.

*Figure 1. Unemployment rates in the countries belonging to the EU (November 2011)*

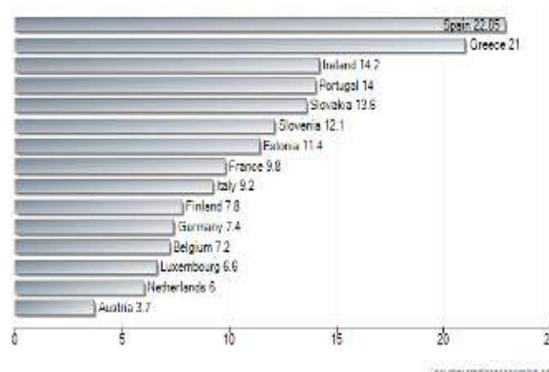


For Estonia, Greece, Latvia, Lithuania and the United Kingdom, no data were available at the time of publication.  
Results of the labour force survey;  
Source: Eurostat, last update: January 2012

Source: Eurostat

The most recent data released by Eurostat changes the hierarchy for the countries regarding their levels of unemployment. As a result, Spain remains the head of the list with a growth of the level of unemployment reaching 22.85%, and Greece with a rate of 21%. Portugal and Slovakia have switched places, Portugal with an unemployment level of 14% and Slovakia 13.6%. The growth in the levels of unemployment points to an aggravation of the economical situation despite all the measures taken towards reaching an acceptable level of employment.

Figure2. The unemployment rates in countries of the EU area. (March 2012)



Source: Tradingeconomics.com

**The problem of long term unemployment.** The social and economical costs of unemployment are higher when the reasons are of a structural nature more than when they are cyclical or frictional, and even higher when the average unemployment period is longer. A common aspect of the European work force market is the impact of long term unemployment.

Finland and Denmark together with Austria and Great Britain have succeeded in containing the problem of long term unemployment to less than 30%. This feature reveals the fact that it is possible to identify groups in the work force market with the highest risk of long term unemployment periods. The British Government has financed ongoing politics on the work force market with the purpose of increasing the chance of employment for the people that had been unemployed for long periods-including the 6 billion pounds "New Deal" program of the "Welfare to Work" strategy.

Long term unemployment is considered a serious economical and social problem. This tends to be concentrated on a reduced number of workers and may cause inequalities in revenues (relative poverty)

-long term unemployed tend to detach themselves from the work force (outsiders) and, as a result, they have little influence in establishing salaries and inflation. This means they may increase the natural rate of unemployment.

-the longer they are unemployed, the less attractive they become to the potential employers even when they are plenty of employment perspectives in the economy.

-most of the times, the national disparities are greater than the international ones, but the data based on national unemployment may hide the major problems in local and regional

unemployment. In England’s case there are few regions (including the South-East) that are operating under full employment and other (like Merseyside and the North-East) that show unemployment rates three times larger than the country's average.

### 3. Tendencies and developments regarding the unemployment in the EU area in the context of the economical crisis

**The crisis effects on unemployment in the EU area.** In the EU area (EA17) the cyclically adjusted unemployment rate was 10.7 % in January 2012, compared to 10.6% in December 2011, while in January 2011 it was 10%. Eurostat has estimated that approximately 24 million men and women in the EU27, 17 million of which were in the EU area, were not unemployed in January 2012. Comparative to December 2011 the number of unemployed has grown with 191 000 in UE27 and 185 000 in EA17. In January 2011, unemployment has increased by 1.4 million in EU27 and by 1.2 million in EA17.

Amongst the member states, the lowest unemployment rate was registered in Austria (4.0%), Holland (5.0%) and Luxembourg (5.1%), and the highest level rates were recorded in Spain (23.3%), Greece (19.9% in November 2011), Ireland and Portugal (both with 14.8%).

Compared to last year the unemployment rate dropped in 10 member states, remained unchanged in two and recorded an increase in the rest 15 EU member states. The biggest decrease was registered in Latvia (from 18.2% down to 14.7% in the period between the third quarters of 2010 and 2011), Lithuania (from 17.5 % down to 13.3 % for the period between the fourth quarters of 2010 and 2011). The biggest increase took place in Greece (from 14.1% up to 19.9% between November 2010 and November 2011), Cyprus (from 6.3% up to 9.6%) and Spain (from 20.6% up to 22.3%). <sup>[1]</sup>*Euro Area Unemployment Rate* by Eurostat.

In January 2012, 5.5 million young people (with ages below 25) were unemployed in EU27, of which 3.3 million just in EA17. Comparative to January 2011, the number of young unemployed has grown by 269 000 in EU27 and 141 000 in the EU Area. In January 2012, the rate of unemployment

amongst young people was 22.4 % in EU27 and 21.6% in EA17, and in the same month of the previous year rates of 21.1% and respectively 20.6% were registered. The lowest rates have been observed in Germany (7.8%), Austria (8.9%) and Holland (9.0%), and the highest were in Spain (49.9%), Greece (48%), and Slovakia (36%).

Figure 3. Evolution of unemployment rates in the Euro Zone

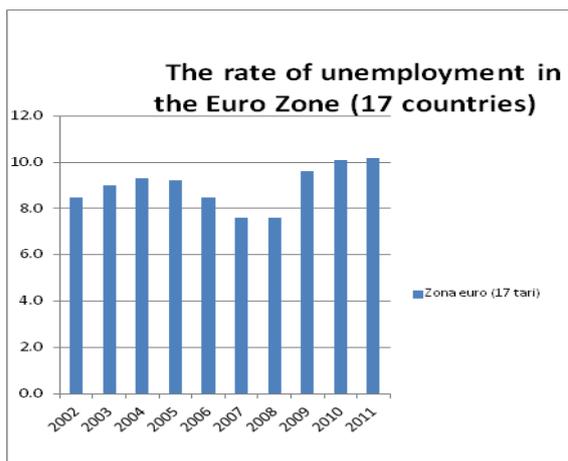


Source: Tradineconomics.com, Eurostat

**Tendencies regarding unemployment in the Euro Zone countries.** In the economical crisis period, the unemployment in the Euro Zone had extended from 7, 2% in March 2008 to 10, 1% in March 2010. This level exceeds the norm of the Organization for Cooperation and economical development, where the unemployment rate reached 8, 7% in March 2010. This growth is felt in each member state even though the **sovereignty** degree varies a great deal between states and groups. Clearly the men are more affected than the women, and the young people seem more vulnerable to this.

After three years of continual unemployment decline, Europe is on the verge of seeing the impact of the economical crisis on the work force. In the European Union as in the Euro Zone the number of the unemployed has increased each month form the minimal number recorded in 2008. Since then the unemployed from the Euro Zone has risen by 3, 7 million reaching a total of 15 million unemployed in May 2009.

Figure 4. The rate of unemployment in the Euro Zone



Source: Eurostat

The historical record in absolute numbers of 15, 8 million unemployed in the Euro Zone in the month of May 2010, had occurred after a decline of 6000 in the month of April, according to the eurostat statistics. In the next month though an additional 35.000 unemployed. The timid try of the economic growth in the last months seem to be insufficient, for now, to determine an increasing volume of the employed in the Euro Zone. According to a specialist's theory, in the labor market, only after a resumption of the GDP with a minimal of 2% will there be new work places. Although, after the profound economic recession in the euro Zone a surplus under 1, 5% of the GDP, like the one now, will not help restore the balance of the labor market. At the beginning of the economic restoration, the employers developed their production without hiring new workers, increasing just the number of hours worked by their current employees. The projections realized by the World Economic Forum do not see a spectacular economical recovery in the Euro Zone. In insert 5 can be observed EA17 a growth of the output of only 0, 8%, and the biggest growth is estimated for Germany, of 1.5% for the year 2013. <sup>[6]</sup>*Labor Force Statistics*

Unfortunately because of the economical crisis in Greece and the austere measures from a number of states from the euro zone that have induced a negative effect on the labor market. The austere measures in different states, with budgetary constraint and reduction expenses like in Greece, where the debt crisis is taking proportions, it has slowed down growth and is threthening again with the increase of unemplment alongside

consumption reduction and the demand in the economy. <sup>[7]</sup>*Monthly Labor Market Fact Sheet*, European Commission, February, 2012

Figure 5. Projections of the Output for 2012-2013

	Year over Year									
	Projections				Differences Year to Year		Q4 over Q4			
	2008	2011	2012	2013	2012	2013	2011	2012	2013	
World Output <sup>1</sup>	5.2	3.8	3.3	3.9	0.7	0.6	3.3	3.4	4.0	
Advanced Economies	3.2	4.5	4.2	4.5	0.7	0.5	4.3	4.5	5.1	
United States	3.8	4.5	4.8	5.2	0.0	0.3	4.8	5.0	5.4	
Euro Area	1.9	4.5	4.5	4.8	1.5	0.7	4.8	5.2	5.2	
Germany	3.8	5.2	5.2	5.5	1.2	0.0	5.2	5.2	5.5	
France	1.0	4.2	4.2	4.5	1.2	0.9	4.2	4.5	4.8	
Italy	1.6	0.4	-0.7	-0.6	-2.9	-1.1	-0.1	-0.7	0.0	
Spain	-0.1	1.7	-1.7	-0.3	-2.8	-2.1	0.2	-0.1	0.6	
Japan	4.4	4.3	4.7	4.6	-0.6	-0.4	4.3	4.6	4.5	
United Kingdom	2.1	0.0	0.6	3.0	-1.0	-0.4	0.0	1.0	2.4	
Canada	3.2	3.3	4.7	4.0	-0.7	-0.5	3.1	4.7	3.8	

Source: World Economic Forum Projections

#### 4. The Labour market in Romania reported to the Euro Zone

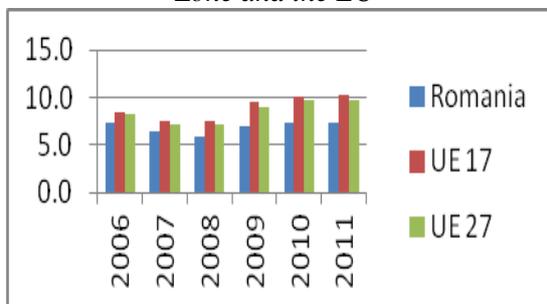
Contary to some public opinions started at the begining of the economical crisis, which stated that all the member states outside the eurozone will rush in to take part in the unique currency for stability and credit worthiness guarantee in the crisis vortex, Romania postponed for at least a year the adhesion to the euro zone. The elite club, to which we aspire, has also had difficulty regarding the labor market, which has deep scars after the recession that passed.

In the EU of the 27 member states , the unemployment rate in the first trimester of 2010 of 9,6% is situated under the average eurozone of 10,1%. It would be simple to say that the unique currency would defeat the labour market, but this reality can not be ignored.

Romania with 8, 1% in the first trimester of 2010, though increasing from the first trimester of the previous year (7, 5%), and the year before that (6, 9), it still remains under the European average. Some Romanians from Spain and Italy returned back home after the market syncopation over there, though the impact on the Romanian labor market was not felt so dramatically. Probably the registration system of the unemployed makes more people of an active age existent outside the labor market to „elude” the unemployment statistics. Officially, Romania bears an easier

unemployment burden unlike the majority of the EU and the majority of the euro zone.

Figure 6. The compared evolution of the unemployment rate in Romania, the euro Zone and the EU



Source: Eurostat

Table 7: The unemployment rate in Romania, Euro Zone and the UE during 2006-2011

Period	2006	2007	2008	2009	2010	2011
Romania	7,3	6,4	5,8	6,9	7,3	7,4
UE 17	8,5	7,6	7,6	9,6	10,1	10,2
UE 27	8,3	7,2	7,1	9,0	9,7	9,7

Source: Eurostat

### 5. Flexibility of the labor market?

A flexible market of the work force has many specific characteristics:

a. Flexible occupation structures-from an hour flexibility point of view and forms a vocational flexibility point of view at the work place

b. The cost and easiness of hiring/laying off – the hiring rules can be altered to make hiring/laying off the work force more cost efficient- these reduce the employers costs to make changes regarding the work force hired. Production and occupation can be correlated easier during the duration of the economic cycle.

c. Short term work contracts- in different industries where workers receive work contracts for predetermined periods which can be changed from month to month.

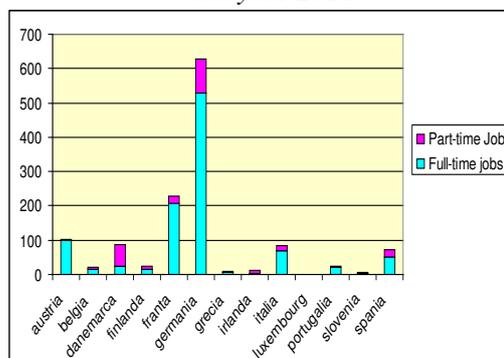
d. A high flexibility of the payment schemes. This can be observed in the payment expansion reported to performance and to decentralized bonuses so that the salaries reflect the difference between work demand and offer from different industries and regions.

e. Locative flexibility- a lot of businesses allege employees that they can move from one region to another as part of their professional development – this may be facilitated through subventions for relocation.

The 2020 European strategy introduced the concept of flexicurity on the labor market. Flexicurity is an integrant strategy which combines flexibility and security on the labor market in the attempt to make a compromise between the employers need for work flexibility and de employees need for security. The member states can implement the principals of flexicurity through the medium of four components: flexible and secure contractual arrangements; continual teaching programs, efficient policies on the labor market; modern systems of social protection. Through flexicurity a lot of part-time-jobs have been secured, and most of them have been in Germany. In insert 7 lower down the part-time and full time jobs are presented.<sup>[2]</sup>European Employment Strategy

Flexicurity is a major element of the European Strategy for occupation. The integrated flexicurity policies play an important role in modernizing the work force and contribute towards reaching the 75% occupation target established through the European strategy 2020. Countries that have made major changes for a more flexible market like UK, Holland and Spain, growths of the inequality income have been recorded and deductions of the qualification of the work force which cannot be seen as optimal from a social point of view.

Figure 7. Distribution of the part-time and full-time jobs of the EA-17 states in the year 2010



Source: OECD

## 6. Conclusions

Regarding occupation, this objective will be evaluated by the quantitative measures of the unemployment rates on the long-run, unemployment among young people and the rate of participation of the work force. This objective can be reached by promoting the flexicurity model, through reduction of the work taxes and implementing some measures that facilitate the participation of the work force in more jobs. Some tendencies, on diverse member states of the Euro Zone prove a high dispersion rate of unemployment reflecting a reduced amortization of occupation of the work force between the states that use the same currency.

The primary objectives of the Euro Pack- (plan elaborated UN 2011) are competitively growth, occupation growth, sustaining public finance and financial stability consolidation. An additional objective is coordinating the fiscal policy at an EU level. Most fiscal adjustments during 2009-2011 were made in Greece, mainly because of the supreme debt problem.<sup>[10]</sup> *The Private Cost of Unemployment*, by Wendell Lewis. Regarding competitively a primary target is cost reduction using the work force alongside productivity growth. The work costs are reduced by reforming the decentralization degree of salary negotiation, index mechanisms and reducing the salaries in the public sector. For example in 2010, Germany lowered the work force costs by 0.4% from 2009. <sup>[11]</sup>*The Social Cost of Unemployment*, by Wendell Lewis. Productivity can grow through deregulation of the industry and through infrastructure and education improvement.

Even though the year 2012 will be a challenge for the Euro zone, with the need of a high refinancing percentage of public and private debt, restrictive conditions for credit and deepening of fiscal austerity, returning on the growth side is possible in 2013, according to the Euro zone Forecast rapport (Previsions for the Euro Zone) launched by Ernst and Young.<sup>[8]</sup>Raport: Eurozone Forecast (Forecast for Eurozone), Ernst & Young, 2012

For this to become reality, the European Central Bank (ECB) has to keep playing a central role through interest reduction and

buying shares emitted by the government in the peripheral countries of the Euro Zone.

## 7. Acknowledgement

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## Opportunities for Using Alternative Energy Resources and Models for Estimating the Fair Value of a Green Energy System

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### Abstract

*The term “alternative” presupposes a set of undesirable energy technologies against which “alternative energies” are contrasted. The nature of what was regarded alternative energy sources has changed considerably over time, and today, because of the variety of energy choices and differing goals of their advocates, defining some energy types as “alternative” is highly controversial. In a general sense in contemporary society, alternative energy is that which is produced without the undesirable consequences of the burning of fossil fuels, such as high carbon dioxide emissions, which is considered to be the major contributing factor of global warming according to the Intergovernmental Panel on Climate Change. Determining the fair value for the assets of an entity is very often a real challenge.*

**Keywords:** green energy, alternative resources, sustainable development, cash flow.

**J.E.L. Classification:** C2, G17, O1, Q42.

### 1. Introduction

To promote a sustainable development was the concern of international forums since the 80's, when the reality led to conclusions, not encouraging at all regarding the mankind's future, if the development has been continued with the same rates of the years 60 – 70 of 20<sup>th</sup> century, by depletion of some essential resources, the threat of starvation, suffocation in waste etc. The immediate conclusion was: the uncontrolled growth and the neglect of the environment,

threatens the future of the planet and the equity between the generations. The rapport of the World Commission on Environment and development since 1986, led by G. Brundtland, offers the definition of the sustainable development as: "the development that aims to meet the needs of the present without compromising the ability of future generations to meet their own needs" Identifying and using alternative solutions to provide energy needs, in a universe moving with high speed on the route of development and progress, is today the forefront of the European and the global agenda. A form of energy increasingly considered is green energy or renewable energy. The advantages of using this type of energy are becoming more evident in the context of depletion of traditional resources and the increase in prices of conventional energy production. Green energy production systems are beginning to be used not only by home users, but also by companies that invest in such systems to replace traditional electricity consumption. Installing a system for green or renewable energy production by an entity leads to a tangible assets recognition if satisfies the requirements for recognizing assets included in the accounting regulations in accordance with Directive IV of EEC, part of the accounting regulations in line with European directives approved by Ministry of Public Finance. 3055/2009, as amended and supplemented. Economic benefits expected from the activity due to its recognition, are represented by its potential directly or indirectly, contribute to the cash flow and cash equivalents of the entity. When installing a system for producing green energy to be used exclusively for the entity's own consumption, the economic benefits generated by the system are the ability to reduce cash outflows, namely the amount

paid for the consumption of electricity from conventional sources..Preparation of this study starts from the analysis, based on literature of valuation models and determining fair value for items in the annual financial statements.To achieve the research has made a documentary on national regulations and the International Financial Reporting Standards applicable to this study.Research methodology contains two steps: presentation of the main evaluation methods used to estimate fair value, focusing on income method, the estimation method used in practice.The next step is a practical step, to customize its application method for an item of income which by its nature does not generate direct income through use by the entity.The proposed method for evaluating a system of non-conventional energy production focuses on future profits generated by the enterprise of such a system and not only by market conditions at a given time.The determination of the evaluation model starts from general to particular, from the specific rule, from theory to practice.

### **Purpose**

Based on the purpose of sustainable development, which may occur only as a part of an organization form: state, economic, administrative, we may detach the role of these organizations in **the drawing and shaping the economic and social system the way that natural resources and life support systems to be maintained**, in promoting new consumer attitude, which impacts the future of the planet and equity between generations, the quality of life, the development and environmental protection.

### **2.Wind energy. A local unconditional resource.**

This paper tries to identify an approach to the possibilities of action and sustainable development requirements related to settlement of the ecological crisis, caused by intense industrial exploitation of resources and the continuous environmental degradation.We started from the picture gives us the physical map of the Romania's eastern area, with the neighboring states.Identifying the community's development potential and creating favorable conditions for efficient use

of all available resources for a sustainable growth is in the government's competence, being responsible for removing barriers which stands in the way of the economic development of the administrative-territorial unit.Especially, a cooperation structure such as Euro, must be concerned with ensuring the development of large geographic areas including administrative units of several neighboring countries, by identifying solutions that highlight common points of these territories and which are adapted to periods of financial crisis that we are crossing. The current economic crisis, widespread worldwide highlights more the need to adapt rapidly and, inclusively, where appropriate, the managerial deficiencies, which does not ensure the proper functioning of the system in the conditions generated by the crisis.Crisis management will be possible only through a rational constructive approach according to the values that support sustainable development in accordingly to the society and nature.This approach is contained in the document European Commission-Europe 2020 "A European strategy for smart, sustainable and inclusive growth" from which we quote: "An efficient Europe in terms of use of the resources as to allow decoupling the economic growth from resource use, to support the transition to a low carbon economy, to increase use of renewable energy to modernize the transport sector and to promote energy efficiency" In this European context of setting the objectives that will mark the next 10 years, is necessary to channel our attention to the objective of increasing the use of renewable energy as part of sustainable development, and to identify the potential resources in the Euroregion N.-E. Romania.An indication of existing resources in the Euroregion is the hilly terrain, favorable appearance of a natural phenomenon such as wind. According to the Ministry of Environment, after Dobrogea, Moldova is one of the regions with the highest wind potential. The average wind power usually exceeds 5-6 m /s. for a period of from 3,000 to 4,000 hours per year.An investment in a wind farm to be profitable, the average wind power has to exceed usually 4 m/s, for a period of more than 3,000 hours annually. These technical conditions are met, the advantages of using wind energy are the relatively low costs per

unit of energy produced (1,600 euro / MW), emissions of pollutants - zero not producing of any kind of waste and decommissioning costs reduced. Nature helps us to meet the conditions for wind power installation, but amazing steps depends on the administration and regulations. The representatives of the Romanian Association for Wind Energy believes that the main barriers that slows down the development of wind energy in Romania are the poor legislative framework, the limitations imposed by Transelectrica to connecting to the network, lack cadastres to purchase land, bureaucracy(1). According to the analysis, "The corruptibility of law - Case study - use of wind energy in Romania "(2), for the commissioning of a wind farm requires about 85 notices, and excessive bureaucracy in the field, overlaps the delayed reaction of the local authorities, leading to a period of about 2 years since the initiating the permitting process, until the implementation. Facing of this situation that occurs in an area that could be one of the solutions by making even small progress in sustainable development even in conditions of crisis, but also constitutes a priority for the European space, any representative of local authorities and any structures and cooperation at local level must take action and initiate emergency public information campaigns and stakeholder consultation, legislative initiatives to amend the regulatory framework and even the development of local strategies / regional related to use wind energy.

### **3. Energetic willow (osier) - An opportunity for the Euroregion N.-E.**

Adequate solutions during times of crisis are those that exploit the existing potential, without requiring high investment costs, ensuring, where possible, maximum benefits in several areas: social, energy, economic. Geographical conditions of the Euroregion N.-E. Romania ensure favorite position in the fight with the crisis, relief and soil nature (river beds, flood plains unused) suitable for the cultivation of plants which in the last 3-4 years, has entered into the attention of many agricultural experts from different countries being nominated in a leading position in the EU, where it was decided to be subsidized as energy plant: energy willow. Energy willow (*Salix*

*viminialis* energy) is a hybrid of willow, fast growing, 3 cm/day reaching 7 m long and 7 cm diameter base in one year, the harvest being 40-60 t/ha. Is planted once and harvested annually with combines and chop is used as fuel in power plants based pellets. Calorific value is 4900 Kcal / Kg reason for using as briquettes or pellets in central power plants and individual schools, kindergartens, homes. To assess thermal benefit, for example Hungary which, through the energy program for 2007-2013 has provided 36,000 ha of willow cultivation of energy in order to obtain pellets of 1,000,000 tons, equivalent to 4.9 million Gcal of heating providing 145,000 suites.

The most important characteristic for which cultivation has gained ground in her last years in several European countries (Hungary Suedia.. Poland, Baltic etc.) is the rapid growth stems, both in length and in volume, but in addition this major advantage; we can enumerate a number of other advantages:

- Cultivation on permanent or periodically wetlands due to evapotranspiration capacity for 15-20 liters of water/day/m<sup>2</sup>. This advantage gives an undisputed place as a plant that makes usable thousands of hectares of land that are in decay, this was notified by countries like Sweden, where the energy willow is grown already 28-year, on the surface of over 50,000 ha., finding an efficient use of the lands unusable before, and on the other hand getting economically, a very profitable source of unconventional energy.

- Capacity of the 20-30 tons/ha of mud per year - from wastewater. This property, along with the advantage that in an area where plantation can be flooded with sewage from wastewater treatment plants, grows faster, has the great advantage that the waste water should not be treated biological being very expensive, on the other hand, the results from water wastewater treatment plants, gets into rivers very clean, avoiding water pollution.

- The willow cultivation creates new jobs for people with lower qualifications.

- The spread of energy willow crop, protects forests from deforestation caused by continuous chasing for cheap firewood.

- Is a safe alternative energy sources (heating) for settlements being used as

biomass (and chop) briquettes or pellets. High calorific value (4,900 kcal / kg) is comparable to other sources of fuel such as natural gas, coal, oil. Besides the energy use, energy willow is used successfully in these areas:

- As a source of cellulose.
- For fixing steep slopes and prevent landslides.
- To manufacture of aspirin.

#### **4. Measurement of green energy production systems, after the initial recognition**

The initial cost of the system contains the cost system components (panels, batteries, cables) and related labor. Given the very specific nature of this system and that none of its components may be used independently of other components to produce electricity, according to their destination, the entire system will be treated as an asset or cash-generating unit. On initial recognition system will be recognized at cost. The initial cost includes all costs necessary to bring the asset into working condition. After initial recognition of the asset will be amortized according to the entity's accounting policy for depreciation of tangible assets. At later recognition in the entity's annual financial statements, it can determine the fair value revaluation of fixed assets by performing revaluation according to allowed evaluation alternative treatment allowed by the national accounting regulations. Thus, fixed assets may be presented in annual financial statements at cost less accumulated depreciation and adjustments for depreciation when using the evaluation model based on historical cost, or fair value at date of revaluation, if the entity chooses the revaluation.

#### **5. Estimating the fair value**

Fair value is determined, usually, as the market value of the asset, for those assets for which there is an active market, with recent transactions. For assets for which no market exists, and is no available information about recent transactions, mathematical models are used to estimate fair value. Green energy production systems specific characteristics determined by the location, need of

electricity provided equipment used to achieve this, specific weather conditions in the area, the energy potential of the area. In conclusion, it can be said that such assets are unique assets, consisting of a set of other assets with a specific use, and not active with general characteristics. As methods for estimating the fair value of tangible assets for which there is no quoted price in an active market and are not frequently traded between the parties can use either method income or replacement cost. Income approach is considered a complex and comprehensive evaluation method, since it takes into account the concrete conditions of the market, on the one hand, and utility assets for the enterprise, on the other hand. The starting point of this method arises directly from the definition of the asset or "asset is a resource controlled by the entity as a result of past events and who is expected to generate future economic benefits to the entity" (3). Based on this definition, fair value income method is determined as the monetary expression of the asset's capacity to generate future cash flows to the firm. In the application of income method for estimating the fair value are required three steps:

1. Estimating future cash flows which will be generated by the asset by the enterprise;

2. Determining the life of the asset and therefore the period for which the estimate;

3. The choice of appropriate discount rate

Typically, future cash flows are given by estimates of future revenues generated from use of the asset, minus the expenses required for the asset. In this case, energy production systems for the use of green electricity by the entity, estimated cash flows are not given the revenue generated by such a system, but are represented by the savings entity realizes due to the reduction or even eliminating payments to electricity suppliers for classic consumption of electricity. The economic benefit resulting from the use of such asset is not productive of benefit, but its ability to reduce cash outflows.

To obtain estimates of cash flows for the entire period determined is necessary to take account of market trends, changes in electricity price forecast, and any other factors that may influence the size of flows. In estimating cash flows for a green energy production starts from electricity expense

that would have supported this year, determined according to actual consumption of energy and energy current market price. So, we can say that the cash flows of a system of green energy production can be determined for the current year, from which the assessment starts, by the formula:

$$FN_i = Q_i \times Pe_i$$

Where,  $FN_i$  = cash flow in the year  $i$

$Q_i$  = quantity of electricity, measured in the kWh, supplied by green power generation system in the year  $i$

$Pe_i$  = standard consumer price of electricity in the year  $i$  applicable entity (price / kWh)

Where some components of green energy production have useful life shorter than the period for which the estimated cash flow, cash flow forecast should take into account the costs of replacement of these components. Thus, for it is known that a replacement will be part of the system, in the scope of this article called "Part A", we consider cash flow as determined by the following formula:

$$FN_j = Q_j \times Pe_j - C_A$$

Where,  $FN_j$  = estimated cash flow for the year  $j$

$Q_j$  = the amount of electricity, measured in the kWh, supplied by green power generation system in the year  $j$

$Pe_j$  = electricity price in the year  $j$  (price / kWh)

$C_A$  = cost occasioned by the replacement of components A

## 6. Determination of Discount Rate

The discount rate used for discounting cash flows should reflect the estimated cash flows associated risks. Discount rate should reflect the risk that cash flow estimates are not obtained. A common method used to determine an appropriate discount rate is the weighted average cost of capital (WACC). The formula for determining the weighted average cost of capital is (4):

$$CMPC = C_c \frac{C_p}{C_p + D} + C_d(1-t) \frac{D}{C_p + D}$$

Where, CMPC weighted average cost of capital

$C_c$  = cost of capital

$C_p$  = own capital

$D$  = debt

$t$  = tax rate

$C_d$  = cost of debt tax rate

Unlike the cost of borrowed capital, which can be easily identified because it is the interest rate, cost of equity is more difficult to estimate, because it has a fixed price to be paid. Shareholders hope to gain income as a result of investments made in the past. In terms of entity this expectation is a cost because, if the entity will not provide the expected return to shareholders, they will give up their investment, will sell shares and could lead to lower future market value of the entity. As a result, cost of capital is the cost to maintain a certain level entity of its share price. Capital cost can be evaluated using equation whose general CAPM (5) model is:

$$C_c = R_f + \beta (R_e)$$

Where  $R_f$  = risk-free interest rate (usually for government bonds)

$\beta$  = systematic risk

$R_e$  = extra yield premium offered by the market or market

The cost of borrowed capital is determined more easily, which is the current market interest rate applicable to the entity. Since interest is an expense to reduce taxable entity and the cost of borrowed capital will be considered net of related tax. The average cost of capital thus obtained can be used as discount rate ( $r_a$ ) for the entity's estimated cash flows. So, taking into account the formulas above, we conclude that the fair value of green energy production system is expressed as (6):

$$V_j = \sum_{i=1}^n \frac{FN_i}{(1+r_a)^i}$$

Where  $V_j$  = fair value of the system

$FN_i$  = cash flow for the year  $i$

$r_a$  = discount rate

The fair value thus obtained is revalued amount of the asset at the date on which to do this.

## 7. Conclusions

From the aspects presented, shows that the most important and vital measure to be taken urgently is that to change the legislation. Mainly Law 220/2008 for setting the system for promoting energy production from renewable energy sources, published in "

Official Gazette" no. 743 of 3 November 2008, which even now, has no application rules, is contradictory and uncorrelated with related regulations, meaning its alignment to the Community. It also requires maximum care and judicious management of the energy sector, which needs certainty and predictability considering that the investments involve high costs and long amortization periods, investors being tempted and avoid the a sector that involves high risks through the lack of stability. Wind energy is an undoubted opportunity for the entire society and for the world economy, being crucial to its operation at the required parameters, considering the cost - benefit balance tilting towards benefits: clean energy, inexhaustible, low costs approx. 40% compared to conventional energy sources. Especially when the price of oil is growing, energy independence and a source for new jobs and local development. In the context of a more difficult period for agriculture, in conditions in which Romanian farmers do not receive the same support as other European farmers, thus being forced to bear an unfair competitive markets where food products can not be competitive, energy willow plantations, especially on flooded or derelict lands, may be a saving solution for users of those areas and the area economy, by encouraging investments related: briquettes or pellets factories, workshops, power stations based on pellets / briquettes or pulp and paper factories .

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# The Basic Framework of Economic Agglomerations and Regional Development

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## Abstract

*Geographers, economists and regional scientists have long been concerned with uneven regional development and the ways by which the unequal regional distribution of economic activity across space influence the process of economic growth among regions. A dominating feature of economic activities is certainly that of agglomerating in certain areas in order to exploit new opportunities like proximity to communication networks, to large population concentrations or to reduce transactions costs, all these leading to localized positive externalities. Benefits of these sorts, known more generally as agglomeration economies, generate increasing returns that seem to stimulate the economic performance of those regions where these agglomerations are located.*

*In this sense, the purpose of this paper is to explore the issue of economic agglomerations and its relationship to regional development. Through a variety of relevant theories and qualitative arguments, we substantiate the reasons why we should have strong expectations about finding a favorable connection between agglomerations and regional development.*

**Keywords:** agglomeration economies, regional development, location theories, new economic geography, endogenous growth.

**JEL Classifications:** R10, R11.

## 1. Introduction

Geographic agglomeration of economic activities on the one hand and regional development on the other hand represent two processes difficult to disconnect. The fact that a lot of industries are geographically concentrated in a particular region gives the

principal evidence for the existence specific agglomeration economies that stimulate companies to co-locate in the proximity of others and function as an unified organism. Definitely, the emergence and dominance of concentration of economic activities in certain regions constitutes one of the facts that scientists associated with modern economic growth. This complex binomial has long been researched by economic historians [1], especially in relation to the industrial revolution that took place in Europe during the nineteenth century. However, there are some observers who have argued that the new treatment of agglomerations and regional development indeed represents a truly rediscovery by different economists with a long pedigree in economic geography. Although following various approaches, our attempt is to provide a comprehensive assessment of different theoretical framework in which this relation economic agglomerations-regional development has been discussed and researched. In this sense, we point out that the modern notions and modern treatment of economic agglomerations and regional development build upon previous classical visions, while at the same time also introducing new insights. In order to achieve this aim, we structured the present paper in the following way. In Section 2 we will thoroughly review the classical and neoclassical insights into regional development by presenting the sources of agglomerations advantages. Section 3 is devoted to develop two similar theories concerning the spatial concentrations of economic activities in particular areas, respectively new economic geography (NEG) and new growth theory. Finally Section 4 reports some general conclusions in relation to all these different competing theories, highlighting the potential of economic

agglomerations to foster the economic performance at regional level.

## 2. Classical and neoclassical views on regional development

The main insights in economic geography and spatial economics from the late nineteenth century up to the 60's are derived from diverse traditions and from various analysts. Concerning the location of economic activities, major contributions were provided by different location theorists like Weber, Losch, Isard and Christaller [2]. Moreover, related work on the causes and regional development effects of the agglomeration of economic activities was also undertaken by scientists like Lichtenberg, Vernon and Chinitz [3]. Their analyses focused on the features of different sorts of agglomeration economies and, more than that, their studies were developed within the traditional analytical framework of agglomeration phenomena, which had emerged as a mix of the contributions of Marshall and Hoover [4]. So, Marshall paid attention to the role of local knowledge externalities generated into an agglomeration, and the presence of non-traded local inputs and also a local specialized labor pool. Hoover along with Ohlin and Isard attributed the sources of agglomeration benefits into internal and external economies of scale or the so called *localization and urbanization economies*. Specifically, localization economies imply efficiencies which come from the concentration of firms in a given sector, while urbanization economies refer to efficiencies which result from the agglomeration of many different kinds of economic activities in a given region. In the vocabulary of more recent scientists, these two types of economies are generally known as *Marshall-Arrow-Romer (MAR) externalities* and *Jacobs externalities* [5]. Concretely, MAR externalities refer to knowledge spillovers generated among companies agglomerated in a spatially concentrated industry. In a dynamic setting, MAR theory claims that local monopoly is more favorable for economic development than local competition, in consequence of the fact that local monopoly inhibits the flow of ideas to others, allowing innovator-internalization. Additionally, Porter admits

the relevance of localization economies, sustaining the conviction that knowledge spillovers in specialized, geographically agglomerated industries foster growth [6]. Unlike the MAR approach, Jacobs theory defines diversity as a crucial source of agglomeration economies, arguing that the most valuable knowledge transfers come from outside the own industry [7].

Moreover, it must be emphasized that agglomeration economies feature four important characteristics [8]. The first one concerns *scale economies* which are de facto the principal rationale for the existence of productivity growth in agglomerated industries [9]. Without these scale economies obtained in production, economic activities would be dispersed at random in space in order to save transportation costs. The second feature is related to *minimizing transportation costs*. If these costs are very high, then the activity is dispersed. On the contrary, if transportation costs are insignificant, companies can be distributed randomly in space because the proximity to markets or suppliers is unimportant. Economic agglomerations will be formed under conditions of intermediate transport costs when the spatial mobility of labor is reduced [10]. Thus, we expect a reversed U-shaped relationship between the expansion of agglomerations and transportation costs. The third feature is represented by *shared inputs* in production and consumption. Due to localization economies, these shared inputs can augment and will be used to produce more various consumption goods in agglomerations connected with fashion, culture and style. The last characteristic concerns the *potential reductions in transaction costs* [11]. When transaction costs are proving to be low, necessary inputs can be channeled into areas where the costs of production factors are maximum.

In a nutshell, all these attributes of agglomeration economies provide legitimate rationales as to why regions characterized by agglomerations will exhibit higher growth than regions without such valuable features.

## 3. New economic geography and new growth theories

After this cycle of analytical developments up to late 1960's in regional science, the

interest in spatial economics issues waned for an interval of two decades. But, twenty years later, it came up a renewed interest in spatial economics in the form of new economic geography, and also regional economics as a whole science experienced a renaissance through the medium of a fusion of fresh developments in both new economic geography, on the one hand, and new growth theories, on the other hand.

New economic geography (NKG) proposed and promoted by Paul Krugman assumes that a region is more developed than other regions as a result of its ability to agglomerate new companies with skilled labor and because exploits efficiently economies of scale and their variety [12]. Krugman's contributions take into account economies of scale resulted into an agglomeration and consumers preferences for diversity. These new approaches to economic geography show that the formation of agglomerations occurs when increasing returns to scale are significant, companies have the ability to set prices, transport costs are minimal, and customers, suppliers and workers are geographically mobile. Thus, if economies of scale are high and transport costs are reduced, this induces a circularity effect that tends to keep agglomerations in the same location. The reason is that companies belonging to large economic agglomerations have certain advantages, since the size of local demand allows them to benefit more of economies of scale and, thus, firms can achieve higher nominal wages. A greater local demand for products stimulates a wider range of different goods, which induce real income effects that concentrate new workers, consumers and companies. These processes are manifested in a larger range of *local forward linkages* (the supply of a higher diversity of products augments the worker's real income) and *local backward linkages* (an extensive pool of consumers attracts more firms) because pecuniary externalities generate scale economies at the individual company level that are transformed in increasing returns at regional level [13]. Usually, this effect will be stronger when local demand is higher and internal economies of scale are greater.

Moreover, it must be stressed out that the self-healing mechanism of formation of agglomerations leads to a reorganization of economic activities as according to the

scheme *center* (where there is a tendency of localization of activities) - *periphery* (where there is a relocation of economic activities). Agglomeration of economic activities in the center region is the expression of a balance between *centripetal forces* that determine economic polarization in the center, and *centrifugal forces* that influence the dispersion of economic activities to the periphery. The description of spatial agglomerations is also consistent with the observation that different producers manage to concentrate and survive in peripheral locations. A first explanation is that peripheral producers exhibit particular local benefits outside the big agglomeration due to increased transportation costs, this meaning a reduced competition for their local demand. The second explanation refers to negative externalities like congestion or high land rates in big agglomerations that may conduct to decreasing returns to scale [14].

Furthermore, a related recent body of literature connected with geography and space has been initiated on the basis of the new or endogenous growth theories [15]. According to these approaches, when individuals or companies accumulate new capital, in this way they contribute to the whole productivity of capital held by others. Such positive externalities may appear in the case of investment in physical or human capital [16]. If such spillovers are sufficiently strong, the private marginal product of human or physical capital may maintain always above the discount rate [17]. When endogenous growth theory is applied at regional level, it appears that increasing returns to scale represent a feature of agglomeration economies. Thus, local external economies are not necessarily associated with market size or pecuniary external economies, but may be associated with the transfer of knowledge or technological externalities [18]. By incorporating research and development activity into Krugman's models, local factor accumulation may have a similar role played by labor migration [12] or input-output links [19], which eventually stimulates agglomeration via local demand linkages. All these arguments provide possible explanations in elucidating the reasons why some regions are more developed than others,

some of them even holding leadership in a particular activity.

#### 4. Conclusions

Even if the differences among the approaches of neo-classical theory, new economic geography and new growth theories related to this binomial economic agglomerations-regional development seem to be completely incongruous, common ground between these distinctive competing theories can be found on several key points. Primarily, in each of these different literatures, as presented in previous sections, the role played by economic agglomerations is seen as a paramount element of regional performance, and the common factor here is represented by the local knowledge generation, accumulation and positive spillovers. Secondly, and connected with the first point, concerns the issue of the high level of interactivity among the agents belonging to an agglomeration. Creating ties between companies concentrated in space represents a solid way for firms to become more competitive and to improve the economic performance across regions. This value chain formed of strong linkages is regarded by all these three theories as being extremely important. Thirdly, a last point of agreement consists in transactional relations which involve flows of certain sorts of business information inside an agglomeration. Untraded interdependencies of these kinds are crucial because they seem to underpin many processes of learning and innovation whose cumulative effects significantly reinforce local competitive advantages.

To sum up, regions characterized by agglomerations are apt to exhibit strong increasing returns effects that lead to superior competitive advantages as they grow.

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## Requirements Regarding the Quality of the Human Resources in Tourism – a Qualitative Analysis in the Counties of Braila and Constanta

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### Abstract

*A research upon the status of tourism in our country is very useful. Thus, a qualitative analysis was carried out by means of organizing focus groups in the counties of Braila and Constanta.*

*The discussions with the participants to these focus groups referred to the personnel's need for training and lead to the idea that this need represents a necessity of the present.*

*The employers expect that their employees should have practical skills and competences as well as a professional training meant to increase their professional performance.*

**Keywords:** human resources, tourism, skill, qualification, training

**J.E.L Classification:** O15

### 1. Introduction

The modernization of tourism plays a major role in Romania's economic development. Therefore, a research upon the status of tourism in our country is very useful. In this respect, in 2011 we have carried out such a research choosing as reference points the counties of Braila and Constanta.

Our purpose was the identification of the employers' position regarding the training needs, the skills and competences necessary for the employees in the touristic field since their professional training contributes to development of the employees' new abilities. [1]

A qualitative analysis was carried out by means of organizing focus groups [2] in the counties of Braila and Constanta. The method used was the "brainstorming". Thus, in both counties meetings were held with the representatives of the firms from the touristic sector (touristic complexes, touristic agencies, commercial facilities etc.).

The discussions with the participants to these focus groups referred to *the personnel's need for training* and lead to the idea that this need represents a necessity of the present. In order to face the competition the personnel needs training.

The counties of Braila and Constanta are very different from a touristic point of view. The opinions expressed during the focus groups have many aspects in common (even if the activity of the provider of touristic services is essentially the same regardless of the area) as well as dissimilarities (enhanced by the characteristics of the two areas).

### 2. Qualitative analysis carried out in Braila county

The representatives of the touristic complexes in Braila consider that more attention should be paid to the activities of checking-in, accommodation and maintenance of the respective facilities. The personnel's training should be improved with respect to the hygienic and sanitary conditions as well as labour protection. Moreover, the necessity to gain more knowledge concerning the culinary production or the food hygiene should not be ignored. The personnel's training should focus

upon the practice in the kitchen, more precisely upon the furnishing of such a space and upon the technology of the culinary products.

The managers of the touristic agencies consider that there are some aspects which are imperative. Among them, they mention: the development of the competences necessary for the promotion of the Romanian touristic potential, the identification and correct usage of the documents required in a touristic agency and the coordination of the touristic activity. The employee should have communication skills, should speak foreign languages in order to keep informed from external sources and to provide descriptions as clear and detailed as possible upon a large number of topics from his domain carrying dialogues with tourists from home or abroad.

The merchants expressed their need that during his training period the worker should acquire that knowledge necessary to identify the quality of the merchandise, to recognise the brand of each group of merchandise and to know the merceological characterization of the different groups of merchandise. They would also need their employees to be better trained in emphasizing the conditions regarding the packaging, the ticketing, the labelling, the transport and the storing of the merchandise as well as the reception of the merchandise and its display to the consumer (merchandising).

Regarding the *employees' training*, the participants showed that the personnel who is active in the county of Braila is mainly qualified according to the norms in force. Although the firms have employees in possession of a certificate, they are interested in being permanently connected to all novelties from the field of the personnel training in order to face the competition. Thus, these organisations have expressed their wish to participate to any new course proposed by the trainer.

An obstacle frequently met in the firms' answers to the question “Which are the main *obstacles* you are facing in your activity and what will help you successfully overcome them?” was related to the quality of the training courses because the graduates have not proven the necessary skills after they have got their qualification certificate. Qualification courses in the field are more than welcomed, but these courses should be qualitative and the evaluation should be strict with an emphasis upon the practical side

Another obstacle which was invoked was “the difficulty of accessing the European funds for the development of the activity”.

The touristic and commercial firms in Braila do not deny the importance of personnel training. The courses by means of which the employees can easily and appropriately serve the food and drinks are necessary. For example, this is a permanent necessity in restaurants in order to maintain your customers and to satisfy as many of their needs as possible. The employees have to be familiarized with the secrets of making of different menus.

Other problems which should be eliminated refer to the competences of communicating with the customers in a civilised and decent manner, the employees' gestures, mimics and language. Likewise, even if they have graduated some courses, the employees do not know the steps to be followed in order to sell, to display and to exhibit the merchandise.

Some other aspects should not be overlooked either. These aspects refer to: “the brushwood” of the bureaucratic system in contact with the governmental institutions and not only; the problems of the economic life, especially the one in Braila which unlike the one in Constanta represents a less developed region with an insufficiently valued touristic potential; the lack of sufficient means to promote the firms and their products due to the lack of financial resources.

The employers have to become aware of the fact that the employees need *skills* specific to their job because otherwise the firm will lose on short and medium term. In this respect, we can refer to the necessity for an employee:

- to have fundamental knowledge regarding the touristic management;
- to speak foreign languages;
- to have skills by means of which to ensure a favourable atmosphere for his clients and to provide accommodation and food services of a high quality;
- to have knowledge about notions of personal hygiene and an adequate posture and apparel.

### **3. The diversity of the instruction needs in Braila County**

*The instruction needs* are among the most diverse according to the problems the employers meet such as:

- free courses for a qualification as a salesman;

- among the objectives of the training courses one should consider those regarding the knowledge about the law in force with respect to the use of the electronic cash registers;
- courses regarding the technology of the activities such as accommodation, food services and tourism;
- developing competences regarding the techniques specific to the activity of front - office and applying the legal regulations specific to the touristic activity;
- qualification courses in communication techniques.

According to some employers from the touristic and commercial agencies, *the IT courses* are welcomed depending on the nature of their activity. Both the IT courses and the foreign language courses are necessary due to their dynamic character.

*The IT and the foreign language courses* are always necessary, but not at an advanced level. The computer/ Fidelio competences are necessary during the activity and therefore the employees have to follow such courses. In the front-office activities and in other activities specific to tourism, the technical knowledge about computers are more than necessary. For some firms it is vital for the employee to know more aspects concerning the use of the Internet.

Very interested in such courses are the ones with businesses in the field of hotels and restaurants. The linguistic courses and qualifications are necessary because the touristic operators need to take part in any conversation or discussion without any effort, to be familiarized with colloquial expressions and to speak fluently. In the touristic agencies, the employees should be spontaneous, fluent, without visibly looking for the right word and they should connect their interventions to the ones of their interlocutors. In addition, if they have to book holidays abroad, the need to speak foreign languages is even more important.

The discussions with the participants to the focus group have revealed the fact that *the personnel's training need* represents a necessity of contemporary life. The training need refers to the need to train and motivate your employees, to offer continuous training because this is the only way to survive, to beat the competition and develop your business. The conviction of those who participated to these discussions is that the investment in people and the development of human intelligence and

skills ensures the firms' competitiveness in their powerful competitive environment.

Regarding *the training of their employees*, most of the participants have claimed that their own employees are qualified for their jobs. The qualification is frequently achieved by the employees from their own financial resources since most firms do not have a budget destined to the instruction and development of their personnel. The crisis is invoked as a cause for the lack of funds for the training and development courses.

The employees who finance their training courses make use of this method because on employment they are asked to have a qualification certificate for the job they apply. If the applicant does not have the certificate, but he has the necessary qualities for the job, then he should qualify as soon as possible in order to be further employed in the firm.

There are firms which partially support the qualification costs sharing the expenses with the employees. Those firms which access different programs for qualification and development of the human resources with national or international financing do not spend a thing for the instruction of their personnel.

The identified *obstacles* could be divided into two categories: obstacles specific to the touristic activity and general obstacles each firm can face. The obstacles specific to the touristic sectors are:

- the increased fluctuation of personnel;
- the lack of qualified personnel;
- the seasonal nature of the activity;
- the compulsoriness to open the hotels on May 1st even if there are no customers;
- the presence of stray dogs in the resorts;
- the disappearance of towels and lingerie;
- the lack of attractions on the seacoast.

Among the general obstacles we can mention:

- the continuously changing legislation;
- the difficulty to access the European funds;
- the excessive taxation.

#### **4. Qualitative analysis regarding training and development needs in Constanta county**

In their turn, the employers in Constanta have enhanced the importance of the communication skills in different foreign languages, especially English as well as the importance of computer competences.

The employers praise *the communication skills* taking into consideration the fact that the employees should be coherent when addressing their customers and to know to listen to them when they express their wishes. The employers consider important a series of qualities which can not be achieved as a result of some qualification courses. Among these we can mention: seriousness, the pleasure of working in a team, the ability to act as part of a team. The employees should be persons aware of the importance of a thing well-done and of the importance of tourism in economy. The employers expect their employees to have the mentality of the thing well-done, but at the same time they are aware of the fact that finding persons with such a mentality is difficult and the cultivation of such a type of thinking is difficult too. Changing the employees' mentality is a complex and lasting process and this is hard to achieve in the firms in which the fluctuation of personnel is rather high.

According to their *training and development needs*, the employers asked for courses of receptionists and maids, IT courses, foreign languages courses, communication courses and public relations courses.

Regarding the methods, we have considered the participative methods adequate because they involve the students during many hours of practice which should have the biggest percentage out of the total number of classes.

Free courses after the working hours would be ideal because the employers do not afford to furlough their employees during working hours.

There have been problems regarding the quality of the courses, some employers being confronted with the situation in which they did not notice any major differences between an employee who has been to a qualification course and one who has not participated to such a course. This happens due to the fact that all the applicants to these courses are accepted and the final evaluation is not so strict. It has been suggested that the selection should include a psychological evaluation as well in order to see if all the applicants have a bent for the job they are training. Another proposal was that the final evaluation should be made in front of a neutral commission whose members do not know the organizers of the course and that they should be from a different region. The tutor for the practical courses of qualification is important as well. This should be a specialist, should have pedagogical training and should be paid for his tutorial activity.

*The usefulness of the IT courses* was extremely appreciated by the employers who

consider that training in this field is necessary even for the employees who have some knowledge in the field because this is a domain which is rapidly expanding.

For many firms, the relationship with the suppliers of services, the clients and even the employees is possible by means of computer programs. This is why the employees have to continuously develop their computer skills.

Precise and short computer programs are required in order to teach the employees to use a program in the field. Likewise, these courses are thought to develop the students' ability to use certain programs, but not at an advanced level.

Similarly, *the usefulness of the foreign languages courses* was emphasized by the employers who consider that the employees should know the basics of at least one foreign language, preferably English. In many firms, the personnel speaks foreign languages, but does not have a certificate to attest their skills.

The employees for whom speaking a foreign language represents a condition to be employed still need to develop their linguistic competences.

As far as its evolution is concerned, the course which offers greater flexibility in choosing the materials, the time intervals and the transfer of teachers to the company's headquarters will be a course appreciated by both the employers and the employees.

Some employers have highlighted the importance of speaking one, two or even three foreign languages even for basic communication in ordinary life [3]. French or Spanish would be of great interest, but the perspective of having tourists from the countries of Eastern Europe does not exclude the learning or re-learning of Russian.

## 5. Conclusions

As a result of this qualitative research, one can assume that the personnel's training needs are extremely important and the employers' requirements are related to the employees' competences and skills.

The employers expect that their employees should have practical skills and competences as well as a professional training meant to increase their individual professional performance reflected in their remarkable organizational performance.

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# The Relationship Between Employment and Economic Development in Romania: A County Level Analysis

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## Abstract

*In this paper, we aim to highlight the peculiarities of the Romanian counties from the point of view of employment. Moreover, we intend to analyse the relationship between employment (under the aspect of structure and efficiency) and economic development in order to show that disparities at the counties' level of development can be explained by disparities in employment. The results of the study highlight the necessity for change in structure and quality of employment (especially in the counties from the North-East, South-East, South Muntenia and South-West Oltenia regions), in order to assure the conditions for a balanced regional development.*

**Key words:** employment, unemployment, economic development, labour productivity, counties.

**J.E.L.Classification:** E24, J21, R23

## 1. Introduction

The labour is and will remain the supreme value that will characterize the society we live in. Every country and region's progress and development is due to the work that its inhabitants do. The more this labour reaches a higher qualitative level, the more visible results are, and the better the quality of life is.

In highlighting the quantitative, qualitative and structural aspects of labour which the human resource performs in society, in other words when appreciating the value of a man's labour, we need to take into consideration the concept of employment, which is an extremely complex one. Thus, in the sphere of employment we find all persons aged 15 years and over, who carried out an economic activity producing goods or services of at least one hour during the

reference period (one week) in order to get income as salaries, payment in kind or other benefits. We mention that for self-employed and contributing family workers who work in agriculture, the minimum duration is 15 hours [7]. We notice that in the sphere of labour force employment we find salaried work, full time work, permanent work, as well as non-salaried work, or even unpaid work, part-time work and temporary work.

In the economic literature and practice, there is the opinion according to which employment, which assures a high level of economic and human development, is the employment that is characterized mainly by a sectoral structure favourable to services [5], a high labour productivity [1], a high share of salaried work and implicitly a low share of self-employed and unpaid family workers, a low share of temporary and part-time work, a high level of tertiary education [8], low risk of poverty in work, etc.

The employment level and the efficiency of using the labour resource at national level are the result of the situation manifested at the level of the Romanian counties. For this reason, our purpose is to highlight the peculiarities of employment in Romania, at county level, focusing on the following elements: sectors of activity, professional status, labour productivity, employment and unemployment rate. Moreover, we intend to analyse the relationship between employment (in terms of structure and efficiency) and economic development in order to show that gaps in the level of development of the counties can be explained by gaps in employment.

## 2. Labour market in the context of economic development at county level in Romania

According to the national legislation on the territorial administrative organization,

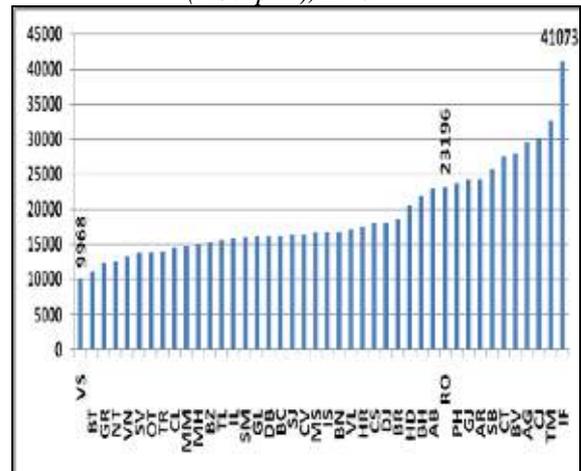
Romania is divided in 41 counties. These counties, according to Law 151/1998, are grouped in eight development regions. These regions constitute the creation, implementation and evaluation framework of the regional development policy.

As in other European countries, the most developed region is the one that includes the capital, and the less developed are the border areas. In Romania, the underdeveloped areas are concentrated in the north-east, at the border with Moldova and in south, across the Danube. Except for the Bucharest-Ilfov region, whose situation in the economic landscape is completely special, economic growth followed a west-east direction (having a significant geographic component), the west markets' proximity acting as a growth spreading factor [2]. Benefiting from their closer position to the western markets and their more reduced dependence on the primary sector, West, North-West și Centre regions have attracted more foreign investors, fact which has significantly contributed to their development.

In spite of the economic growth recorded in the 2000-2008 period, most of the counties recorded significant gaps compared to the national average. Thus, in 2009, according to data in figure 1, which presents the ranking of the 41 counties in relation to GDP per capita (expressed in lei/capita), the Ilfov County holds the first place, followed by Timiș, Cluj, Argeș and Brașov. Vaslui, Botoșani, Giurgiu, Neamț and Vrancea counties are on the last five places. These counties are part of the north-east, south-east and South Muntenia regions, which depend on agriculture, having a high degree of ruralisation. It can be easily noticed that only ten counties have a GDP/capita above the national average, whereas the level of economic development in most of the counties is below the national one.

Taking into consideration that economic development is strongly influenced by the human resource, we shall analyse the main regional gaps in the labour market, at the level of the Romanian counties.

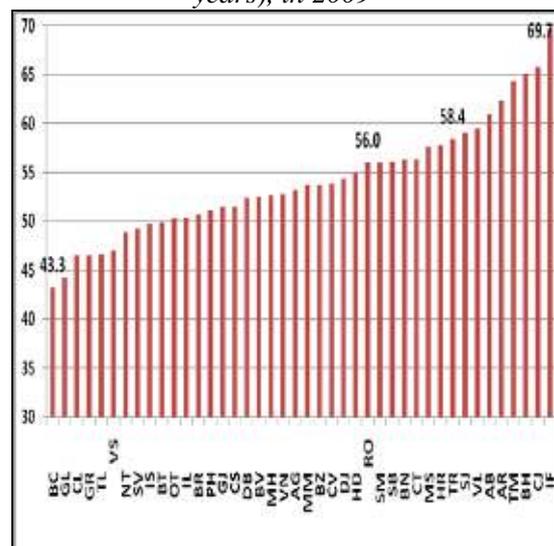
Figure 1. GDP/capita in Romania's counties (lei/capita), 2009



Source: Own calculations based on data from [6] and [7]

Appreciating the general characteristics of the labour market entails highlighting the main statistical indicators that measure the labour force: the employment rate and the unemployment rate. Analysing data in figure 2, we can observe that the civil employment rate of population of working age (15-64 years) records values between 43.3% (in Bacău County) and 69.7%. Only in 15 counties, the employment degree is above the one existing at national level (of 56%).

Figure 2. Civil employment rate (15-64 years), in 2009



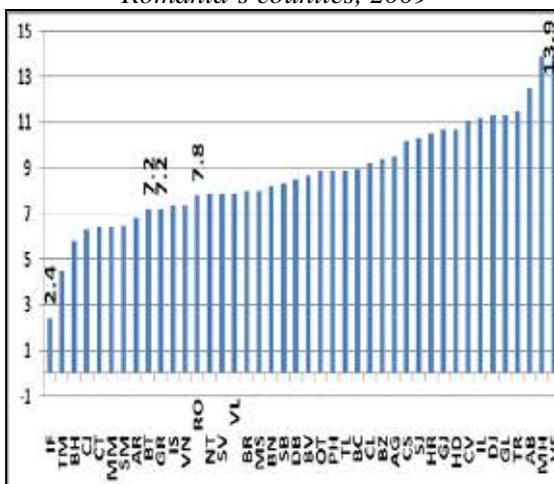
Source: Own calculations based on data from [7]

In general, we notice that counties with a higher level of development are characterized by higher employment rates, and counties with a lower level of development have a lower degree of employment. An unusual case is

Teleorman County. Despite the fact that this county has a higher employment rate of the population of working age (of 58.4%), it is characterized by an inefficient employment determined by the extremely high employment in agriculture (55% of the total employed population), reduced labour productivity (62% of the national average) and reduced GDP/capita (60% of the national average). Beside the inefficient employment, this county also has a high rate of registered unemployment, of 11.5% respectively [7].

Moreover, in terms of the unemployment rate, there are significant differences from one county to another (figure 3). Vaslui and Mehedinți counties recorded the highest unemployment rate (13.9%), and Ilfov County the lowest one. Mehedinți and Dolj counties, both part of the south-west Oltenia region, have a high unemployment rate (13.9%, and 11.3% respectively). These were affected by the economic crisis in 2009, recording, at the same time, also a lower level of development (65%, 77% respectively of the national average of GDP/capita). Galați County was also affected by high unemployment (11.3%), as well as by utterly reduced employment of the population of working age (44.2%). Bacău County recorded the lowest employment rate in Romania, of 43.3%, by 12.6 percentage points (p.p.) below the national average. All these four counties have in common a lower employment rate and a higher unemployment rate, as well as a reduced level of development (with GDP/capita between 65% and 77% of the national one).

Figure 3. Registered unemployment rate in Romania's counties, 2009



Source: Our processing based on data provided by [7]

On the contrary, although the *Botoșani* County (in the N-E region) records a lower unemployment rate of 7.2%, the degree of employment of the population of working age (of 49.8%) is by 6 p.p. below the national average. This fact confirms that aggregated indicators of the labour force do not always reflect the real problems of employment. Thus, an analysis of the employment structure is necessary.

### 3. The implications of employment structure on economic development at the level of the Romanian counties

In the last decade, the tendency recorded in the employment structure, from the point of view of the sector of activity where the employed population works, was positive, meaning that the employed population in agriculture decreased and the one employed in the secondary and tertiary sector increased [4]. This reorientation of the labour force towards non-agricultural sectors can be correlated with the creation of new jobs in the urban area, in the context of the growth of the private sector in economy, but also of the fact that some localities were declared towns [2]. However, compared to the average level reached by the EU-27, Romania has a significant gap to recover.

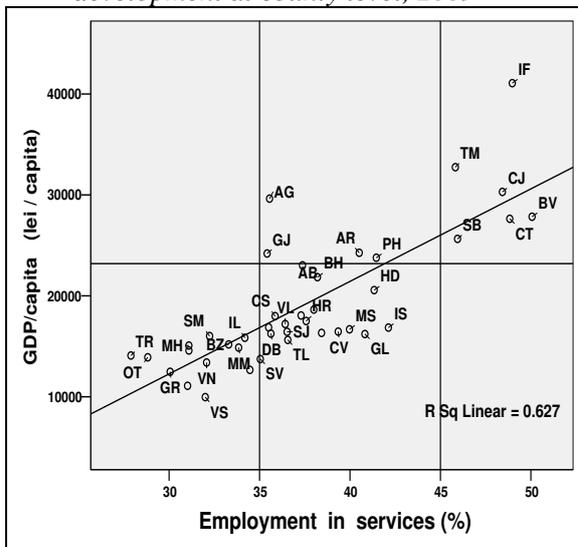
The highest shares of employed population in services are recorded in Brașov, Constanța, Ilfov and Cluj [7], but only in Brașov county, the services sector is the main supplier of jobs. The share of employment in services is of 50.1%, by 7.3 p.p. above the national average (of 42.8%).

We have carried out a statistical analysis, based on the Spearman correlation coefficient, in order to establish the intensity of the relationship between the share of civil employed population in services and GDP/capita (figure 4). The results of our analysis highlight that, at the level of the 41 counties, in 2009, there is a strong direct correlation (Spearman correlation coefficient = +0.811) between employment in services and the level of economic development.

The counties with a low employment in services are characterized by a low level of development (Teleorman, Giurgiu, Vaslui, Olt, Botoșani, etc), and in the ones where the share of the employed population is high also the level of development is high (Ilfov,

Constanța, Cluj, Timiș, Brașov, Sibiu). The level of GDP/capita is usually lower in the counties that record a higher degree of ruralisation and employment in agriculture (Teleorman, Giurgiu, Botoșani, Călărași, Vaslui etc.), and the other way around. This fact confirms the economic theory [9], according to which there is a negative relationship (Spearman correlation coefficient = -0.899) between employment in agriculture and the level of development.

Figure 4: Direct correlation between employment in services and economic development at county level, 2009



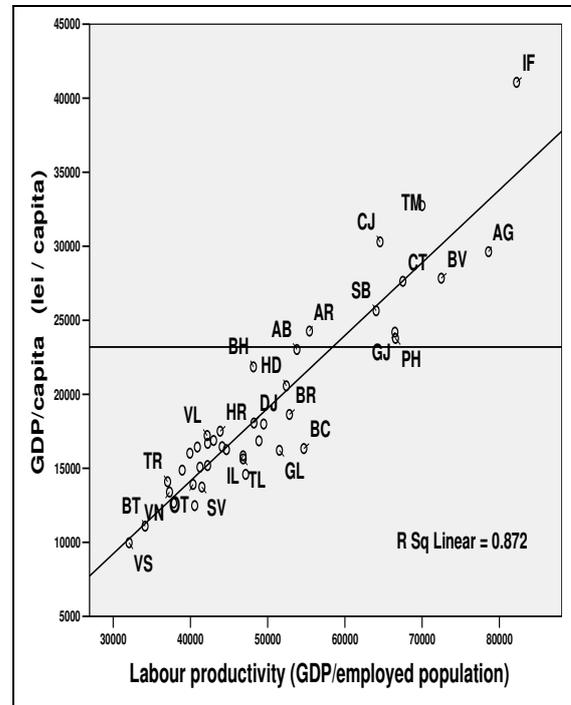
Source: Own calculations based on data from figure 1 and [7]

Significant gaps are also recorded in terms of the efficiency of using human resources at county level in Romania. Labour productivity, calculated as ratio between GDP and civil employed population, is above the national average only in ten counties (in approximately the same counties as in the case of GDP/capita). Data, in figure 5, reflect the fact that a strong direct relationship is identified between labour productivity and GDP/capita (Spearman correlation coefficient = +0.892), at the level of the 41 counties, in 2009.

We notice that a high level of labour productivity is the basis for a high level of GDP per capita (in the ten counties that have a labour productivity and GDP/capita above the national average). On the other hand, the inefficiency in using the labour force in Vaslui, Botoșani, Teleorman, Vrancea, Neamț etc. counties was reflected in the low

level of economic development existing in these counties.

Figure 5. Direct correlation between labour productivity and GDP/capita, at county level, 2009



Source: Own calculations based on data from [6] and [7]

The direct correlation identified between labour productivity and employment in services (Spearman correlation coefficient = +0.788) confirms the fact that a sectoral employment structure favourable to services assures the conditions for reaching a higher productivity.

Gaps in terms of sectoral employment structure are reflected in gaps existing in the professional status of the employed population. The existence of a high employment in agriculture determines, on the one hand, a decrease in the salaried population, and, on the other hand, an increase in the number of self-employed workers and unpaid family workers.

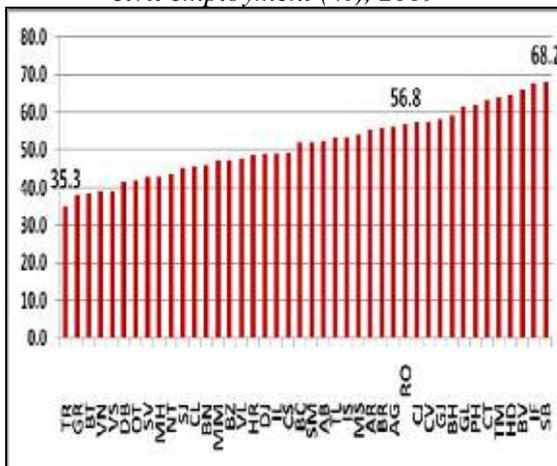
The employees constitute a very important segment of the labour market, a segment where the supply is really confronted with the demand for salary-earning jobs. This market segment registered tendencies regarding the number and structure of employees, by sex distribution, residence environments or sectors and types of economic activity, as well as by salaries.

These tendencies are major guides that can explain some tendencies in other social spheres of interest, such as the evolution of the income levels and structures, the demand, the access to certain social services, etc, and finally they can explain the level of economic development of a country [3].

As for self-employment, in Romania, this can be seen as the only solution for survival, as a consequence of the situation that no other form of employment is attainable. Many of those eliminated from the salary system or those who did not have employment opportunities, from the very beginning, became “un-employed” people or employed at the limit of the formal labour market, exposed to fluctuating and small incomes [10].

In figure 6, we notice that, in 2009, Teleorman, Giurgiu, Botoşani, Vrancea and Vaslui counties had a share of employees in total civil population below 40%. This reflects the fact that less than 40% of the employed population had a salaried status, the rest of it, over 60%, were self-employed, sole traders or unpaid family workers. Moreover, we notice, that in half of the Romanian counties, salaried work was below 50%, and that it was over the national average level of 56.8% only in 12 counties.

Figure 6. The share of employees in total civil employment (%), 2009

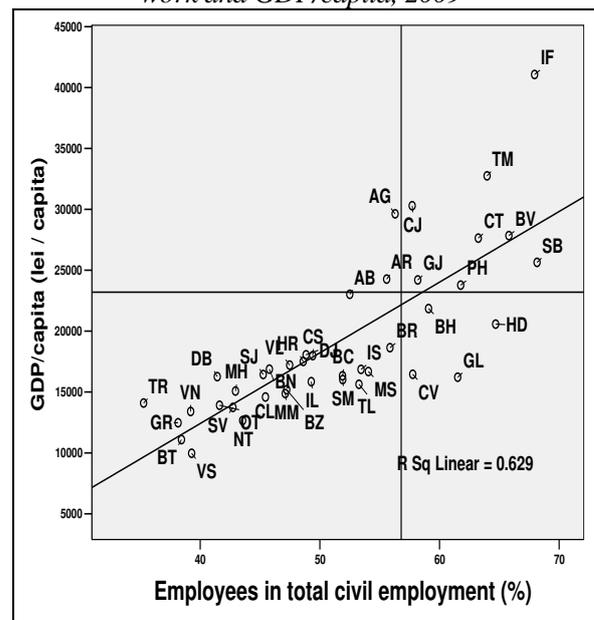


Source: Own calculations based on data from [7]

According to data presented in figure 7, in the counties with a low and very low level of development (Vaslui, Teleorman, Giurgiu, Botosani, Olt, Vrancea, Suceava, etc), the salaried work expansion rate is reduced and very much reduced. These counties have, generally, a low employment in services and secondary sector, but a high one in the

primary sector. At the other pole, we have counties with a high level of development accompanied by a high rate of the share of employees in employment. The higher salaried work expansion rate is obtained either because of the high share in services (Constanța, Timiș, Braşov, Ilfov, Cluj, etc counties), or a high share in industry and constructions (Prahova, Hunedoara, Galați, Gorj, Bihor, Argeş, etc), being known that, in Romania, most of the workers in agriculture have the status of either self-employed, or contributing family workers. At the level of the 41 counties, in 2009, between the share of employees in total employment and GDP per capita, a direct strong correlation is identified, thus confirming that at county level the direct relationship between the level of development and the level of salaried work (Spearman correlation coefficient = +0.845).

Figure 7. Direct correlation between salaried work and GDP/capita, 2009



Source: Own calculations based on data from figure 1 and 6

We consider that increasing the share of salaried work in total employed population is necessary, in most of the Romanian counties, if we take into consideration the fact that the salaried status is superior compared to the other categories of employed population, from the point of view of income security and social protection and that expending salaried work corresponds to a high level of economic development.

#### 4. Conclusions

The results of the comparative analysis at county level confirm the hypothesis according to which it is not enough to highlight only the level and evolution of the aggregated data on employment and unemployment (the employment rate and unemployment rate) in order to appreciate the state and evolution of the labour market. The reason is that behind these indicators there are severe problems in employment.

The extremely reduced work in salaried conditions (35% - 50% of total employed population), in half of the Romanian counties, is a severe problem of employment, which affects the entire economy. The negative consequences are to be found on the level, structure and security of the income, on the capacity of saving, investing respectively, on the system of social insurance and education, on forming budgetary incomes, in other words on socio-economic development.

Furthermore, the results of the statistical analysis confirm the fact that disparities in the level of development can be explained by disparities existing on the labour market, at the level of the Romanian counties. The hypothesis, according to which there is a direct relationship between the level of economic development and an efficient employment structure, is confirmed. In the counties with a higher level of GDP/capita (Ilfov, Timiș, Cluj, Brașov, Argeș, Constanța etc), there is efficient employment, based on services and industry, under the circumstances of a strong tendency towards work in salaried conditions. Predominantly agricultural employment (in Teleorman, Giurgiu, Botoșani counties) or higher employment in agriculture, to the detriment of the secondary and tertiary sector (in Călărași, Vaslui, Olt, Mehedinți, Ialomița, Suceava, etc. counties) accompanied by reduced labour productivity, determine a low level of economic development.

Some measures must be taken in order to increase the level of development, but moreover a balanced regional development. These are meant to transform the structure and quality of employment, meaning the growth in the share of employed population in services, labour productivity, salaried work, level of education etc. (precisely in the counties in the less developed regions of

Romania: North-East, South – East, South-West Oltenia and South-Muntenia).

#### 5. Acknowledgements

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## Center-Periphery in Terms of Spatial Peripherality. Analysis at the Romanian Counties Level

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### Abstract

*This paper aims to analyze the degree of spatial peripherality of Romanian counties, at European level. Thus, in a first stage, are classified the indicators which measure the accessibility (spatial peripherality). Then, are selected four accessibility indicators. In the second part of the paper is analyzed the accessibility of Romanian counties in Europe, through factor analysis and cluster analysis. The main conclusion is the identification of a clear center-periphery model in terms of spatial peripherality.*

**Key words:** center-periphery, spatial peripherality, spatial peripherality in Romania.

**J.E.L. Classification:** R11, R12, O18, F15

### 1. Introduction

The literature considers peripherality an inverse function of accessibility: when the accessibility is higher, the region in question is less peripheral.

Wegener believes that "accessibility indicators describe a particular location taking into account opportunities, activities or assets in other locations and the location itself (these areas may be a region, city or a corridor) [1].

The researches in the area have stopped on the methods to analyze the spatial peripherality through some indicators. Copus A. K. divides these indicators in two groups [2]:

- the first group includes the indicators that estimates the "economic potential" or "market potential". In this case, it is assumed that the potential for economic activity for any location is a function both of its proximity to other economic centers as well as the economic dimension. The

analogy with the law of gravity is explained by the fact that the influence of each center on the economic potential of a location is assumed to be directly proportional to the volume of economic activity and inversely proportional to the distance separating them.

- the second group includes indicators such as "travel time / costs" and "accessibility." This group of indicators has been developed greatly in recent years and there's even a "soft" that estimates the peripherality.

Another classification of indicators to measure accessibility (spatial peripherality) was made taking into account the complexity criterion. Thus, can be identified [3]:

- simple indicators of accessibility: only consider transport infrastructure in the area. Quality of infrastructure is determined by the total length of roads, highways, railway lines, the number of railway stations or airports number. These indicators can express important information about the area itself, but they do not reflect the fact that many destinations of interest are located outside the area.
- complex indicators of accessibility: take into account connectivity of transport networks, making a distinction between itself and the network activities or opportunities that may be affected by this. These indicators include always the term of "spatial impedance", term that describes the ease of reaching other destinations of interest. Impedance can be measured in terms of travel time, cost or inconveniences.

Spiekermann et. al. (2011) emphasizes that accessibility is composed of two functions: a function that aggregates the activities or opportunities that could be accessed (activity function) and a function that includes the effort, time, distance or cost

needed to be able to access them (impedance function). The same author, based on the premise that accessibility is composed of two functions, divided the accessibility indicators in three types [4]:

- travel cost: if destinations are considered only a particular type (for example, regions of a certain size) and the impedance function is the time or cost of travel (the impedance function is linear), the indicator of accessibility is represented by the average or total trip cost for a predefined set of destinations.
- cumulated opportunities: if only destinations within a certain travel time are considered (the impedance function is rectangular), and the destinations are taken as is (the activity function is linear), the accessibility indicator measures the number of potential destinations (customers, business contacts, tourist attractions, etc.) that can be reached in a given time, e.g. a day.
- potential: If the impedance function takes travel behavior into account, i.e. the diminishing inclination to travel long distances (the impedance function is nonlinear, e.g. exponential), the accessibility indicator is a potential indicator. The activity function may take account of agglomeration effects or economies of scale (i.e. may be nonlinear, e.g. a power function).

In this study will be used indicators of potential accessibility type.

## 2. Variable selection

Criteria for selection of indicators were [5]: relevance, robustness, notoriety, complexity, accessibility, actuality.

The four indicators selected for analysis spatial peripherality are: potential accessibility by road, potential accessibility by rail, potential accessibility by air and multimodal potential accessibility. These indicators have been proposed as benchmarks of potential accessibility by Working Group "Geographical Position" of the Study Programme on European Spatial Planning (SPESP) and developed by ESPON 2006 [1].

The main criterion for selection of these indicators is the high degree of awareness and robustness, since they are frequently used and studied in the field [1][3][6]. In

addition, these indicators are the most complex [4] and are most recently developed and quantified.

Table no. 1. Data available for selected indicators

Indicator Criteria	by road	by rail	by air	Multimo dal
<b>Availability</b>				
NUTS 0	unavailable	unav.	unav.	unav.
NUTS 1	unavailable	unav.	unav.	unav.
NUTS 2	unavailable	unav.	unav.	unav.
NUTS 3	available (2001, 2006)	av. (2001, 2006)	av.(2001, 2006)	av. (2001, 2006)
<b>Type of data</b>	quantitative	quant.	quant	quant
<b>Source</b>	ESPON	ESPON	ESPON	ESPON

Source: author's representation

If the decision about the selection of indicators by theoretical criteria did not raise special problems, the same can't be said about choosing the level of analysis (NUTS 3, NUTS 2 etc.), the only data available are for NUTS 3 level (as shown in Table no. 1).

For four indicators analyzed were not identified missing values for any of the 42 cases (counties)

## 3. Analysis at the level of Romanian counties

For statistical analysis was used the SPSS software. The database includes 42 cases (counties of Romania) and five variables (four indicators of potential accessibility by mode of transport and the counties of Romania).

Nature of the data is as follows: nominal data (county variable) and data rate (potential accessibility indicators). Indicators values were taken from the ESPON database, where was used as a method of normalizing the distance from a reference value. Indicators values for each county are normalized. The European average is considered 100, counties assigning grades in proportion to the European average. Therefore, regions with a score above 100 are above average, while those with scores below 100 are below average (with a low degree of accessibility and therefore a high degree of spatial peripherality).

Table no. 2. presents descriptive statistics for the analyzed indicators recorded for the 42 counties of Romania. Notice that the potential road accessibility (ROAD\_IND)

mean value is 27.75, with a minimum of 14.6 and a maximum of 46.1. Rail accessibility (RAIL\_IND) average is 24.17, with a maximum of 43.8 and a minimum of 13.0. Air accessibility indicator (AIR\_IND) recorded an average of 51.39, with a maximum of 119.7 and a minimum of 21.1. Multimodal accessibility (MM\_IND) average is 47.88, with a maximum of 106.7 and a minimum of 21.5.

Table no. 2. Descriptive statistics

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
RAIL_IND	42	13.0	43.8	24.171	6.329
ROAD_IND	42	14.6	46.1	27.755	6.721
AIR_IND	42	21.1	119.7	51.398	24.703
MM_IND	42	21.5	106.7	47.888	21.195
Valid N (listwise)	42				

Source: author's calculations (SPSS output)

The essential condition to apply factor analysis is that variables to be correlated. To test the correlation is necessary a prior test of normality.

Table no. 3. Testing normality of variables

One-Sample Kolmogorov-Smirnov Test					
		RAIL_IND	ROAD_IND	AIR_IND	MM_IND
N		42	42	42	42
Normal Parameters <sup>a,b</sup>	Mean	24.171	27.755	51.398	47.888
	Std. Deviation	6.329	6.721	24.703	21.195
Most Extreme Differences	Absolute	.171	.129	.152	.147
	Positive	.171	.129	.152	.147
	Negative	-.122	-.051	-.110	-.107
Kolmogorov-Smirnov Z		1.109	.834	.983	.950
Asymp. Sig. (2-tailed)		.171	.490	.288	.327

a. Test distribution is Normal.

b. Calculated from data.

Source: author's calculations (SPSS output)

Normality test can be performed by One-Sample Kolmogorov-Smirnov test. Statistical assumptions of this test are:

- H0: no significant differences between the shape of variable distribution and the shape of normal distribution
- H1: there are significant differences between the shape of variable distribution and the shape of normal distribution

According to the table no. 3, the value of sig is greater than 0.05 for all four indicators (0.171, 0.490, 0.288 and 0.327), which means that it accepts the null hypothesis H0: there are no significant differences between

the shape of variable distribution and the shape of normal distribution.

Table no. 4. Correlation matrix of the four indicators

Correlation Matrix					
		RAIL_IND	ROAD_IND	AIR_IND	MM_IND
Correlation	RAIL_IND	1.000	.678	.531	.550
	ROAD_IND	.678	1.000	.701	.733
	AIR_IND	.531	.701	1.000	.998
	MM_IND	.550	.733	.998	1.000

a. Determinant = 2.338E-04

Source: author's calculations (SPSS output)

Coefficients of correlation matrix indicates: high values of these coefficients (greater than +0.5, less than -0.5) shows that between the variables considered are significant statistical links (direct link if the value of these coefficients is positive, reverse link if the value of this coefficient is negative). In this case, all coefficient values exceed the value of +0.5, and principal component analysis can be applied (table no. 4).

Following factor analysis three factors were obtained (Table no. 5). Decision to be taken at this level is the number of factors to keep in the analysis.

Table no. 5. Factors derived from factor analysis

Component Matrix <sup>a</sup>			
	Component		
	1	2	3
MM_IND	.944	-.320	8.224E-02
AIR_IND	.930	-.349	.116
ROAD_IND	.881	.196	-.431
RAIL_IND	.762	.595	.254

Extraction Method: Principal Component Analysis.

a. 3 components extracted.

Source: author's calculations (SPSS output)

Factor analysis rules for choosing the factors are the following [5]:

- to have eigenvalues greater than 1,
- kept factors must explain more than 10% of the total variance,
- selected factors must explain cumulatively more than 60% of the variance.

From the analysis of table no. 6 can be

seen that the optimal solution for this case is keeping a single factor, which: has eigenvalues of 3112 (> 1) and explains more than 60% of the total variance (77.802%> 60%).

This shows that the four indicators are best represented in a single common factor which may be called “total potential accessibility”. In the event that had retained two factors, the four indicators were divided into two groups, each representing a different side of total accessibility.

Therefore, this analysis shows that the selected indicators help to define the same concept and have been carefully selected from the literature.

Table no. 6. Factors selection

Component	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	3.112	77.802	77.802
2	.617	15.423	93.224
3	.271	6.764	99.989
4	4.500E-04	1.125E-02	100.000

Extraction Method: Principal Component Analysis.

Source: author's calculations (SPSS output)

Component matrix, presented in table no. 7, shows differences in factors loads. Factors' loading is the basis of their names [7].

Table no. 7. Component Matrix

	Component		
	1	2	3
RAIL_IND	.762	.595	.254
ROAD_IND	.881	.196	-.431
AIR_IND	.930	-.349	.116
MM_IND	.944	-.320	8.224E-02

Extraction Method: Principal Component Analysis.

a. 3 components extracted.

Source: author's calculations (SPSS output)

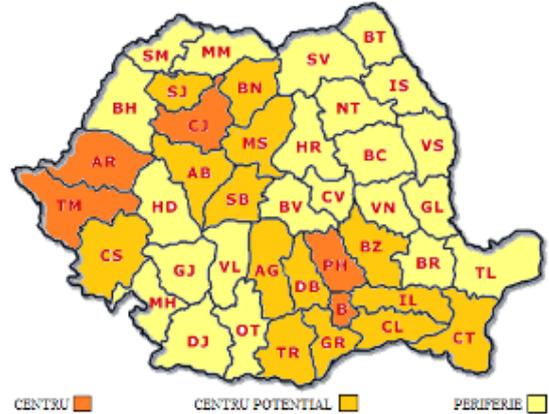
In this case, we can see that the four indicators of peripherality are best represented by factor 1, and they have an approximately equal weight in its composition, which may justify calling this factor “total potential accessibility”.

In conclusion, should be kept all four indicators (because they are strongly

interrelated), being represented by a single factor, which we can call “total potential accessibility”.

Therefore, by the non-hierarchical analysis (K-Means Cluster Analysis) were obtained 3 clusters. Obtained clusters are represented graphically in figure no. 1.

Figure no. 1. Center-periphery structure by total potential accessibility for Romanian counties (2006)

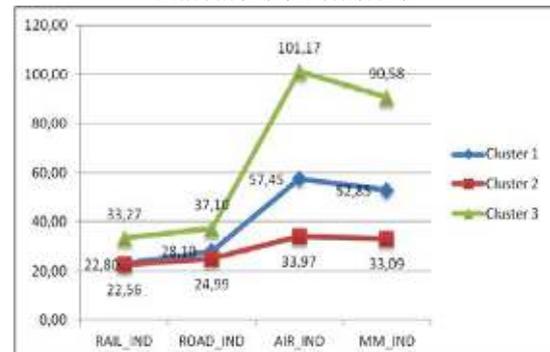


Source: author's calculations

As can be seen in figure no. 1:

- cluster 1 includes the following counties: Buzau, Constanta, Arges, Calarasi, Dambovita, Giurgiu, Ialomita, Virginia, Severin Nasaud, Salaj, Alba, and Sibiu;
- cluster 2 includes the following counties: Bacau, Botosani, Iasi, Neamt, Suceava, Vaslui, Braila, Galati, Tulcea, Vrancea, Mehedinti, Olt, Valcea, Hunedoara, Bihor, Maramures, Satu-Mare, Brasov, Covasna, Harghita;
- cluster 3 includes the following counties: Prahova, Arad, Timis, Cluj, Bucharest and Ilfov.

Figure no. 2. Mean values of the four indicators on clusters



Source: author's calculations

Figure no. 2 contains the mean values of each cluster, on each of the analyzed indicators: potential accessibility by road (ROAD\_IND), potential accessibility by rail (RAIL\_IND), potential accessibility by air (AIR\_IND) and multimodal potential accessibility (MM\_IND). For cluster 1, the mean values of the four indicators are: 22.8 (RAIL\_IND), 28.1 (ROAD\_IND), 57.4 (AIR\_IND) and 52.8 (MM\_IND). These values give to cluster 1 a middle position.

For cluster 2, the mean values of the four indicators are: 22.6 (RAIL\_IND), 24.9 (ROAD\_IND), 33.9 (AIR\_IND) and 33.0 (MM\_IND). Thus, as we can see in figure no. 2, cluster 2 occupies an inferior position. For cluster 3, the mean values of the four indicators are: 33.2 (RAIL\_IND), 37.1 (ROAD\_IND), 101.1 (AIR\_IND) and 90.58 (MM\_IND). Therefore, the same figure shows that cluster 3 records best values.

Therefore, based on cluster analysis, three clusters were obtained. The mean values recorded for accessibility have allowed a possible name of the clusters: center, potential center and periphery.

Also, in figure no. 1 and figure no. 2, can be seen a center-periphery structure, arranged in three levels, where cluster 3 shows a high degree of accessibility in the European context, on the transport modes analyzed and can be considered CENTER. On the same considerations, cluster 1 includes potential centers and cluster 2 represents the periphery.

#### 4. Conclusions

In conclusion, the analysis of spatial peripherality at Romanian counties level highlights a clear center-periphery model.

Also, can be identified three centers located in the west of the country (Timis, Arad), center of Transylvania (Cluj) and around the capital (Bucharest, Ilfov, Prahova). We see that around the center with high accessibility (low periphericity) are positioned potential centers (Buzau, Constanta, Arges, Calarasi, Dambovita, Giurgiu, Ialomita, Virginia, Severin Nasaud, Salaj, Alba, and Sibiu). Peripheral counties are considered: Bacau, Botosani, Iasi, Neamt, Suceava, Vaslui, Braila, Galati, Tulcea, Vrancea, Mehedinti, Olt, Valcea, Hunedoara, Bihor, Maramures and Satu-Mare, Brasov, Covasna, Harghita. We note

also a low degree of accessibility (high periphericity) for the entire Northeast Region.

#### 5. Acknowledgment

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## Employment of Manpower in the Regional Context of Romania's

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### Abstract

*Regional development is a long process, but while difficult, is a continuous process of compromise and consensus solutions to identify realistic development potential for each region, which means: transparency, information, communication and cooperation. But to put these principles requires regional partnerships with regional actors. They are designed to identify common interests and issues to act accordingly. We as Europeans must think regionally and full employment of labor resources increase income for each region. Therefore, in this paper we made a short analysis of employment in the regions of Romania.*

**Keywords:** regional development, region of development, sustainable development, unemployment.

**JEL classification:** R23

### 1. Introduction

In Romania concerns the study of regional problems dating from the first part of the twentieth century. The precursors regional issues nationally, we remember the eminent Romanian sociologist Dimitrie Gusti, that since 1925 rural coordinates the preparation of monographs, and after 1945 start preparing urban monographs (first is the Reșița). From the regional perspective, the merit of these

works is that "the social order", monographs become a necessity pragmatic, results from these investigations are required to base the development of sustainable development programs in rural communities studied. They are also points of support to attract funding from national and international bodies involved in supporting "sustainable development".

In the paper "Fundamental problems of Transylvania" (1945), Victor Jinga made a complete, economical, social, political and history of Transylvania, and this in turn represents a referential of studies on regional issues.

L. Tiganescu by his "input-output" founded using input-output method in regional economic analysis.

Very important is the contribution of Ion Blaga in regional economic analysis work "territorial distribution of productive forces in Romania". The paper stresses that rational territorial distribution of productive forces is required to solve two problems simultaneously: economic efficiency and population growth and a fair allocation of its territory. The author supports the balanced development of the counties to stop migration from less developed counties to other counties, especially for large cities, making it difficult to solve in the future lifting of economic and social problem areas lagging behind.

"Arranged space systems. Modeling - Optimization - forecasting", teachers Baptism, M., Celac, M represents an important

contribution to the grounding of planning and regional economic development.

After 1990, from the perspective of Romania's integration into EU structures, there were concerns in the preparation of studies led to the development programs. First studies teachers mention Nicholas Valentine, Daniela Luminita Constantin, Parlog Cornelia, Matthew Lucka, Anghelescu Stoica and others.

Very important are the studies made at the Institute of Economic Forecasting of the Romanian Academy by recognized experts in the field (Phd. Dorin Jula, Phd. Gabriela Frenz, Phd. Carmen Păuna) who had a great impact on the development of the first documents on regional development in Romania. After the 90 have been developed valuable thesis on regional issues such as thesis Luminita Constantin, of Dorin Jula, Ailenei Dorel's thesis, Mariana Voineagu, Daniela Antonescu and others.

Although a number of researchers in the field have great interest for regional development of Romania, and this was the complete success of transition and economic restructuring, the period immediately following 1989 was not for the authorities in our country dedicated to this trial period.

The year 1995 was the year the were taken into account explicitly the problems of regions, local issues in the draft strategy to prepare Romania's EU accession. That was the period when the gap between words and deeds beyond the debate about decentralization, local self-government, on the one hand and on European integration, cross-regional networks, on the other hand [1].

In the Phare program , external advisors appointed by the European Union together with representatives of the ministries have prepared in 1997 a set of guiding principles for regional development in Romania in the Green Paper. Result of measures taken in the program led to the development and adoption of *Law 151/1998 on regional development in Romania*, which has shaped the content of regional development, has created the legal framework for establishment *development regions* and have established regional and national structures to develop Regional.

As I said, in Romania, could be applied to regional development policy was established eight Development Regions [2]:

- Region 1, North-East includes six counties: Bacau, Botosani, Iasi, Neamt, Suceava, Vaslui
- Region 2, South-East includes six counties: Braila, Buzau, Constanta, Galati, Tulcea, Vrancea;
- Region 3, South includes seven counties: Arges, Calarasi, Dambovita, Giurgiu, Ialomita, Prahova, Teleorman;
- Region 4, South-West includes five counties: Dolj, Gorj, Mehedinti, Olt, Valcea;
- Region 5, Western includes six counties: Arad, Caras-Severin, Hunedoara, Timis
- Region 6 includes 6 counties North-West: Bihor, Bistrita Nasaud, Cluj, Maramures, Satu Mare, Salaj;
- Region 7, the Center includes six counties: Alba, Brasov, Covasna, Harghita, Mures, Sibiu
- Region 8, Bucharest - Ilfov including the capital Bucharest and Ilfov County;

Development Regions is the implementation, development, monitoring and evaluation of regional development strategies and programs of economic and social cohesion which they are implemented. Regional development in Romania, is defined as "all policies and local public administration authorities, designed to improve the economic performance of some geographical areas established development regions and supported by Government, EU and other institutions and national authorities and international interest "[3].

A special role in the process of accession to the European Union have had studies prepared by the European Institute of Romania in 2001-2004, some of them referring to regional development.

Another stage important developments in research on regional development in Romania was the establishment in 2000 of the Romanian Association of Regional Sciences (ARSR), an association member European Regional Science Association (ERSA) and create research centers of regional development in Bucharest, Timisoara, Iasi, Galati, Suceava, Alba Iulia and other counties. In the four

national symposia (2001-2004) ARSR managed to meet specialists in regional development theory and practice in our country and abroad (each national symposium was attended by senior representatives of RSAI and ERSA).

For Romania, the integration European Union was one of priorities. Time integration into the European Union has brought joy to become members of European and responsibility to live up to other EU countries. The fundamental challenge is for Romania, operating capacity of regional policy on independent axes and influence the political dimension.

Romanian regions are below the economic development of regions in European Union countries. Therefore, the integration time required to reduce these discrepancies, in this respect is necessary to adopt measures of economic policy, social and administrative reform processes to sustain.

Approach to economic, social, political and administrative region aim to certain limits disciplinary, but can and should be supplemented by those due to certain general processes of this unification and European integration, problems of religious fundamentalism and state or, last but not least, the phenomena of poverty and economic migrationismul.

In order to achieve regional policy objectives [4] in 2007-2013, Romania has three instruments: the European Regional Development Fund (ERDF) which finances infrastructure projects generated, innovation and investment, European Social Fund (ESF), which finances projects for training and other assistance programs for employment and the Cohesion Fund (CF), which finances large infrastructure projects, environmental and transport in new Member States, Spain and Portugal (living standards are under 90% of EU average).

One Romanian Operational Programmes agreed by the European Union is the Regional Operational Program (ROP) [5], which is a very important tool for implementing the national strategy and regional development policies. Is applicable to all 8 regions of Romania.

## 2. Indicators for regional development

Starting from the idea that not all regions and all countries are identical, so between disparities occur, which can be analyzed from different perspectives: the unemployment rate or employment rate, which are relevant indicators for the general welfare productivity / capita, which measures relative performance or economic efficiency of the regions, the indicators introduced recently in the European Commission reports addressing disparities in terms of demographic trends, educational attainment of the population, level of investment in R & D and number of patent applications. Although comparisons between these indicators can be useful in establishing trends in economic development, national and regional major criterion for regional policy intervention is the disparity in terms of income and production. Without insisting on many indicators that can measure differences for the categories mentioned, I review some such alternative instruments that can quantify the notion of regional development:

-a long time, the main indicator used by the European Commission to establish eligibility for support through regional policy was GDP / capita, calculated using the exchange rate, measured both at national and regional

- GDP / capita, calculated using purchasing power parity, is another indicator used to have reduced the considerable differences. Development disparities are reduced, but more standard purchasing power is calculated at regional level. In many states, there are significant variations in terms of purchasing power between different geographical areas and between cities and rural areas. Because it was very important to determine whether redistributive efforts of Member States or not considered when defining the processes made regional policy, has introduced a new indicator: Regional GDP per capita, adjusted for taxes, transfers and other expenses public. Additionality principle, the contributions of European funds should not replace national investment, but to supplement and extend them. There are studies showing that the regional distribution of income after deducting taxes is more humble than disparities for

regional GDP values. Disposable income (individual) is an indicator that, unlike other indicators, including private capital flows, which may be relevant for less developed regions, where the local population is dependent on financial support of those who emigrated.

Obviously, these indicators, regardless of the successive attempts of use in a correct and representative in regional convergence process analysis provides only an image synthesis, predominantly economic.

### 3. Regional development in Romania

In recent decades, gaps emerging from developed countries, but also increase disparities within them. When our country decided to join the European Union, the national economic space organization in the appropriate unit of regional development policy implementation and development of appropriate statistical system have become key elements of Romania's development policy in the European context.

Administrative structure Territorial our country is made up of a regional (41 counties and Bucharest) and local (263 municipalities, of which 84 municipalities and 2688 communes). As we have discussed in a previous chapter the 8 regions are defined as "areas which correspond to groups of counties", established by their voluntary association based on agreement signed by representatives of county councils and that general council of Bucharest.

### 4. The regional unemployment rate in Romania

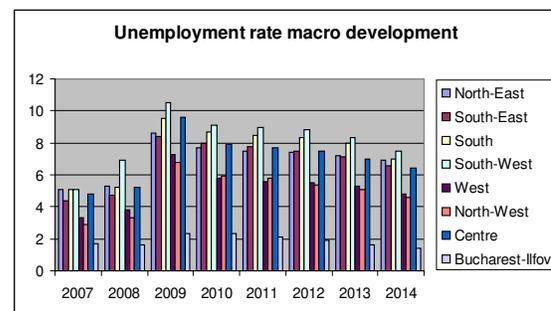
Employment indicators are used in analysis to measure sustainability social dimension of this concept so broad. The importance of employment is fundamental, both individually, bringing value to the individual and is considered reason "to live", but also at company level, while the taxes come mostly in the profitable activities. According to a survey by Eurostat [6], in Romania, the unemployment rate registered in 2009, 6.9%, while the EU average was 8.9% that year. In

2010, noted a slight increase in the unemployment rate in our country, to 7.3%, and in the media union, which increased to 9.6%. These increases are largely due to the current economic crisis.

Transition to market economy has negatively affected the employment of Romanian regions population, employment has become one of the most tense areas of transition. In the period 1992-2004, employment has fallen continuously in most regions of our country as a result of economic restructuring, the regions most affected by a high share of industry in GDP, because in these regions have been massive restructuring mining. In an analysis of Eurostat [7], in 2010 in Romania, the lowest unemployment rate was registered in the Bucharest-Ilfov (4.8%), and the unemployment rate was registered in the Central Region ( 10.5%). For example in this study note that there are some disparities both among developing regions in each EU country and between regions of our country.

One of the visions of sustainable regional development is to increase employment. The chart below show the evolution of unemployment in each macro development during 2007 -2014, the last four years are forecasts made by the National Commission for Prognosis [8].

Chart. 1



Source: Statistical Yearbook data after Romania and those offered by the National Commission for Prognosis, 2011.

As shown in the graph above, in 2009 compared with 2008, they felt the current economic crisis As the unemployment rate has increased in most regions of our country. The only region which has greatly increased the unemployment rate is the Bucharest-Ilfov, here

I might say that employment increased from 1.225 million people in 2008 to 1,231,000 people in 2009. Bucharest-Ilfov region has the lowest unemployment rate in our country. National Prognosis Commission [9] published a set of regional forecasts, namely "the territorial Forecast 2011-2014", where there is a recovery in employment situation in all regions of our country since 2011. However, in the persistence of the current economic crisis is likely that these forecasts may not exactly reflect reality.

Can say that the employment situation in the regions of Romania are brought into balance economic development in recent years, the new process of globalization, it is and threatened by two major phenomena: aging population and labor migration continues. Those who choose to migrate are mostly young high school graduates or higher. The most common form is the inter-regional migration. In particular high school graduates going to continue studies in cities that are part of the developed regions and do not return, finding a job better paid and more secure in these regions. Employment policies come to counteract undesired effects of phenomena present and focuses mainly on the situation, not taking into account a lot prevention and creating a long term strategy.

## 5. Conclusions

These development regions have similar sizes of population and territorial units are large enough to constitute a good basis for developing and implementing regional development strategies, enabling efficient use of financial and human resources, and to see if it develops sustainable.

Today, almost everything takes place under the banner of sustainable development, the company develops the application of sustainable development must become sustainable education, industries and develop sustainable agriculture, research needs to support sustainable development, water resources are used sustainably and more .

Thus, in our country will see below that the large disparities between regions.

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## A Spatial Perspective over the Creative Economy of the Eastern Europe

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### Abstract

*The objective of this paper is to provide a spatial distribution of creative economy in European Union, in 2011. For this purpose, we measure creative economy by proposing a five dimensions index.*

*The results are displayed in the Creative Economy Map of EU. The further discussions highlight the position of Eastern developing economies in this context.*

**Key words:** creative economy, Five Dimensions Creativity Index, talent, technology, tolerance, information society infrastructure, intellectual rights.

**J.E.L. classification:** R12, O10, O30, O34, F02.

### 1. Introduction

An increasing number of studies and papers shows the growing importance of a *new economy* in the nowadays society, called *creative economy* [1].

Even there are several acceptations concerning the definition of this concept, all opinions agree that creative economy concerns the activities based on intellectual rights exploitation.

From historical perspective, The Labor Department of UK (headed by Tony Blair) was the first in Europe which formulated the term “creative industries” as a specific concept to the new cultural industries. By its demarche, the British government aimed to assert the creativity’s potential in creating wealth and employment. Its example was followed by other European states, which defined the activities concerning creative economy in their own way.

According to the KEA European Affairs’ Report (entitled The Economy of culture in Europe), the main European acceptations for referring to the creative economy are:

“creative industries” (as the components of creative economy), “copyrights industries”, “the economy of experience” and “sector of specific studies” [2]

Table no. 1. Spatial distributions of creative economy acceptations, in Europe

“Creative industries” approach	Austria Flemish Community of Belgium Denmark (2000) Estonia Latvia (2005) Lithuania Sweden (2002) Romania Bulgaria
“Copyrights industries” approach	Denmark(2006) Finland Hungary Latvia (2005) Norway
”Experience economy” approach	Sweden (2004) Denmark (2003)
Sector specific studies	French Community of Belgium France Ireland Poland Portugal Spain Slovak Republic

Source: “The economy of culture in Europe”, KEA European Affairs, 2006, p. 48.

No matter the specific view over it, all perspectives agree that creative economy has become a major force of economic growth, with a contribution to national economies, which often overcome all others sectors.

Table no. 2. Contributions of the creative economy to the GDP (percentage)

	Food Man.	Textiles Ind.	Real Estate act.	Creative ec.
<b>Denmark</b>	2.6	0.3	5.1	3.1
<b>France</b>	1.9	0.4	1.8	3.4
<b>Germany</b>	1.6	0.3	2.6	2.5
<b>UK</b>	1.9	0.4	2.1	3.0
<b>Bulgaria</b>	2.2	2.0	0.4	1.2
<b>Romania</b>	1.9	2.1	0.5	1.4

Source: “The economy of culture in Europe”, KEA European Affairs, 2006, p. 68.

## 2. Creative Economy Measurement

In order to reveal its influence over the human development, in general, one important step in creative economy’s analysis is to measure it. This attempt presents many difficulties regarding data collection and comparison, the different statistical systems applied by countries, the penury of in-depth research studies, etc.

The main creative economy indexes used in scientific literature are: Global Creativity Index [3], Euro Creativity Index [4], European Creativity Index [5], Hong Kong Index [6] and Flemish Index [7].

This paper proposes a new index for creative economy measurement, which aim to reveal the EU 27 creative potential and their capacity to attract creative class.

Our Index is a development of Global Creativity Index, proposed by Richard Florida [3], by including other two Indexes (Information Society Index and International Property Rights Index), near the other three, represented by 3T model of economic development (Technology, Talent and Tolerance). Each Index, part of the Five Dimension Creativity Index, contains several other Sub-indicators.

**Technology Index** (TI, proposed by Richard Florida) uses three variables for measuring the technological countries level: R&D investment, researchers and innovation.

**R&D Investment** (RDI) measures the R&D spending as share of GDP in EU members’ economies.

**“Researchers” Index** (RI) represents the number of professional researchers, engaged in R&D, per million capita.

**Innovation** (II) variable measure the patents grated per capita in the considered regions.

**Talent Index** (TaI) represents a mix of human capital and creative class variables.

**Human capital** (HC) is determinate by the standard measure of educational attainment.

**Creative class** (CC) consists in the share of a country’s labor force that is engaged in a higher degree of problem solving in their everyday work

**Tolerance Index** (ToI) implies the measurement of tolerance toward ethnic and racial minorities (TERM) and toward LBGT community (LBGTT).

Both sub-indicators are measured by Gallup Organization, on the basis of a international survey applied annually.

**Information Society Index** (ISI) measures the information society degree of development and combines three variables: Information technology expenditure, broadband penetration rate and level of internet access.

First sub-indicator represents *Information technology expenditure* (ITE) in millions of euro and as a percentage of GDP.

**Broadband penetration rate** (BPR) shows how widely broadband access to the internet has spread in the European countries on the general level, not specifying by user group.

**Level of Internet access** (IA) is the percentage of households who have internet access at home. Target population considered are the households with at least one member in the age group between 16-74 years. The data is collected by the National Statistical Institutes or Ministries and is based on Eurostat’s annual model surveys on ICT (Information and Communication Technologies) usage in households and by individuals which has been carried out once a year since 2002. Data for countries other than EU Member States is provided directly by National Statistical Institutes.

**International Property Rights Index** (IPRI) is concerned with the countries’ respect for intellectual rights, whitout which creative economy cannot prosper. It is elaborate by Property Right Alliance [8]and contains other three components: Legal and Political Environment (LP), Physical Property Rights (PPR) and Intellectual Property Rights (IPR).

**Legal and Political Environment** (LP) is determined by the variables Judicial Independence. Rule of Law, Political

Stability and level of Corruption.

*Physical Property Rights (PPR)* is concerned with the country’s strength of the rights property systems and includes Protection of Physical Property Rights, Registering Property and Access to Loans variables.

*Intellectual Property Rights (IPR)* The IPR component evaluates the protection of intellectual property. In addition to an opinion-based measure of the protection of IP, it assesses protection of two major forms of intellectual property rights (patents and copyrights) from de jure and de facto perspectives, respectively. [8].

Table no. 3. The main Indexes and Sub-Indicators of the Five Dimensions Creativity Index (FDCI)

	Main Indexes	Sub-Indicators	Data source
<b>FDCI</b>	TI	RDI	Eurostat
		RI	The World Bank
		II	
	TaI	HC	UNESCO institute
		CC	International Labor Organization
	ToI	TERM	Gallup’s Organization
		LGBTT	World Pool
	ISI	ITE	Eurostat
		BPR	
	IPRI	LP	Property Rights Alliance
	PPR		
	IPR		

Source: author

The overall Creativity Index combines all five dimensions, giving an in-depth perspective over the creative economy.

The measurement methodology is:

- Each of the 13 sub-indicator value is collected, for all the EU member states;
- The values are ascending ranked. (The country with the best values receive 1<sup>st</sup> rank, and so on);
- The values are normalized by division with the total number of records (27,

when data are available for all the states);

- The index is calculated as the difference from the maximum value (1) and the average score (for all 13 variables) obtained by each state. There will result values between 0 and 1; as an economy will have a more developed creative economy, its score will be more close to 1.

### 3. Results

By using the briefly presented methodology from the section before, we succeed measure the Five Dimension Creativity Index for 2011.

Because some of the data are not yet available, we approximate some indicators by regression.

In the top of the list, we find Sweden, with the highest FDCI score (0,9). Other studies, conducted in 2004, respectively 2010, found Sweden in the same position. It appears that Sweden has not only a strong creative economy, but owns the meanings for its sustainability, too.

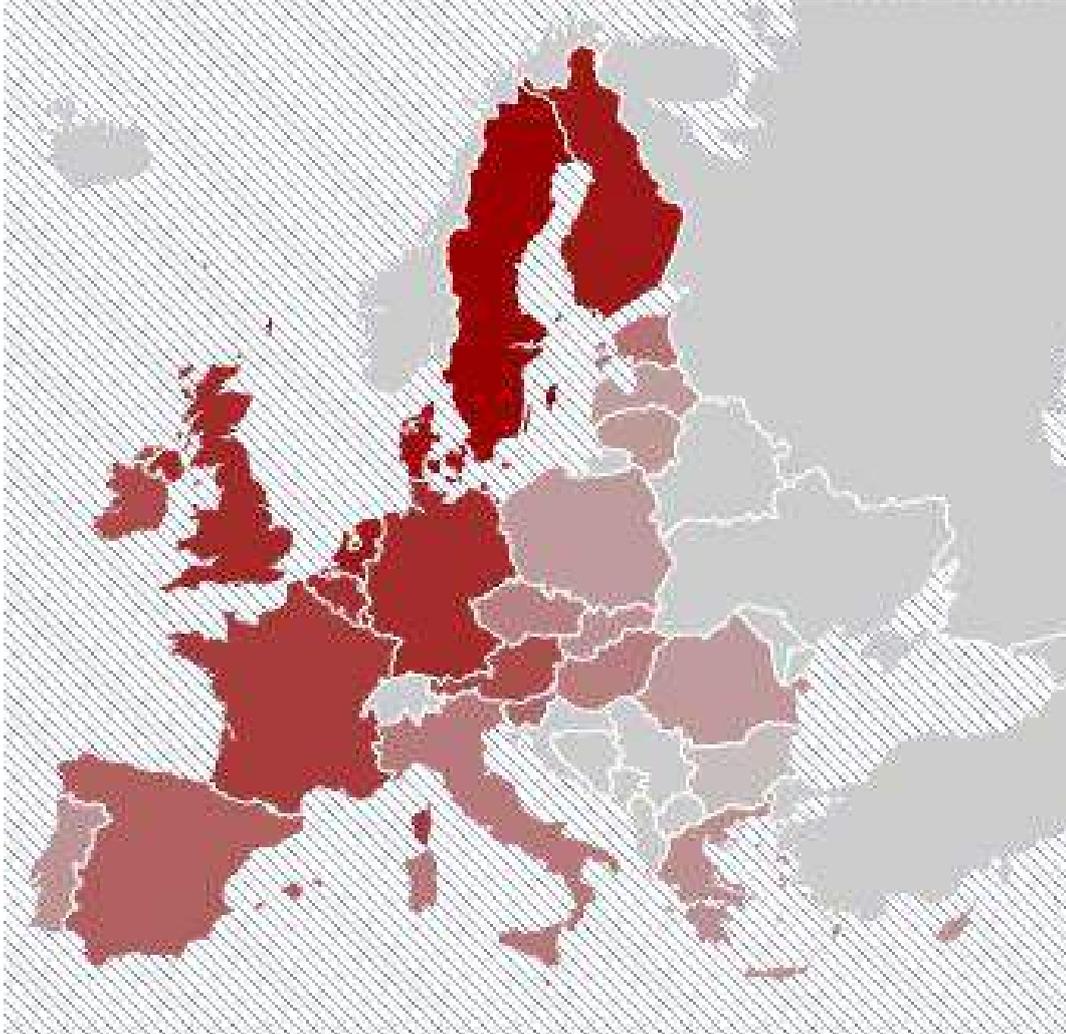
Also we may observe that the most powerful creative EU members are, specifically, Nordic Countries and the most developed EU’s members, generally.

Table no. 4. The top 10 European Countries concerning creative economy

Country	FDCI
Sweden	<b>0.90</b>
Denmark	<b>0.84</b>
Luxembourg	<b>0.82</b>
Finland	<b>0.80</b>
Netherlands	<b>0.79</b>
United Kingdom	<b>0.72</b>
Germany	<b>0.71</b>
Belgium	<b>0.69</b>
France	<b>0.64</b>

Source: author calculations

Figure 1: The Creative Economy Map of EU



Source: author

Figure 1 shows The Creative Economy map of EU, in 2011. The zones where red color intensifies to brown are the regions where creative economy is more developed.

We can observe a concentration effect of creative economy in the North-West of European Union. As we approach to the Eastern borders, the RDCI levels are strongly decreasing. According to this observation we can classify EU members in three categories, regarding their creative economy development:

- Highly developed creative countries;
- Countries with a developed creative economy;
- States with a developing creative economy;
- Countries with a low developed creative economy.

Table no. 5. The EU countries classification, according with the level of creative economy development

<b>Highly developed Creative economies</b>	Sweden, Denmark, Luxembourg, Finland
Developed Creative Economies	Netherlands, United Kingdom, Germany, Belgium, France
Developing creative economies	Malta, Austria, Ireland, Spain, Slovenia, Estonia, Italy, Czech Republic, Hungary
Low developed creative economies	Greece, Portugal, Slovakia, Cyprus, Lithuania, Romania, Poland, Latvia, Bulgaria

Source: author calculations

Romania’s Creative Economy has one of the lower levels from EU (0.22). The small numbers of researchers, the high grade of corruption, the low compliance with the intellectual rights and the spreading of piracy affect strongly the development capacities of this country.

A similar situation is shared by Bulgaria, Latvia and Poland.

Even they are included in the “countries with a low developed creative economy” category, Greece, Portugal, Slovakia, Cyprus, Lithuania record better FDCI results.

#### 4. Conclusions

Our research reveals, in part, the importance of creativity in reshaping European Union development.

By measure the Creative Economy in Europe, using the proposed Index (FDCI), we observed an effect of concentration in the north-west part of EU. Surprisingly, the center of this core-periphery pattern is in the North Europe (Sweden), in accordance with the EU’s real economic peripheral pattern. This underlines once again the high importance of creative economy development for enhance the general development of the states, in actual context.

For attuning to the new *creative age*, the developing economies from Eastern Europe should improve their intellectual rights compliance, diminish piracy, stimulate the creative activities, increase the valorization of their human capital and enhance the tolerance and understanding toward certain social groups (like ethnic minorities and gay or lesbian communities).

#### 5. Acknowledgment

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## Labour Market, Where?

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### Abstract

*Creating conditions for employment factor to be active and creative is a socio-economic problem facing all countries today. Government management efficiency and quality of governance must be assessed in terms of results in the use of labor resources of the country.*

*The complexity of the concept of labor market and determine its development involves the need to use a complex system of specific indicators, which highlight the many issues raised in the labor market.*

**Keywords:** labor market, labor resources, the working age population

**J.E.L. Codes:** J68

### 1. Introduction

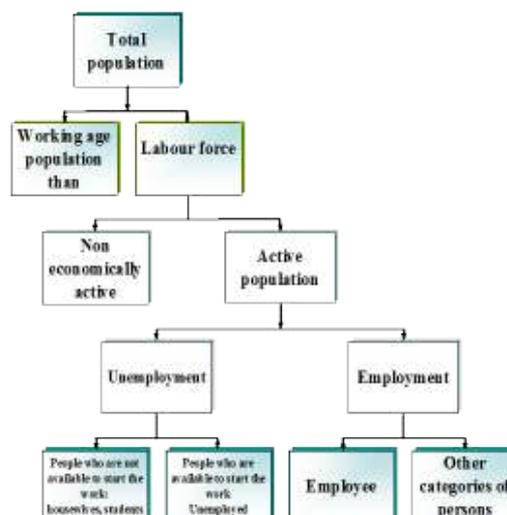
Important area of the market economy of any country, the labor market has an important role in providing dynamic interdependencies economy of any country. The labor market reflects the multiple facets of economic and social life, offering an insight into key issues and interdependencies that occurs within it, and the influences it may have on other sectors or areas of actin in its direction. Economics generally, and science macroeconomic economy and human resources management were increasingly concerned demografico-economic problems and social behavior of the potential labor supply. Literature published in recent decades, labor resources devoted to employment is extremely rich and diverse. Have undergone an extensive critical analysis, the older theories of employment and new theories were developed, which capture aspects of change current quantitative and qualitative structural employment of labor resources.

### 2. Classification employment indicators and nonemployment

General background to the dimensioning of employment and labor resources is neocupării demographic factor. Starting from the total population of a country can highlight indicators of employment and the labor nonemployment, as shown in graphic 1.

Labor resources, have the general background population, ie number of people of working age and their ability to provide specified services needed in society, regardless of legal working age, ie those below and above the legal working age in activity. Although the plot does not show a distinct category of manpower, they are the result of aggregation of employment, with a segment of the working population covered outside working age but are performing an activity, especially the common situation where retired people from different reasons, continued active life.

Graphic 1- Population breakdown



Removing from the labor resources, those working above the age prescribed by law, and although people are in legal age of employment, pursue any activity due to

inability to work, get an overview of stock potential labor force, resulted in the active population, which includes the unemployed population structure, consisting in turn of people do not want or can not find work and employment consists of summation of those working as employees and other categories of persons practicing as employers, self-employed, unpaid family workers, members of agricultural societies or cooperatives.

Labor supply of those resources is practical work, the potential for work that is available to start an activity. In fact, labor resources are identified active population willing to engage in existing working conditions and wages offered by the market, being influenced both by demographic phenomena and processes and the economic situation, the size and structures of social and economic activities.

### 3. From theory to reality

Analysis and labor market developments, require the submission of a system of indicators measuring quantitative and qualitative elements, general human resources and labor resources in particular, indicators are based on the information system.

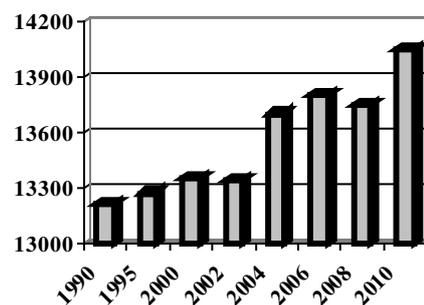
Numerical expression of an indicator can not be assessed as more or less, unless you are able to make a comparison with other periods of time, with different areas within the national, or when not the case with other countries .

In essence, the need to monitor key labor market indicators and their trends shaping allows a study of the evolution of these indicators and to determine possible factors of influence are behind these changes and taking action to influence the meaning desired evolution of these indicators.

### 4. Labour force

In Romania, the evolution of labor resources presents an upward trend, suggestive aspect highlighted in Chart 1. At the end of 2010, the labor resources in Romania recorded an increase of 830,700 thousand people compared to 1990, the number of people who carried out certain activities in the national economy was 13216.9 thousand [1].

Chart 1 – The evolution of labour resources in Romania during 1990-2010



Source: <http://www.insse.ro>, FOM101A

This increase in the number of labor resources in Romania is the effect of several causes such as: Law no.19/2000, which provides for gradually increasing the retirement age, active measures taken in the employment policies in terms of stimulating active life extension or more people outside the legal working age, which for various reasons wish to pursue a particular activity.

Table 1 – Dynamics of labour resources in Romania

	1990	2000	2010
Total population (number of people)	23211395	22455485	21462186
People who are not engaged in (number of people)	9994495	9097085	7414586
Population carrying on a (Labor resources) (number of people)	13216900	13358400	14047600
Resources for work / total population *100 %	56,94	59,48	65,45
Dependency ratio (number of people)	1,32	1,47	1,89

Source: <http://www.insse.ro>, POP101A, FOM101A and own processing

It should be noted however, that during the 20 years of the analysis there are slight decrease in the absolute level of labor resources. Thus in 1991, the labor resources decreased by 138,700 persons over the previous year, something that reveals a large number of people emigrate. Deviations from

the general trend of evolution of labor resources is recorded in 1998, 2000, 2002 and 2007, when the labor resources decreases, either because of diminishing active population or reducing the number of people outside the legal age labor willing to work [2].

A highly sensitive indicator is the dependency ratio of people working and not working, ie labor resources. This indicator can be interpreted as the number of people carrying out any activity that returns to a person performing an activity and the number of those doing some activity back to a person not engaged in any activity. The table above dependency ratio is calculated as the number of labor resources per one person not engaged in any activity.

As can be seen from Table 1 data during the 21 years of the analysis, the absolute value of labor resources in Romania is increasing, also the share of labor resources in the total population evolving upward [3], both on account of the shrinking, but also on the rise in the number of people in work.

As the figures in the table above, the dependency ratio evolving positively in the sense that if in 1990, 132 people in the category of labor resources supporting 100 people who does not work in 2010, 100 persons not work are supported by 189 people performing an activity.

Increasing the share of labor resources in the total population and dependency ratio effects outlined above is extended working life for some people able to perform useful work, and increasing labor market entry for some categories of young people.

## 5. Total population aged 15-64 years

According to Law no.19/2000 on the public pension and social security retirement age, increasing in stages from 2000 to 2014, both women and men, the women from the age of 57 years in 2000 to 60 years in 2014, and the men from the age of 62 years in 2000, up from 65 in 2014. Now, in 2012 [4], the standard retirement age is 64 years and four months for men and 59 years and 4 months for women.

Analysis of this indicator reflects a level overview of labor available to a country. The generality of this indicator is derived from the fact that its structure includes persons

who are above age limits, but for various reasons does not work, as students, teachers, housekeepers, people with temporary disability, individuals of freedom, so that will not dwell too much on it.

Workers in Romania [5], represented the working age population, as the figures in Table 2, has seen the past 20 years, a slight and insignificant involution, with variations over time.

*Table 2 - Evolution of the total population aged 15-64 years in Romania between 1990-2010*

Indicator	1990	2000	2010
Total population	23211395	22455485	21462186
Men of working age	7227313	7231646	7191849
Women of working age	6559136	6643058	6513562
Total population aged 15-64 years	13786449	13874704	13705411
Young + elderly population	9424946	8580781	7756775
Economic dependency ratio	<b>68,36</b>	<b>61,84</b>	<b>56,59</b>

Source: <http://www.insse.ro>, POP101A, POP101C and own processing

In 2010, there is a decrease in the number of men of working age people with 35.4664, which represents a decrease of 0.5% and a decrease in the number of women of working age with 45,574 people or a reduction of 0.7%, compared to 1990.

Regarding the economic dependency ratio, ie number of people aged between 0 and 16 years and men aged over 62 and women older than 57 years per 100 people in working age in decline accentuated.

Decreasing value of the indicator has currently positioned in the sense that fewer young people and elderly people per 100 working age, but do not forget to keep in mind that the population structure ie working age in 2008, includes persons born until 1992, when the birth rate in Romania was still quite high, it decreases gradually as we age and life expectancy at birth record a growing population.

The evolution of labor can be highlighted by analyzing the population replacement rate of working age, an indicator that expresses

the contribution to the renewal of the young working age population.

Replacement rate of population in working age population is younger than 16 years, reported a third of working age, the evolution of this indicator in Romania are presented in Table 3.

Reduction in working age population, already presented issue is further highlighted by the progress of the replacement rate of working age population. Young population, in 1990, as seen from the calculations in Table 3, provide a replacement rate of 128.55% of the working age population, while in 2010, the value of this indicator decreased by 52.32 percentage points [6].

Table 3 - Evolution of the replacement rate of working age population in Romania

Indicator	1990	2000	2010
Male 0-15 years	3018588	2293862	1787950
Men 16-62 years	7227313	7231646	7191849
Girl 0-15 years	2888452	2192360	1695038
Women 16-57 years	6559136	6643058	6513562
Population 0-15 years	5907040	4486222	3482988
Working age population	13786449	13874704	13705411
Replacement rate înlocuire	<b>128,55%</b>	<b>97%</b>	<b>76,23%</b>

Source: <http://www.insse.ro>, POP101C and own processing

Marked decline in the rate of replacement of the working age population in Romania, proves once more reduced the labor, the effect of reducing the number of births after 1990.

Offsetting this effect is considering working longer, result in the implementation of measures to increase the capacity of older workers between 55 and 64 to remain in business for more time promoted especially by gradually increasing age retirement and early retirement limit.

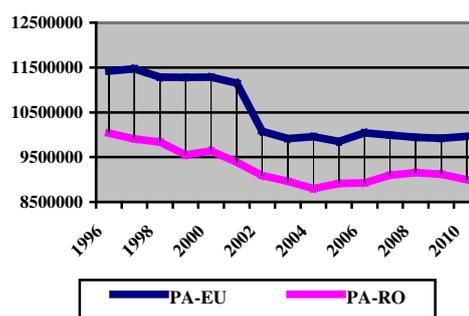
## 6. Active population

In Romania, the present absolute level of active population and other indicators of labor is determined by two different calculation methodologies, namely: on the Balance Employment [7] and the Survey on

Household Labour Force - AMIGO [8], the methodology used since 1996. This is because since the pre-accession to the EU, Romania started harmonizing Romanian statistical system with the European Union, research AMIGO [9] is just one of those examples.

To emphasize the difference between the two methodologies in terms of absolute number of active population, due to the fact that the two indicators that compose the active population that is employed population and unemployed, have different definitions [10] we constructed Figure 2, which activity indicates that the population of Romania between 1996-2010, shows a general downward trend with some oscillations at certain times, regardless of the indicator is considered for the analysis.

Chart 2 – Differences between PA-EU and PA-RO



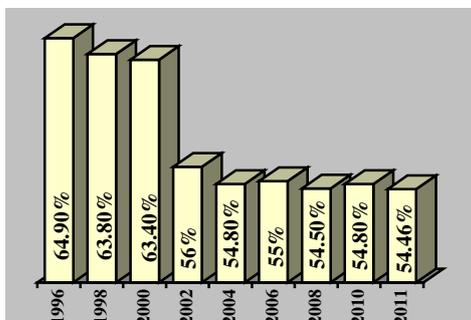
Source: <http://www.insse.ro>, AMG101A and FOM102A

Active population calculated in accordance with EU methodology, is higher than that calculated according to national methodology, throughout the analysis, recording it in 2010, a decrease of 12.76% compared to 1996, while the active population calculated according to national methodology falls in 2010, with only 10.35 percentage points. Differences in value between the active population sizes, based on two methodologies, varies throughout the period analyzed, levels of active population is approaching or leaving, depending on the dynamic components.

Currently unavailable due to statistical data for 2011, as the sheer size of the active population, but that analysis is as complete and as accurately reflect reality, in Figure 3

will be presented evolution rate enabled the population of Romania, until year 2011 inclusive.

Chart 3 – *The level of activity in Romania*



Source: <http://www.insse.ro>, AMG155A

As was natural, the relative level of activity follows the same trend with the absolute level of the active population. In 2011 recorded with decrease by 0.34 percentage points over the previous year and a decrease of 16.21% from the beginning of the analysis.

The downward trend of the active population in Romania, regardless of method used to determine them, is due to continuing population decline is due to the decrease birth or due to negative migration balance, demographic phenomena that influenced the population of Romania, after 1990.

## 7. Opinion

E volute of manpower in Romania, are on an upward trend overall, as recorded in late 2008, an increase of 530,500 thousand people compared to 1990, when a certain number of persons carried activating the national economy was 13216.9 thousand people, which demonstrates the effectiveness of employment policies undertaken by Romania in the promotion of equal opportunities in employment, increase participation rates of women in the workforce; objectives in the policy field in Europe. By 2015, the growth forecast of manpower under the two scenarios presented in Chapter acestestui varies between 100.27% and 100.48%, the difference in absolute value being 218,835 people.

Workers in Romania, represented by the working age population, has seen the past 20 years an involution slight, but insignificant. In 2009, there is a decrease in working age men with 15,162 people, representing a decrease of 0.21%, and an increase of women of working age with 69 people or an increase of 0,00,105%, compared to 1990.

Replacement rate of working age population represented the population under the age of 16 years, reported a third of working age, subtract the last two decades from 129% in 1990 to 76 percentage points at the end 2009, compensation of this effect in view of longer working lives, reflected in gradually increasing the retirement age and limiting early retirement.

The activity of the population of Romania between 1996-2008, is experiencing a steady decline due to continued population decline is due to the decrease birth or due to negative migration balance, demographic phenomena that influenced the population of Romania, after 1990. Urban focus most of the active population aged 25 and 49 years, male employment a priority in this age range. Young people and the elderly, labor is the dominant rural areas, women over 65 are prevalent in this group of active population.

## 8. References

- [1] <http://www.insse.ro>, FOM101A
- [2] own analysis based on aggregate data series FOM101A
- [3] <http://www.insse.ro>, POP101A, FOM101A
- [4] Law no.19/2000 on the public pension system and other social security rights is, Annex 3
- [5] <http://www.insse.ro>, POP101A, POP101C
- [6] <http://www.insse.ro>, POP101C
- [7] Throughout this chapter, this indicator will be called PA-RO, calculated according to the methodology that the active population in Romania
- [8] Throughout this chapter, this indicator will be called PA-EU active population that is calculated according to EU methodology
- [9] The statistics used in the European Union, the corresponding term is Household Labour Force Survey - HLFS
- [10] PO-RO, includes all persons who have a lucrative occupation, which normally carries one of the national economic activities, is framed in an economic or social activity, under a contract of employment or independently in order to get income as wages or payment in kind.

PO-EU, comprises all persons 15 years and over who have been in economic activity producing goods or services for at least one hour during the reference period, in order to get income as wages, payment in kind or other benefits.

SO-RO, unemployed person is a person who meets the following conditions: is looking for a job at age 16 or over and until the conditions for retirement, health and physical and mental capabilities render it suitable for performing a work, no job, no income or, in legal activities, earned less than the minimum gross wage in the country, is available to start work in the near future, if it find a job.

SO-EU, unemployed are people aged 15-74 years during the reporting period meet the following conditions: have a job and not engaged in order to get income, are looking for a job; are available to start work within two weeks if they would find a job.

## Sequences of Unemployment in Romania

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### Abstract

*The Romanian economy's transition from centralized economy to market economy, started 22 years ago, was a difficult time for our country, which caused significant changes in all areas of society: political, economic and social, manifesting a series of disturbances across the economy, labor market is one of the most affected by this transition and the emergence and development of unemployment is only one of these consequences.*

**Keywords:** inactivity, unemployment, imbalance

**J.E.L. Codes:** J68

### 1. Introduction

Both the character table and the contents of the complex, labor market leads to a huge human potential, with important implications in the evolution of economy and society, while the labor market is strongly influenced in turn by the state and economic change any boom or economic decline nationally and worldwide, affecting one way or another level of employment and unemployment.

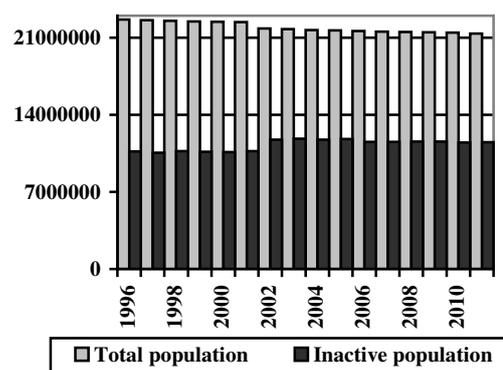
### 2. Inactive population

Gradual reduction of the active population, both in absolute terms and as percentage of total population, as was naturally led to increasing levels of inactivity in Romania, the inactive population is a very important indicator of progress which should be considered in analysis of labor market dynamics.

Inactive population trends in Romania for the period 1996-2011, shown in Diagram 1, shows a sharp rise inactive, both in absolute and in relative size throughout the period, the

significant increase of 1,024,074 since the inactive 2002, to those recorded in 2001. If in 1996 the rate of inactivity, determined as a percentage of inactive population in total population was 47.17% at the end of 2011 the value of this index increased by 6.58 percent, which represents an increase of 811,946 inactive [1].

Chart 1 – Evolution of the share of inactive population in total population



Source: <http://www.insse.ro>, POP101A, AMG145A, Press release no. 131/27.06.2011, 202/26.09.2011 and 275/22.12.2011

Inactive or non-active population comprises all persons, regardless of age, who are active in seeking work, and this is a factor of pressure on the working population and especially of the employed population, and also causing higher costs for those working to support inactive people.

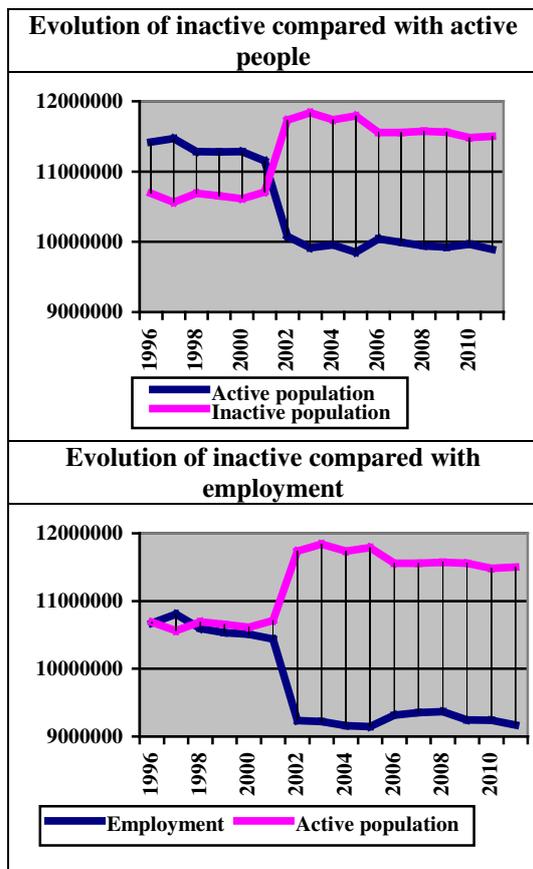
Determined at the same scale of values for the images can be more intuitive and easier to compare, Figure 2, represents an evolution in the last 16 years of inactive population, compared to the active population and the occupied.

A first look at changes in the three categories of population, shows us that the differences are more pronounced when comparing inactive population with

employment than with the active, they mainly from dynamics of unemployment.

Regarding evolution inactive compared to the active population, is observed up to the year 2001, higher values of the active population, because after 2002 the situation to change in favor of the inactive population. If in 1996, was inactive population surpassed the population with 732,084 people at the end of 2011, the number of inactive persons is 1,607,899 higher than the active ones [2].

Chart 2 – Evolution of inactive population during 1996-2011



Source: <http://www.insse.ro>, AMG145A, AMG101A and AMG1101

Evolution of inactive compared to employment, showing differences more apparent than in present. Employment has values higher than inactive only by the end of 1997, the inactive population increased by 94,781 persons to the number of employed. These differences remain relatively small until the end of 2001, for early next year with employment to 2,500,511 people from the lowest idle, the difference at the end of 2011 to reduce the amount of 2,331,161 people.

Therefore we can say that the number of inactive people have a general upward trend and uneven with many variations over time, the end of 2011, the inactive population increasing by 107.59% from early 1996.

Inactivity amplification phenomenon in Romania, due largely to the aging population in general and especially of the working age, many people benefit from the legal conditions for retirement, which meant changes in the ratio of activity and inactivity.

### 3. Unemployment

The Romanian economy's transition from centralized economy to market economy, started 22 years ago, was a difficult time for our country, which caused significant changes in all areas of society: political, economic and social, manifesting a series of disturbances across the economy, labor market is one of the most affected by this transition and the emergence and development of unemployment is only one of these consequences.

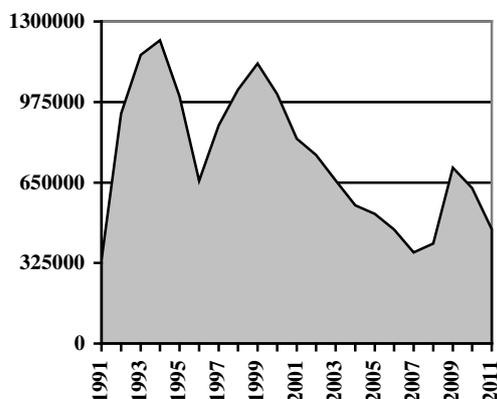
Initially it was thought that the transition from centralized economy to market economy, lead to rapid economic growth, especially to improve the living standard of most of the population, but since 1990, unemployment in Romania, become a reality and a priority when there came the first surplus labor, amid restructuring and privatization of national economy and in particular industries, something that required the development of a new legislative framework.

Introduction in 1991, Law no. 1 social protection of unemployed and their professional reintegration, constituted the legal framework that serves to protect the unemployed, but also offered at the same time a source of statistical data, highlighting the evolution neocupării labor, which is why to Figure 3, showing the evolution of unemployment in Romania since 1991 and not 1990, when they actually showed the first signs of unemployment in Romania, some characteristics of the unemployed will be available later as improving and improving year Alizee depth.

In the first four years after 1990, has been issuing a large number of jobs, number of unemployed in Romania increased by 886,485 people by 1994, when a total of

1,223,925 registered unemployed, which is the maximum recorded history of this indicator in Romania [3].

Chart 3 – Evolution of unemployment in Romania



Source: <http://www.insse.ro>, SOM101B and <http://www.mmuncii.ro>, Quarterly Statistical Bulletin on Labour and Social Protection, trim IV./2011

For a short time in 1995 and 1996 respectively, the labor market in Romania there is a positive development of unemployment, meaning that during this period there is a decrease of 556,361 unemployed, representing a decrease of 46.28%, then until 1999, the unemployment phenomenon is strongly felt, as a result of socio-economic imbalances that were created when closing other productive structures, recorded the second maximum number of unemployed who Romania has registered so far, that is 1,130,296 people.

Processes of restructuring and privatization of economic activities, especially in large companies, leading on the one hand the availability of a large number of labor, but also contributes to the creation of new jobs, it is only one issues raised in the labor market in Romania contributed to reducing unemployment after 1999.

For seven years respectively in 2000-2007, the employment of labor in Romania, has experienced continuous growth and sustained reduction in the number of unemployed as a consequence of this development. Thus, in late 2007, the number of unemployed in Romania was of 367,838 people, which means a decrease of 762,458 unemployed than in 1999, and an increase of 30,398

persons for the first year of existence and manifestation of unemployment in Romania.

With the development of the legal framework in 1991 and so far, while relying on statistical data and aggregate unemployment developments in Romania, is characterized by three periods of expansion manifested between 1991 and 1994, 1997 and 1999, 2008 and 2009, which is due to various causes. If the upward trend of unemployment in 1991 and 1998 is mainly due to deep economic and social transformation as a result of our country's transition from a centralized economy to a market economy system, which generated a significant force redundancy work mainly in the industrial sector as a result of restructuring and privatization processes running and the closure of unproductive structures especially in the mining sector, growth in the number of unemployed since 2008, takes place at the expense of installation and the crisis in Romania economic exhibited worldwide, which is why the unemployment phenomenon will be analyzed expression from that period.

#### 4. Unemployment during the financial crisis

Both the character table and the contents of the complex, labor market leads to a huge human potential, with important implications in the evolution of economy and society, while the labor market is strongly influenced in turn by the state and economic change any boom or economic decline nationally and worldwide, affecting one way or another level of employment and unemployment.

It is known that the impact of financial crisis that was unleashed in the United States in the second half of 2007, deepened and entered a tempestuous phase in 2008, spreading rapidly worldwide, damaging economic performance throughout the world.

In this sense, the global economic crisis have been felt ever more intense and the Romanian economy, since 2008. The economic recession caused a slowdown in economic growth, which affected key sectors of national economy, its effect is more extensive repercutându both on economic indicators and the human factor.

Lack of financial resources, lower foreign and domestic investments, shrinking demand

for some goods and services led to lower production and restricting access to credit, which has an immediate impact on firms that tend to develop on this basis, gradually led the closure of units, the loss of jobs and reduction of others, to release every year a significant number of force, unemployment sizes with increasingly higher in Romania and strong labor market knowledge imbalances.

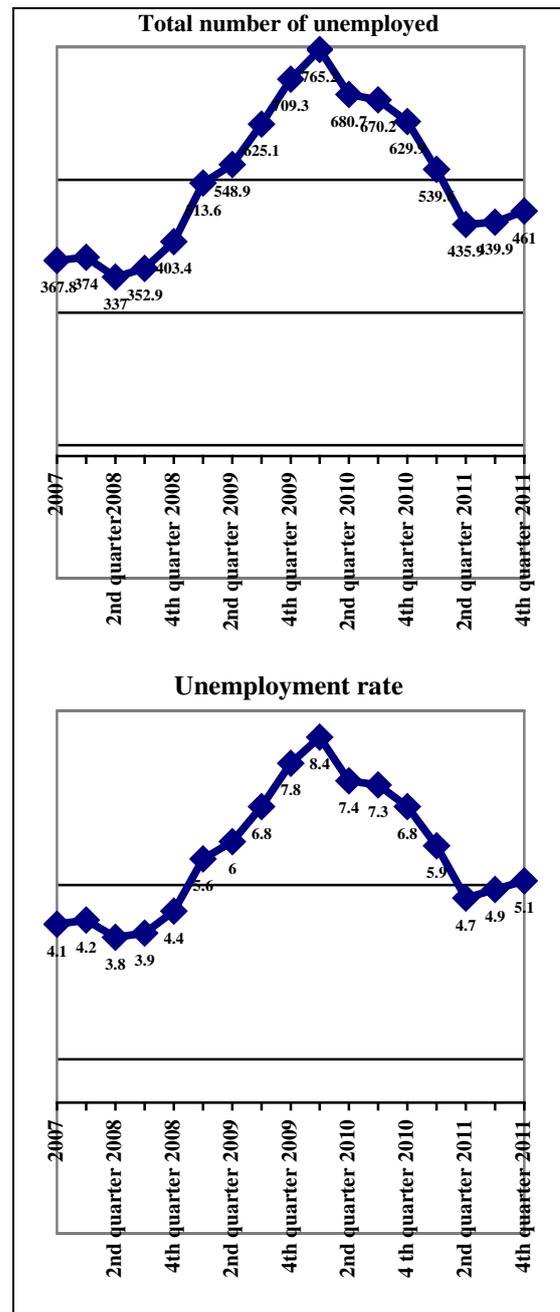
As a result of the labor market is the main source of income for an important segment of the population and demand for labor is derived from production and demand for goods and services, any impact on this market has shown both direct and indirect effects labor market. Reducing the demand for labor, also constitutes an important factor of pressure on employment levels, meaning that many employers intend to respond to this crisis by reducing labor costs, which inevitably affect wage levels or by reducing it, either by reducing working hours, thus also contributing to the deterioration of living standards of employment. The severity of these impacts depend upon the initial level of unemployment, a system of social protection, the adoption of strategies and creative measures labor market.

After a period of eight years in the evolution of unemployment had a downward trend [4], due to positive growth rates, which were made by our country, while providing a certain stability of employment, in 2008 global economic crisis began to be felt and the labor market in Romania, but especially damaging level of employment was manifested in 2009.

As can be seen from Figure 4, compared to 2007, the total number of unemployed expressed in thousands nationwide increased by 9.6% in 2008, the most significant increase recorded in the first quarter but 2010, the number of unemployed was higher 208.07% compared to 2007.

Regarding evolution quarters of unemployment shows that the largest increase occurred in the first quarter of 2009, the number of unemployed persons increased by 110,180 from the previous quarter. Also be noted that since the Second quarter of 2010, there is a positive development in terms of unemployment, the number at the end of 2011, being 304,272 less compared to the third maximum period.

Chart 4 – Evolution of unemployment in Romania in 2007-2011



Source: <http://www.mmuncii.ro>, Quarterly Statistical Bulletin on Labour and Social Protection. 61-69, quarter I-IV 2010, quarter I-IV 2011

Seen from the same diagrams that the unemployment rate over the period analyzed is characterized by an increase of one percentage point, the greatest growth occurring in the first quarter of 2009, when the unemployment rate was 5.6%, more higher by 1.2 percentage points from fourth quarter 2008 unemployment rate of 8.4%

recorded in the first quarter of 2010, being higher by 3.3 percent from the end period.

*Table 1 – The top ten occupations affected by unemployment*

2008		2011	
Occupation	No. unemp loyme nt	Occupation	Nr. unemp loyme nt
unskilled workers in manufacturing	10201	unskilled workers in manufacturing	71157
manufacturers and installers of steel structures	7170	unskilled workers in agriculture	66403
shop and market vendors	6052	unskilled workers in the maintenance of roads, highways, bridges, dams	32184
unskilled workers in agriculture	4616	unskilled workers in housing	27467
workers from grinding machines, grinding and sharpening	4105	transport laborers and freight handlers	26219
unskilled workers in the maintenance of roads, highways, bridges, dams	4080	manufacturers and installers of steel structures	13295
mechanics, installers and repairers of agricultural machinery	3798	shop and market vendors	12500
unskilled workers in housing	3309	staff for care and supervision at home	8239
carpenters and workers assimilated	3258	unskilled workers in public services	7683
transport laborers and freight handlers	3109	mechanics, installers and repairers of agricultural machinery and industrial	6468

Source: <http://www.mmuncii.ro>, *Quarterly Statistical Bulletin on Labour and Social Protection*. 65, 69, quarter IV. 2010 and quarter IV 2011

Increasing the number of unemployed since 2008 and increasing this phenomenon in 2009 and first quarter of 2010, is due mostly collective and individual dismissals

that took place in Romania, but also because of the lower of employment, due to reduced demand for some goods and products, due to the reduction of financial resources generated by the current global crisis, which affected our country, while the absolute and relative reduction of unemployment, which took place after the first quarter of 2010, the labor market due to absorption of a number of 377,772 people in 2010 and 366,113 in 2011, achieved by implementing the National Programme of Work Employment of NEA.

Closely related to the level of unemployment experienced in Romania, statistical data presented in Table 1, reveals the top ten occupations in Romania, affected by unemployment.

In the past four years and beyond, most people affected by unemployment in Romania, are those with lower levels of education, something highlighted by the statistics presented in the table above and the explanations given by the Occupations Code in Romania in the level of training required for the ten occupations.

Training of an important part of all unemployed in Romania, shows a preponderance of persons with primary, secondary and vocational [5]. This can be interpreted as meaning that anyone can perform unskilled labor, but not mutually valid, meaning that anyone can perform and skilled labor.

Thus as can be seen from the figures in Table 1, the top ten occupations affected by unemployment in Romania, have a bigger high ranging from 12.31% in 2008 and 58.95% in 2011, demonstrating and mutations of the industry due to rising labor share complex, involving a higher level qualification, while restricting and even the gradual disappearance of simple labor, unskilled or routine tasks. The training provides both a growing employment security rather than job, knowing that fewer and fewer people today, a job for life. The training of human resources in general, but especially those working in particular, contribute to increased employment opportunities in the labor market, people with secondary or primary level professional training, is at risk of unemployment to an extent higher than workers with a higher education.

## 5. Opinion

Inactive population trends in Romania for the period 1996-2009, shows a marked increase both in absolute and in relative size throughout the period. If in 1996 the rate of inactivity, was 47.17% at the end of 2009 the value of this index increased by 5.13 percent, which represents an increase of 554,898 people dead. So if in 1996, employed 100 people claimed that 55.96 100.18 inactive in young adults and 17.5 26.69 elderly, in 2009, increasing pressure on employment in that 100 people are employed need support in the 46.31 118.01 inactive young, 42.28 and 28.72 older adults. Amplification phenomenon inactivity was due largely aging population in general and especially of the working age, many people retirement benefit of legal conditions, leading to changes in the relationship between activity and inactivity.

Since 1990, unemployment in Romania, became a reality and a priority when there came the first surplus labor, due to restructuring and privatization of national economy and in particular industries. Until 1994, has been issuing a large number of jobs, number of unemployed increased by 886,485 people, compared to 1991, bringing to 1,223,925 unemployed, which is the maximum recorded history of this indicator in Romania . For a short time in 1995 and 1996 respectively, the labor market in Romania show a positive trend in unemployment, then until 1999, the unemployment phenomenon is strongly felt, as a result of socio-economic imbalances that have created with the closure of other productive structures, recorded the second maximum of the registered unemployed that Romania so far, that 1,130,296 people.

Most affected by unemployment, are people with low education level and in terms of sex, since 1997, men are more exposed to unemployment than women.

Global economic crisis have been felt ever more intense and the Romanian economy, since 2008. The unemployment rate in the period between the first quarter of 2008 and fourth quarter 2009 increased by 3.7 percentage points, the greatest growth occurring in the first quarter of 2009, when the unemployment rate was 5.6 %, 1.2 percentage points higher than the fourth quarter of 2008.

## 6. References

- [1] <http://www.insse.ro>, POP101A, AMG145A, Press release no. 131/27.06.2011, 202/26.09.2011 and 275/22.12.2011
- [2] <http://www.insse.ro>, AMG145A, AMG101A and AMG1101
- [3] <http://www.insse.ro>, SOM101B and <http://www.mmuncii.ro>, Quarterly Statistical Bulletin on Labour and Social Protection, quarter IV/2011
- [4] <http://www.mmuncii.ro>, Quarterly Statistical Bulletin on Labour and Social Protection 61-69, quarter I-IV 2010, quarter I-IV 2011
- [5] Source: <http://www.mmuncii.ro>, Quarterly Statistical Bulletin on Labour and Social Protection 65, 69, quarter IV 2010 and quarter IV 2011

# Territorial Arrangement and Sustainable Urban Development

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## Abstract

*Local economic and social development is a process which refers to the development of a local or regional economy capacity to stimulate a stable economic growth, and, therefore, to create jobs and conditions for harness the opportunities of fast changes in economic, technological and social field. Local administration, community-groups based aim at the efficient administration and management of existing resources, entering, if necessary, into a partnership relationship with the private sector.*

*Sustainable development approach aim at social progress and quality of life, a process that, when meeting present needs, there are also taken into account the future generations problems and economic constraints.*

*The paper presents aspects of territorial arrangement issues, spatial development and sustainable urban arrangement - components of local development - as well as the conclusions regarding the items outlined in the study.*

**Key words:** territorial arrangement, sustainable urban development.

**J.E.L. classification:** R- R1-R10–R11-R12

## 1. Introduction

Increasing pollution, greenhouse gas emissions and risks related to water provide, due to a bad management, have a negative impact on climate change and, therefore, determines deterioration of environmental conditions. Thus, the link between environment, energy efficiency and assuming accountability determines advanced cities to take into account the matters related to sustainability, such as: clean public transport, encourage efficient energy buildings, a better management of facilities (equipments,

infrastructure), which contribute to the important benefits of climate change. Unsafe areas in terms of the environment, like polluted sites close to solid waste stores with drains and open sewers, near industrial areas, increase the impact of climate change, through the sea level rise, higher temperatures, uncertain effects on ecosystems and a high climate variability and volatility, making difficult the recovery after disaster. The lack of informations, of national support policies, of the access to financing and other assistance types hinders the action of local authorities who have not enough resources and information to identify and give priority to actions for energy consumption reduce, through efficient measures and an improved urban planning. Actions should help to create the necessary resources to improve the city, area services, to socio-economic benefits, such as improving air and health quality, a "green" community space, increase competitiveness by reducing energy costs.

## 2. Territorial arrangement and development

After World War II, the objective of each society was of development, designed to an economic way, in order to increase production through industrialization. In time, the term was redefined as a process which leads to welfare increase, beside the economic activity and material wealth, as important as education, culture, health, environment. The phenomenon involves mobility, change in order to achieve economic and social objectives. From this perspective, government (central, local) should provide a sustainable economic, social, institutional development on the areas and throughout the territory, leading to an increased quality of life, locally and nationally.

Local economic and social development is a process in a specific region or geographical area, which refers to the development of local

or regional economy capacity to incentive a stable economic growth, and therefore, create jobs and conditions for harnessing the opportunities of rapid change in economic, technological and social field. Intended objectives refer to the economic prosperity and social welfare, by creating a favorable environment for business, integration of vulnerable groups in community, engage people in their own regions problems. Also, there are taken into account the social and cultural features of development.

In this process, local administration, groups-based communities pursue the efficient management and household of existing resources, hiring, if necessary, a partnership relationship with the private sector aimed to stimulate regional or local economic activities, creation of jobs.

Among the actors involved in the actions there are the authorities and public administration bodies (at local, county, central level) responsible for sectoral policies in the industry, environment, labor, public works, transports etc., the economic activities and public services representatives (enterprises, banks, unions, educational institutions, NGOs etc.).

We speak about sustainable development that when meeting the requirements of the present generation, it facilitates also the fulfilment for future generations options. It focuses on both economic and social development and the environmental conditions protection and improvement.

Sustainable development is, actually, an outlook objective, in relation with the notion of development based on qualitative and quantitative progress at the same time. Approach aims at social progress and quality of life, addressing the needs of present, while taking into account the future generations problems and economic constraints. The objective of this policy is to facilitate implement of a way of production and development in a perspective for a long time; attention is centered on the individual.

Sustainable development is firstly a responsible patrimonial conception of our times, without limit to the environmental protection or ecological behavior of works. In this sense, public policies should establish the measures which meet the present needs without compromising those of the future generations too. It is a way of growth that

ensures economic, social and environmental progress of society for a long-term.

There are retainable five essential purposes taken into account in sustainable development texts:

- fight against climate change and for atmospheric protection, representing a major stake of solidarity between people, territories and generations;

- preservation of biodiversity, a major component of ecosystems sustainability;

- satisfy all human beings, objective which corresponds to Rio Declaration, which states that these are at the heart of sustainable development matters; they have the right to a healthy and productive life in harmony with nature;

- social cohesion, solidarity between territories and generations, conditions of social progress;

- a rhythm of development, referring to the responsible ways of production and consumption, respectively: less pollution, reduced resources consumption, maximum reducing of environmental risks.

Local development requires existence of a regulatory framework, of local development strategies and of resources.

Sustainable development undertaking takes place in all sections of the territory, so it must be defined on each of its areas, because the objectives differ dependent of the level it refers.

In territorial arrangement issues it can not be a separation between the space use (natural, agricultural, urban) and the activities which are taking place in the area (trade, construction, production). Neither stakes nor goals may be similar, so that have to be developed different methods and means for each project, for each area. For example, considering a region arrangement project is different from that of a lot. (bounded to a restricted area).

Currently, the major guide of sustainable territorial development is Local Agenda 21. The implementation of the procedures of this program aims to mobilize interested actors (economic, social) towards the strategic development objectives achievement, including land development; the objectives must take into account a sustainable heritage value and resources of a land harness. In the context of local development, a sustainable territory arrangement involves consideration

of the following elements: Local Agenda 21, the human settlements, land development projects, agriculture and the countryside, tourism and transports.

A project or a program of action achievement in the field of territorial arrangement, requires comply with sustainable development criteria, as follows:

- research in territorial arrangement, policy development, strategies, studies of documentation and of territorial arrangement specifications;
- creation and development of database and documents;
- endorsement and approval of documentation developed;
- territory actors participation throughout the period of the project, from the start, to the moment of put into practice;
- cross-cut approach, clearly expressed by disarticulation of working methods;
- evaluation of the project;
- monitoring and control related to put into practice strategies, policies and operations of territorial planning;
- an ongoing improvement strategy.

As such, territorial arrangement is a component of local development. These activities of territorial arrangement and urban planning imply implementation of strategies, policies and programs for sustainable development in spatial profile, throughout the national territory, as well as monitor their put into practice according to the branch specifications.

In the context of territorial planning and sustainable development, it must be also considered the **spatial development** issues. Sustainable development encompasses not only an economic development to respect the environment and to protect current resources for future generations, but a **balanced spatial development**, too. Aspect involves harmonization of spatial needs of the economy and society with ecological and cultural mission of areas, which contribute to a sustainable and balanced spatial development.

Prospects for the European Union are towards a gradual evolution from an Economic Union to an Environment Union and, further, to a space that integrates the social dimension, saving regional diversity.

Since 1999, it have appeared new ideas about cities development while the EU

ministers responsible for spatial planning and cities development adopt the European Spatial Development Perspective (ESDP).

Essential concepts of ESDP aimed at integrated multi-sectoral strategy for spatial development consist of:

- an integrated approach in which sectors specific to development activity (economic transport, environment development) influence each other;
- a wider horizon of development, essential for an integrative model;
- strategy elements - actions interconnected in order to achieve balanced and sustainable development;
- the responsibility of developed regions and territories to implement the fundamentals of development.

There are considered three guiding principles for spatial development policy in the European Union:

- development of a urban polycentric and balanced system, strengthening of new urban-rural relationship;
- promoting integrated transport and communication concepts in order to ensure parity of access to infrastructure and knowledge;
- rational management of natural and cultural heritage, to contribute to regional identities and cultural diversity preservation.

As regards integrated spatial development policy, the European Union Territorial Agenda adopted in 2007 focus on exploiting the potential of European regions and cities for sustainable economic growth and provide more jobs, one of the priority consisting of balanced development and innovation strengthening by the network of cities and cities-regions.

Taking into account the definition of the European Regional / Spatial Planning Charter adopted since 1983, “regional/spatial planning is the geographical expression of economic, social, cultural and ecological policies of society”<sup>[4]</sup>. It is also a scientific discipline, an administrative technique, an interdisciplinary model towards a balanced regional development and a physical organization of space, based on an overall strategy.

### **3. Sustainable urban development, a local development component**

Cities play a vital role in the development of European regions. They are key of the European Union competitiveness growth, they are the space of most jobs, firms and institutes of higher education while their action is decisive in achieving social cohesion. In the conditions of sustainable economic development provided through a series of measures designed to reduce the poverty, social exclusion, environmental issues, an integrated approach of urban development, not only encourages growth and jobs throughout Europe, but also includes issues related to the social and environmental objectives.

The concept of **integrated model** of urban development occurred in the early 1990s, along with urban renewal projects for disadvantaged areas. The notion of **regeneration** is related to overall or partially degradation of the city. It may be the case of degraded central areas, due to aging buildings and public spaces gradual deterioration, or of neighborhoods with social buildings. The regeneration process is, therefore, designated to revitalize the areas-problem, mainly by taking into account the shortcomings the natural and built environment face, heritage preservation, social integration and employment, as well as the economic activities of cities and their neighborhoods, but also in rural areas. The developed actions combine economic measures (injections of business), social (constructions of better quality buildings, reconstruction of residential areas), urban planning measures (restructuring of public spaces etc.).

The integrated approach takes into account both the environmental impact and the social impact of urban development. The complex feature of integrated urban development stay in expanding of its actions in several areas which cross the boundaries of a development project. For example, green spaces are seen in line with renovation of abandoned constructions and lands, clean transport systems should cover not only passenger services, but alternative models for transport, but also items related to energy efficiency, renewable energy and phonic and air pollution. This principle to identify untapped potential applies both for the assembly of cities and for the neighborhoods considered individual and for inner-cities areas.

Thus, the process has progressed and its use has expanded to the urban projects as a whole, from the renewal of disadvantaged areas to other urban issues (transport, planning, economic development).

Subsequently, the idea of sustainability has become an inevitable requirement due to the impact of urban development on the environment and on quality of life.

Sustainable cities must achieve, simultaneously, economic competitiveness and social and environmental progress in the context of socio-economic transformations expressed by reshaping industrial structure and transition to service economy. The aim is to remove the significant challenges, determined by changes, respectively, lack of opportunities for access to jobs, poverty, labor migration, households decline, abandoned land, lack of local business and trade, poor quality of natural and built environments and vandalism increase.

Integrate sustainable development into urban projects means, firstly, a political approach that is based on a vision of social progress, human development, based, in turn, on the need of human settlement at the center of concerns. A step of this process means to launch an organization, an operating approach supported by a joint, equitable, participatory and universal action; means starting a project where taking into account the three pillars of sustainable development (economic, social and environmental) should be decided interdependent and not by juxtaposition.

Based on the European Sustainable Development Strategy 2001 (Göteborg Strategy), reviewed in 2004, referring to environmental and sustainability issues of the integrated approach, the European Council has adopted the EU Sustainable Development Strategy in 2006, for towns and cities, with important themes: climate change, clean energy, sustainable transport, sustainable production and consumption, preservation and management of natural resources, public health, social inclusion, demography and migration as well as problems of global poverty.

The European Union ministries, the European Commission, the European Parliament, the Committee of Regions and other European institutions develop actions to support the development of European

cities and regions, in order to achieve the new sustainable development strategy goals, which, according to the "Leipzig Charter on Sustainable European Cities", recommends: (European Commission, 2009, quotes Leipzig Charter on Sustainable European Cities).<sup>[5]</sup>

- widespread use of integrated urban development policy approaches (by creating and providing high quality public spaces, modernizing infrastructure networks and improving energy efficiency, innovation and educational pro-active policy);

- a special attention focused on disadvantaged neighborhoods, through ongoing strategies to ennoble physical environment, to strengthen the local economy and local labor market policy, to promote an affordable and efficient urban transport;

- creation and maintenance high quality of public spaces which held an important role for the environment of urban populations. They can attract business, tourism and labor;

- a modern infrastructure network to achieve an affordable quality transport system which include a network for a city-region link; improving the supply of networks, such as waste water treatment and water supply;

- improving energy efficiency, including an efficient use of natural resources.

As important partners in the target for economic growth and sustainable new jobs, cities, towns and metropolitan areas play a crucial role in removing obstacles in growth and employment, such as social exclusion and environmental degradation; they also attract investments, offering new economic opportunities and the perspective of life quality growth. Faced with competition, they work with authorities and administrations from adjacent areas to form city-regions, these meaning a better framework for activities related to developments and complex actions, in a large urban area, developing new forms of regional governance.

#### 4. Conclusions

In approaches about urban regeneration and development, problems processing imply an integrated and comprehensive way and not according to political and administrative responsibilities. In practical terms, this means

that the main problems related to physical regeneration to be considered in relation to social, economic, environmental and cultural aspects of life and urban development. It is also necessary, public and private sector join, working with affected local communities and their involvement in joining actions.

Partners involved in urban medium and long term development plans have to design, from an early stage, a strategy for ongoing development after the public investment programs period, too. Monitoring and evaluation are an integral part of each development plan; they develop and reinforce each other, on clearly defined bases, they allow the assessment of progress, achievements and shortcomings.

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## The Regional Development Strategy. Case Study The Nehoiu and Pitesti Towns

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### Abstract

*In recent years there are being discussed various aspects of regional development in our country. Thus, plans and strategies were made for developing our country regions, with influence in their localities. It is the case of Pitesti and Nehoiu both belonging to different development regions, but having an important role in the local and regional development.*

*Regional development attracts a number of positive consequences for both localities, such as rehabilitation and expansion of road and rail traffic routes, housing development through collective or individual housing, upgrading and development of certain technical aspects of the urban system, tourism, and not least the industry.*

*"Cities recorded four stages of community development - building, recruiting people, transition and maturity" [3], but over time there had been added others such as "the fifth stage companies called decay, also as suggested the sixth stage - leaving "[1].*

**Keywords:** regional development strategy, implementation projects, functional diversification.

**Classification J.E.L.:** O18

### 1. Introduction

Regional development is an increasingly debated topic in the last decade by different authors and researchers from various fields. Authors like Ioan Ianoş, Radu Săgeată, Sorin Filip, Vasile Cucu, Nicolae Ilinca, Popescu Claudia, approached various issues of regional development of the country. Besides the previously mentioned authors, who

analyzed various regional issues, important data on local development are found in various studies such as General Urban Plan of the two cities, Integrated Urban Development Plan of the City Pitesti, made by competent authorities. These documents include a complete description of the two settlements and other information needed to be studied in order to take into account when drawing up regional development strategies.

### 2. Materials and methods used

The materials used for this study are the statistics on economic activities, the financial resources involved in local development and the public opinion on certain activities that can be locally developed.

As methods used in the current study we can mention the collecting of recording statistical data method from various organizations in the two localities, the information examination method, the questionnaire method and the explanation method.

### 3. Case study

Placing the two localities in the regions related development, Pitesti, in Wallachia South Development Region and Nehoiu in the South – East Region, is an important point in local development. Both localities are crossed by roads with national importance, which have a great contribution to their development as settlements. While, Nehoiu city is crossed from north - south by DN 10 (Buzau - Patarlagele - Nehoiu - Intorsura Buzau - Brasov) and crossing Buzau's Valley and Brasov's Depression, Pitesti is located at the intersection of several roads of national (DN 7, DN 65, DN 73) and

international importance (E 81), representing "old trade routes" [5], which interconnected the Romanian Country and Transylvania, but also between Pitesti and other important cities of the Romanian Country (Bucharest, Craiova Curtea de Arges, Campulung).

With respect to development strategies of the two cities forecasts can be made that may lead to important changes but long-term sustainable development is difficult. For more sustainable communities in the two settlements, in the planning process should be adopted long term policy and economic diversification. Thus, following a detailed analysis in the development of the two cities outlines some prospects of improvement and development of services sector, especially tourism, but also joining these villages to the projects implemented at the national, regional or local level.

For an upward trend in the national urban hierarchy and an increase in the development capacity, both cities need local authorities and economic operators investment interested in areas such as public or private nature, or mixed. Another solution for the development of these settlements is the proper exploitation of local resources (both as to material and human) that will lead to new businesses, especially SMEs and infrastructure improvements.

Long-term sustainable development is achieved through planning which aims to functional diversification. Experts believe that at present moment, the only opportunity for the development of cities is the diversification of economic activities but it has many implications both in the economic and social branch. This solution was adopted since the socialist period when the process of industrialization began. In the case of the town Pitesti, an important aspect that influenced the development of the village, was its location at the intersection of "two different geographical and agrarian regions, the fields and hills, so that trade was practiced with products from different areas" [2].

These two important reasons mentioned above, had a significant impact on village local and regional development, in time becoming the most developed urban center in the county of Arges.

In the case of the town Nehoiu there had been found several ways of diversification of

development activities of related industries that are a dependent branch of the dominant center (wood processing industry) and this will ensure economic efficiency and achieve vertical integration in the city but also the development of complementary industries with a different profile from the dominant activity. Even if some of these activities will be related, most are based on branches using female labor surplus (the city relies mainly on male labor force, creating an imbalance in the relationship between the two labor categories). In addition to these sectors an important role is played in tapping the surrounding region (forest resources) by the development and revitalization of small industry and handicrafts, which can lead to imbalances in the attenuation of the center now.

Over the time, economical speaking, the town Pitesti experienced some changes, namely the transition from an economy based on industry to the tertiary economy. An important role was played as Romania joined the European Union, which has involved taking some well-established term commitments. There have been changes both in economic, in the urban and social field. Local development assumes a match between "socio - economic objectives set out from local priorities arising from European, national and regional level, as well as changes currently occurring in the dynamics of spatial, economic and social at the county level and development region under the influence of global economic crisis" [3].

"Detailed and comparative studies, modern methods, factorial analyzes have demonstrated the importance of functional diversification in identifying the features of settlement systems. It was found that the unequal presence of specialized functions in cities creates large differences in the settlement systems, which can be as important as those determined by the size and centrality. From the beginning specialization may occur due to an accident or a community of courageous decisions, then it will take local specificities footprint and will remain attached to the town for a long time" [2].

As a result of the research, the town Nehoiu was constantly evolving, and maintaining its specific industry. The global economic crisis started in U.S. in 2007, made his presence felt in Europe. In Romania,

including the two analyzed cities, "the effects of the crisis have been felt since 2009, at the beginning but have deepened over time" [1]. This has some negative effects on local and regional development projects, affecting the two cities. Returning to the urban development process in Pitesti some projects were adopted, which are to solve "problems faced by medium and long term city, population reduction, competition exerted by the global economy, global warming and energy dependence" [3]. The problems regarding the situation on the town Pitesti were structured into three major components, namely society, economy and habitat, characterized by different strategic objectives, aiming to develop Pitesti by the year 2020.

The town Nehoiu is looking for a new identity because of the economical problems that it encountered, in conjunction with existing national (both political and economic). With the bankruptcy of some industrial units, it has also occurred in this city, the private sector (tourism companies, forestry industry, bakery, trade), which represents an important opportunity in developing its economy.

From the strategic goals that contribute to the development of the three major components the most important for both cities are: the company focus is on development of public services, education and social care - health to improve the quality of life and cultural and sports development objectives; the economy focuses on competitiveness and sustainable performance through innovation and technological development, and promoting diversification of the economic sector and tertiary sector development, which, according to General Urban Plan "are turning to third sector" [4]; is intended also to improve habitat quality housing through the development of well-established urban areas, equipment and technical facilities - municipal, development of accessibility by public transport and increase environmental quality.

Most of the projects designed for the two localities are funded by the European Union and have established deadline, some of them have also their own funds available in each local municipality.

Following the implementation and completion of the projects it is expected that

Pitesti "will become a pole of economic development, innovation, knowledge, communication and culture, logistics hub, both regional and national" [5].

In the year 2000 was amended the criteria for deprived areas which have been declared by the Emergency Ordinance no. 75/2000. This ordinance provides that, for declaring an area as deprived it must meet at least one of the following conditions: the area needed to lack means of communication, a weak infrastructure, the percentage of unemployed in the area to be at least three times the national percentage of unemployed in the last three months before the preparation of the declaration of the deprived area. "These criteria reduced the chances of regions affected by industrial decline to be declared disadvantaged areas, while limited reliability due to statistical indicators, unemployment rate, taking into account" [6].

As a result, the wider countryside has been advantaged in this regard because of reduced accessibility and underdeveloped infrastructure. A geographical area may be declared disadvantaged area for a period of 3 years (minimum) and 10 years (with the possibility to extend this period by Emergency Ordinance no. 24/1998).

The economical restructuring issues have convinced local authorities to take the necessary steps in declaring the city Nehoiu a disadvantaged area. Therefore, by GD. 661/2001, the city has become a favored area for 3 years (22.10.2001 - 22.10.2004). The area has been granted certain tax incentives under specific legislation (exemption from customs duties and VAT for machinery to modernize processes, returned duties for imported raw materials or necessary components for local production; income tax exemption, exemption from fees for change of destination or sealing of land for investment; grant amounts in the Special Development Fund to stimulate the export business of finished products and industrial services, funding programs special financing investment projects of companies through co-participation in the state capital), facilities that have boosted investment thus, by the end of 2002, a total of nine companies, most of which are SRL and all members of the SME (8 were between 10 and 49 employees and only one has between 50 and 249 employees) were created. Contrary to the specific of the

area only two of them regard the wood industry (one deals with the exploit and process timber and the other deals with the production of furniture) and 7 of the companies are engaged in manufacturing in one of the sub-branches.

The investment attracted in the period when the city was declared disadvantaged area were 1.6 million, while facilities granted was only 59,824 euro. However, businesses that have turned to the most important flows of investment (over 1 million) were the wood industry, furniture factory and the timber thus recording the highest values of exports and turnover.

Cheap skilled labor and the existence of communication that connects with the rest of the country have attracted foreign investors in the town Nehoiu. Recently, the representative corporation IKELA, S.A Nikmob has invested in the city and provides mobile production activities with supply contracts in 24 countries.

The other companies that have invested in the area engaged in trade, construction, agriculture, real estate, auto and motorcycle repair and maintenance of personal goods, mainly services rendered and rental companies. After local social capital subscribed in MDL, these companies fall in group size up to 10 million.

#### 4. Conclusions

To initiate the creation of such regional or local development projects, the local and county councils should be more actively involved in providing facilities (under applicable law) to investors willing to develop businesses in these areas in order to develop local economies.

The administrative system of the two analyzed cities has a certain openness and interest to attract investment, both economic and urban-household.

#### 5. Acknowledgements

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# The Integration of Regions in Romania: a Case Study of the Regional Development Fund

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## Abstract

*This paper aims to explore the way in which the objective of making regions visible actors at the European level can be achieved in Romania through the absorption of Structural funds. Firstly, we will highlight the importance of coherent and effective policies for the development of regions. Secondly, we will examine the way in which the actors involved in the implementation of regional development project can promote a proactive and transparent dialogue. Previous studies have shown that a weakness and main risk of such projects is the fact that the continuous collaboration with managing authorities is deficient. Hence, the way in which the stakeholders understand the importance of maintaining a close contact for the good functioning of the projects is crucial*

**Keywords:** regions, Managing Authority, absorption capacity, regional and local authorities, collaboration.

**JEL Classification:** R11

## 1. Introducere

The purpose of this paper is to present the role of proactive and continuous communication during the implementation of regional development projects. We will examine the way in which the political split and lack of effective communication can stop all initiatives in regions development and the quest for proactive policies at a European and national level. The arguments and conclusions presented here are according to those of well known authors like Gheorghe Zaman, Stephen Weatherill and Ulf Bernitz. They discuss the local challenges for national authorities in order to foster a cohesion

policy, where the foundation is given by regions as key factors for increasing the state's efficiency. The European Regional Development Fund allocates resources to sustain the economic growth of European countries. European Development projects taking into consideration the limited absorptive capacity, the vulnerability of a discriminative behavior at the hands of politicians and administrative officials. [1]

We ground our present study on the interminglements of a clear communication policy between partners and the absorption capacity of regional actors. Thus, we will also focus on the close and continuous collaboration of central and local authorities subordinated to the Ministry of Regional Development and Tourism that manages the Romanian policy for regional growth. The Ministry carries out the European Regional Development Fund through the general Managing Authority and has as intermediary organisms (i.e. The Regional Managing Authority) the 8 agencies for regional development [2]

The majority of the European states have encountered difficulties in absorbing the European funds within their first years after adhesion, especially due to a "lack of a long-term perspective" from the part of the central authorities, due to the insufficient human resources when having to co-finance projects or after the austerity hit the European expenditures, the low administrative capacities at central and local level. The scholars underline the relevance in fund's absorption of the lack of inter-institution coordination, the failure of public-private partnership and limited abilities from the part of the human resources, etc.[3] Obviously, among the above mentioned dysfunctions, Romania has its uniqueness, adding to this list the disregard of the

administrative system for the absorption of structural funds. Taking in consideration the above mentioned, our analysis can be done through a clear-cut delimitation of the conceptual dimensions of the term "capacity of absorption", as well as the favorable context to our country on the process of decreasing the difference between the western and the eastern part of Europe. [4]

## **2. The Implementation of Regional Development**

The European Regional Development Fund (ERDF) is one of the Romanian operational projects, agreed by the European Union and a very important instrument concerning the implementation of the national strategy and the policies for regional development. At the same time, it is the strategic document that implements elements of the Strategy for Regional Development within The National Plan for Development (NPD) and helps, among other operational programs, to achieve the objective of the National Strategy for Regional Development and the Strategic National Framework of Reference.

In this paper the economic region is relative and changing, but is not "spontaneous", as sociologist Vladimir Pasti referred to "the spontaneous transition and the compulsoriness of a firm intervention towards shaping interior-oriented transition with the direct objective of imposing development, so that Romania's faith is not decided for many years ahead from now on".[5] This might result in the rupture of the Romanian Transition from any strategy for development if is connected with weaknesses such as the low administrative capacity, lack of inter-institutional coordination, rigidity and incoherence.

Soon after the early '90, a large "institutional transformations" have taken place, and today, after 5 years from Romania's integration to the EU, we are preparing to reposition the role of these institutions with the regional administrative authority, in order to adjust to the process of decentralization, and facilitate the process of absorbing the structural funds. Lazăr Vlasceanu defines development as: "a system of institutional transformations produced in the most diverse social sectors with the

purpose to increase the performances of humans and organizations". [6] As Stephen Weatherill and Ulf Bernitz said in *The Role of Regions and Sub-National Actors in Europe*: "the regions have an enduring interest in achieving some measure of compensation for the centralizing tendencies of the process of European integration. The issue for the regions and sub-national actors is how they can affect the EU law-making process in a manner that satisfies their aspirations. This will be clear after the year 2015 rapports concerning the structural funds, for each operational program in turn. And the more effective such associations are shown to be in driving forward regional interests the more one would wish to challenge the notion that the EU harms regional power. It may in fact provide an arena within which regions may go over their States' heads, individually (by opening offices in Brussels) or, probably more effectively, collectively, in so far as functionally comparable groups emerge." [7]

The natural rapport between development and social-economic policies will be noticed only after the completion of the first 7 year cycle (2007- 2013), in which Romania has revived structural funds. The question that rises is: are we going to succeed or not in implementing the projects according to the National Plan for Development, so that they affect the regional economic growth?

At the same time, the shaping of the National Plan for Development (2014-2020) it is an important moment (2011-2013) for Romania's Government, because they will have to enforce the strategy for development according to the directions imposed by the "Europe 2020" strategy and will have to strongly negotiate the next budgetary activity (i.e.2014-2020) in which again it will benefit from more or less structural funds.

According to Traian Rotariu, "the territorial disparities consist in the differences among various regions, geographic territories at the level of a territorial entity, highlighted through relevant indicators connected to the level of socio-economic development of that given society, differences that are considered undesired from a functional point of view or in rapport with the accepted principles of social equity." [8]

Consequently, the series of actual regional disparities that are the rationale of these funds, are the result of historical evolutions, generated by the geographic conditions and increased by those socio-economic and political. After Romania's European integration, both the Romanian Government and the European Commission have tried to implement the policy for European cohesion by adopting a series of crucial documents (i.e. the National Plan for Development 2007-2013, in December 2005, The Regional Operational Plan 2007-2013, in June 2007 and the National Plan for Rural Development 2007-2013, in February 2008), which aimed the reduction of regional unbalances, through a transfer of communitarian resources, made an appeal for proactive measures in order to increase the absorption capacity for structural instruments (structural funds FEDR and FSE as well as the cohesion fund). A crucial instrument for understanding the *E.U.'s Regional Policy and economic disparities is the NUTS* (i.e. Nomenclature of statistical territorial units). All the regions that belong to the European Union can be found in the Nomenclature of statistical territorial units (NUTS). The purpose of this classification is to facilitate the gathering and harmonization of statistic data, in order to realize socioeconomic studies and analysis, as well as to allocate structural funds, the allocation of these being made on the criterion of the existence of a GDP/ inhabitant, at regional level, under 75% of the UE average. The Nomenclature is grounded by the next principles: favoring each member state's its specific administrative organization, on the grounds of the institutional division at a given point and creating a hierarchic level on three stages: NUTS 1 NUTS 2, NUTS 3.

In Romania there are four micro regions at NUTS 1 level (micro region 1- The North-West and the Center Region, micro region 2- East Region and South East Region, micro region 3- Region Bucharest-Ilfov and South-Muntenia and Micro region 4- West Region and South-West Region), taking into account the existent administrative structures and the 8 regions at NUTS 2 level, the 8 regions being declared as development regions, with a certain statistic role. According to the OUG no.75/2001 concerning the functioning of the National Institute of Statistics, whose activity will make possible the economical-social

analysis, from the above-mentioned indicators. The strategic goal of European Regional Development Fund, is supporting an economic, social, territorially balanced and durable development of all Romania's regions, according to the specific needs and resources, focusing on the support of sustainable development of the urban economic centers, consolidating the business environment and basis infrastructure, in order to transform Romania's regions, especially the poor ones, into attractive places for foreign investments. [9]

In order to achieve the general objective of regional development, this strategy aims the following specific objectives:

- To increase the economic and social role of urban centers, through a multidimensional approach, in order to stimulate a more balanced development of the regions;
- To increase the accessibility of investments into regions and especially to urban centers and their surrounding areas;
- To increase the quality of the regions' social infrastructure ;
- To increase the regions' competitiveness by enlarging the number of business-friendly locations;
- To increase the role of tourism in the regional development.

The implementation of the Regional Development program in Romania will ultimately lead to the reduction of interregional disparities. The rationale is to make sustainable economic poles within the interior of the regions, by decreasing the disparities between the urban and rural environment, among the urban centers and the adjacent areas, and in what concerns towns, the disparities between the investment-friendly areas and those that are not.

The financing from EU has represented during 2007- August 2011, approximately 84% from the European Regional Development Fund budget. The rest originated from national funds, public co-financing (14%) and private co-financing (2%). This was the case until 19 August 2011, when the European Commission took a series of measures that had a significant contribution in reviving Romania's, Greece's, Portugal's, Ireland's, Latvia's and Hungary's economy. The Commission has

made possible a supplementary co financing of 714 million euro. [10] After 15 November 2011, the European Parliament decided the vote of a rapport that contains the reduction of public co financing costs from 15%to 5% for the 6 above mentioned states.

The distribution of funds is made on the basis of the priorities that the Regional Operational Program has set. Each priority has a certain allocated budget and contains a number of key domains for intervention that aim the achievement of development objectives. According to the principle of subsidiarity, through regional politics, the UE member states preserve competences in solving the identified problems at the level of their own regional structures(that in Romania are still on hold, being very few state institutions endowed with regional authority in the administration), in supporting the development of infrastructure and job-creating investments.

The most popular indicators in comparing regions are: GDP/inhabitant, the standard power of acquisition, unemployment rate, the level of educational, the average life span, the degree of urbanization, entrepreneurial spirit (number of companies per 1000 inhabitants), direct foreign investments and poverty. [11]

The existing differences in the EU and the policy of convergence applied through the institutionalization of structural and cohesion financing represent the actual framework of reference in defining the capacity of absorption. There are differences among the interpretations of the capacity of absorption term at global and European level.

At a global level, it is thought that the term refers to” the capacity of the countries with low incomes to absorb a great volume of external assistance in a productive way”, the main issue in this situation being a priority in terms of receiving the help. The structures for regional development play a special part in implementing the structural funds, yet, the diversity of institutions at European level leads to different results. In this way, in states defined by a strongly- centralized administration in managing the community funds(Ireland, Portugal, Greece), the territorial structures play a minor part, whereas in the countries with a very low level of centralization(Sweden, France, Great Britain) bigger responsibilities are assigned at the level of regional bureaus of

national administration.[12] At the same time, within the federal states that have a decentralized system, it is noticeable that the regional authorities cover the problems triggered by implementing the structural funds partially or totally, situation present in the non-federal countries as well, but which apply the principles of regional autonomy.

On trying to realize a certain structure that classifies the different systems of implementation, Taylor, Bachtler and Rooney(2000) have proposed another typology grounded on the ”administrative complementation”, respectively, the measure in which the system of structural funds implementation is designed together with the national programs. In this way, the following situations are acknowledged at European level:

- differentiated systems- the cohesion policies operate outside the context of national policy(specific to Belgium, Denmark, Holland, Sweden, Great Britain);
- subsumed systems- both the structural funds and the national policies are unified(applied in Netherlands, Austria and Spain);
- Composite systems- the differentiated system is structured at the top of the hierarchy of the national system(in France, Finland and Italy)[13]

In order to give answer to the challenges triggered by the economical crisis that has affected the whole world economy and EU economy as well, the European Commission has elaborated a European plan for economic Recovery, containing a set of proposals aimed to adapt the economic cohesion policy to the newer economic realities. At national level, the Romanian Government has taken over the following measures from the European Plan of Recovery:

- raising the standard level of national initial founding given to beneficiaries(from 15% to 30% out of the eligible value)
- introducing the possibility to prefinance beneficiaries in the case of projects that are subdued to help from state/ minimal (up to a degree of 35% of the entire help value)
- accelerating the public acquisition procedures for the major projects of infrastructure;

- rules for improving the budgetary and financial management;
- making the internal coordination for the Managing Authority of the Regional Operational Program more efficient.

The analysis of the requests of financing and the average value of these, at regional level, on the 31st of December 2009, highlights the following:

- In the South, South West and West regions, although a relatively small number of financing requests were handed in, their average value is greater; this situation could raise bigger interest in these regions for projects with greater regional impact;

- In the North West, Centre and North East regions a greater number of financing requests has been handed in, yet, with lower average value, compared with the average at program level. This situation could represent a greater interest in these regions for local development projects ;

- The Bucharest-Ilfov region is characterized by a small number of requests and with smaller average values as well. This situation can find its explanation in the small number of potential beneficiaries in this region (only 48 local public authorities), compared to the other regions (for example: 574 in the Centre region or 557 in the North East region). [14]

An important issue is that of the long period of time that passes between the handing-in of the project and the signing of the financing contract, in some cases this period reaching 1 year. In comparison, the red-tape practice in other European countries has managed to render efficient this process and shorten the time, as in the case of Ireland (30 days at maximum). In Romania, the last years' practice reveals that on numerous occasions, there are situations in which certain beneficiaries, especially the small city halls, the poor county councils or the private enterprises and NGO's lacking resources, even though they had signed the contract of financing, they encounter serious problems in obtaining rapidly a credit necessary for starting their project, and, at the same time, the financial conditions (rates, bank guarantees, etc.) are difficult, mainly restrictive, generating financial difficulties prone to affect the project and its conclusion.[15] Usually, in the practice of banks, there is a restriction, concerning the projects that benefit from structural funding, in the way that, the investment within that project (land,

buildings, and equipments) cannot be introduced in the bank guarantee.

In our case the target population have included: project managers, financial managers, experts hired in project implementing teams projects unfolded on all the priority domains of ERDF, within the all the Romania's regions), projects won by beneficiaries as institutions (central or local public administration, NGOs, schools, universities, research institutes, small or big enterprises, social service providing associations) .[16]

The average length for the evaluation of contracted projects (starting with the submission of the request and up to the signing of the financing contract) in this period (2007-2009), has been of 346 days, within which:

- the stage of evaluating the administrative conformity and eligibility - 35 days;
- the stage of technical and financial evaluation- 53 days;
- the handing-in and the analysis of the Technical Project- 120 days;
- visiting the actual place- 18 days;
- the stage of pre-contracting-120 days.

From the analysis of the evaluation project unfolded up to the 31st of December 2009, it is revealed that 31.5% out of the financing requests have been rejected throughout the different stages of this process. The financing requests that have been rejected during the stage of evaluating the administrative conformity and eligibility represent 50% of the total of the rejected requests, until the 31st of December 2009. The main causes involved were: 50% - the lack of and/or the vagueness of some documents, 20%- inability to respect the standards from the solicitant's guidelines, 15%- ineligibility, 5%- not respecting the minimal/maximal value, 10%- other (over-term handing in, lack of answer for clarifications, etc.)

In our study we have sent an electronic survey to a group of selected managers in the implementation of regional projects from local city hall of the 8<sup>th</sup> regions. We aimed assessing the way in which they appreciate their collaboration with the Managing Authority for implementation of the regional development projects. In order to make a qualitative assessment of this situation, we asked them to appreciate the way in which they have cooperated with the Authority

during the implementation, as this was indicated as the main problem during the project implementation. On a Likert scale from 1 to 10, the majority of 53% the collaboration was assessed as a 3 or 5 from 10, so it can be regarded as deficient. More than 20% stated that the collaboration can be assessed as a 4, pointing out the lack of efficiency in the institutional organization for regional growth. The measurement of the quality of collaboration between Project Managers and the Managing Authority

### 3. Conclusions

In conclusion, it is predicted that all these changes in the general context of Romania's economy will have a negative impact over the European Regional Development Fund implementation, through the reduction of the co-financing possibilities of both public (local authorities, regional or central) and private beneficiaries, and this will determine them to revise again their priorities and adapt them to the new economic situation of the country.

During this paper we aimed presenting the opportunity of making regions a visible actor in the sustainable development. Moreover, as the Romanian policy is lacking the clarity of objectives for making regions a crucial factor in accumulation structural European funds, a major impact is the dependency from the central administration. Previous studies underpinned the idea that the main problem of successful implementation the projects is having a good collaboration with the Managing authority in order to facilitate the overcome of difficulties in achieving the program's objective. Managers have indicated that they have to deal with uncertainty in the project's cycle of life so this can be avoided by planning, participation, leadership, and investment.

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## Innovative Clusters and Foreign Direct Investments in the Nord – East Region

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### Abstract

*Research on the competitiveness of regional clusters of Foreign Direct Investments (FDI) in the same and related industries has been dominated by a profoundly optimistic view, concerned far more about the integrative possibilities of dense social networks than the dysfunctional consequences of such networks.*

*The aim of this paper is to offer a description of relationship between Foreign Direct Investments and innovative clusters in Nord-East Region of Romania and the new result of interactions between different actors from the innovative systems. In this matrices, in host countries, Foreign Direct Investments have to follow efficiency seeking type and not labor and market orientated FDI.*

**Key words:** Innovative Clusters, Foreign Direct Investments, Nord-East Region, research & development (R&D),

**J.E.L. Classification:** F23, F43, R58

### 1. Introduction

The cluster concept has a long history. Over the years it has received many names, including “pole of competitiveness”, “industrial district”, “concentration” etc. Today, a popular name is “cluster” or “pole of competitiveness” (in France and Belgium), but the most frequently used term is “cluster”. Professor Michael Porter is considered to be the inventor of the “cluster” term; he defined it as “a geographical concentration of interlinked companies and institutions from a certain economical field”. Clusters have the following components: [1]

- Interlinked industries and other entities, such as specialized suppliers and the according infrastructure;

- Distribution channels and customers, complementary product and service providers and companies affiliated as competencies, technologies etc are concerned;
- Linked institutions, such as research institutions, universities, benchmarking organizations, training entities and others.

The most important dimension of a cluster is the distance between the companies and as a result the entire cluster theory is based on the geographical proximity. Nevertheless, there are also other dimensions like technological gap (how similar are the technologies used by the two enterprises), differences between the firms in regard to the labour force qualification, market position and social relationships, which determine clusters.

### 2. Methodology

This article aims to identify the relationship between clusters and Top 100 FDI in Nord-Est Region. In order to achieve this goal a content analysis of 10 relevant articles have been made. The analysis was focus on identifying a definition of clusters, the new diamond of innovation and witch type of FDI are involved in innovative clusters. The selected articles were selected during 1998 – 2010 from Harvard Business Review, Discussion paper, Report of Ministry of Romanian Economy. The results of this analysis will be showed in part five and six of this article. So, the third part will focus on the concept of clustered while the fourth part concentrates on the new diamond of innovation, the new concept of clusters.

### 3. The concept of clusters: background and different approaches

With the transformation from an economy based on material production to an economy

based on knowledge, research in organization theory and strategic management on competitive advantage has been extended from firm-based approaches focusing on intrafirm capabilities to perspectives which see distinct advantages in the firm’s embeddedness in inter-organizational networks and the way these are managed. In many industries, inter-organizational networks are geographically concentrated in the form of clusters, which are considered a source of regional competitiveness.

Most research on clusters has adopted Porter’s definition of a cluster, focusing on interdependencies and complementarities in exchange relations. The literature reveals a tendency to interpret the competitive advantage of clusters with respect to the benefits obtained from a coherent and stable collective order, sustained by inter-firm behaviour that is oriented to building interpersonal trust, sharing tacit knowledge and institutionalizing exchange along a common standard. The key terms used in this literature include concepts indicating social closeness and stability in the form of organizational routines, connectivity, social capital, collective identity and untraded interdependencies.

#### 4. The New Diamond of Innovation

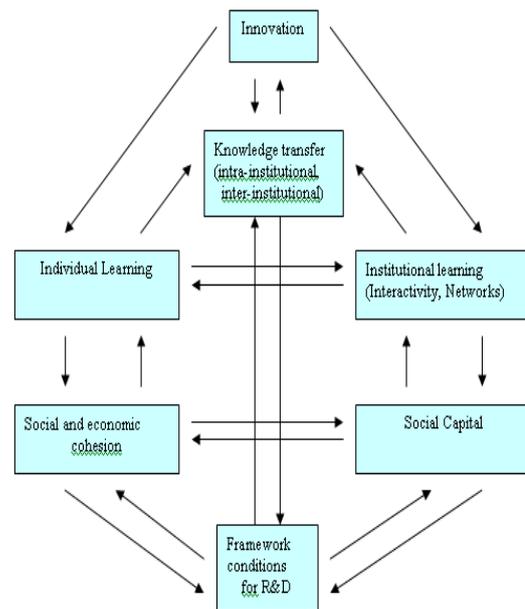
In today's economic context, one does not only speak about clusters. Often the discussion goes about innovative clusters. Innovation can be seen as a result of interactions between different actors from the innovative systems. The systemic view of innovation was first promoted by Lundvall (1992) and Nelson (1993), and more recently by Guth (2004). Considering these new ideas, the traditional linear model of innovation becomes less relevant. Learning, trust and social capital turn into foundation piles of this model.

The “New Diamond of Innovation” Model taking into consideration the competitive advantage theory of Porter and the individual and institutional learning concepts. [2]

Without oversimplifying we can summarize main characteristics for success as follows:

- Clusters are unique. They follow different objectives and approaches and they are built on the national socio-economic and cultural framework conditions.

Figure 1 New Diamond of Innovation



Source: Guth, 2004

- High level of trust between companies and between the private and the public sector as well as influential local government decision makers are clearly related to good performance.
- Cluster initiatives supporting strong clusters (high concentrations, strong value chains, high visibility) are more successful. Those initiatives which focus on sectors which are already advanced usually do achieve better results. [3]

#### 5. Romanian experiences in innovative clusters

In Romania, the planned and autarchic economy before 1989 was leading towards a certain type of clusters, namely the former "industrial centers". The period after the Revolution was marked by a huge decrease of the industrial activity, by a relocation of resources and a repositioning of the economy. It is only after 2001, when the economical growth has finally started, that a discussion about industrial concentrations makes sense. In total we found 55 clusters or potential clusters in the eight regions. Although the results of the different workshops should not be used too much for comparing the single regions, we see that we have identified on average seven clusters per region. This speaks for a rather coherent regional distribution.

What we see is, that the experts assessed the labor force situation as rather favorable. We can make out in total nine clusters from five regions:

- in Bucharest/Ilfov the food cluster;
- in the North West the clusters clothes, tourism, wine and wood;
- in the South West agriculture and tourism
- in the South glass;
- in the South East also tourism

In three regions labour force in the field of tourism seems to have some potential for further improvement. Also the wider agriculture and food sector (incl. wood and wine) could profit from a more sophisticated labour force. [4]

## 6. FDI and clusters in the Nord-East Region

We identified the following clusters in North-East Region:

- clothing and footwear cluster: are present in the counties Bacau, Iasi, Vaslui by several local companies. The triple axis of the cluster is highlighted innovative collaboration with the Faculty of textile, leather and industrial management, Univ. Technical “Ghe Asachi” and cooperation between schools and industry by providing equipment no longer used in production, an example being Astrico program;
- clusters in medicine: the medical centers present in Iasi, Bacau, Neamt. The obvious example of innovative cluster in this area is the existing collaboration with Univ. of Medicine and Pharmacy "Gr. T. Popa ", Inst. "Petru Poni" Iasi, Inst. of radiology Iasi, Hospital “St. Spiridon” Iasi. Another innovative element of the cluster is given by the institutional dimension involving North-East Regional Development Agency by development projects;
- clusters of turism: are present in Neamt and Suceava counties. Institutional involvement in innovative cluster is highlighted by collaboration with the Faculty of History and Geography “Stefan cel Mare” Suceava, University “A.I. Cuza” Iasi, Inst. “Ghe. Zane” Iasi and the involvement of “Bucovina Turist Association” through specialization and cooperation with local tourism firms. The

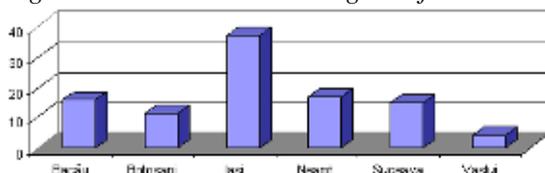
result was the establishment of local tourist information centers;

- clusters in the food industry are present in Botosani, Vaslui, Iasi. Institutional support is provided by Univ. of Agricultural Sciences and Veterinary Medicine "I.I. Brad "Iasi, Faculty of History and Geography “Stefan cel Mare” Suceava, Suceava Agricultural Research Center, Agricultural Research Center in Iasi. One of the projects implemented in this cluster was tele-learning between Science and Agricultural High School of Veterinary Medicine „Podul Iloaiei”. Also it is a continuous support of county agricultural offices by specialists in agriculture;
- Cluster wine sector is currently present in Iași by local companies and collaboration with Univ. of Agricultural Sciences and Veterinary Medicine “I.I. Brad” Iasi and Iasi wine research center.
- Cluster in pharmacy: Piatra Neamt and Iasi. Innovative cluster is complemented by cooperation between local firm “Antibiotice” Iasi and University of Medicine and Pharmacy Iasi.
- IT Cluster in Iasi and Bacau. Local authorities were involved in the creation of business centers, for exemple, business center “Tehnopolis” Iasi, Iasi business incubator business and IT industrial park in Bacau; projects between the Univ. “A.I.Cuza”, Univ. Technical “Ghe Asachi” and local businesses.
- Cluster of wood industry in Suceava, Neamt and Bacau. Institutional support is provided by the Forestry Department of Suceava and local chambers of commerce and industry.

The analysis of foreign direct investment FDI in the Top 100 North – East FDI show several aspects of FDI. FDI were identified from the Amadeus database in terms of percentage shares of at least 10% owned by a foreign shareholder. Classification was done according to the revenue in 2011. The largest FDI of the North - East is “Altex Romania SRL”, owned by “Abacus Ltd.” from Netherlands with 74% of shares. The income amounts is 189,934 thousand euros. The distribution of FDI is as that follow: in Iasi FDI are 37%, in Neamt County 17%, 16% in Bacau County, 15% in Suceava County, in Botosani County are 11% and only 4% of

FDI in Vaslui County. There is a concentration of more than 1/3% in Iasi, in Suceava and Bacau County have approximately equal number of FDI and less FDI are in Botosani and Vaslui County. (Figure 2)

Figure 2 FDI in Nord-Est Region of Romania



Source: own calculation, 2012

The top five investing countries by nationality in Nord-Est Region of Romania in 2010 are: Netherlands, Austria, Germany, France and Greece. Investor first country is Italy. Netherlands and Germany are also present in the NE Region. Netherlands is the second largest investor. Belgium, which is ranked 13 in Romanian industrie by FDI, here is the third country investors. This picture of FDI is explained by the presence of Italian FDI in the textile industry. Most active FDI in manufacturing, followed by services and distribution. This shows that FDI in the NE region are the type of markets and resources seeking and the type of efficiency. In terms of expansion and expansion into other markets, more than 20% of FDI own branches, most on the local market. Only one ISD, „Ball SA” has opened branches abroad, in neighboring countries. This shows poor orientation of FDI in capital outflows. Local FDI is still orienteted for own market expansion It should be noted and regional market presence of FDI in the same representative industry like “Egger Romania SRL” Radauti, the first manufacturer of wood panels in Romania and one of the biggest in CEE, “Bearings SA” Barlad, present in the top 500 CEE companies, “Ambro SA” Suceava, the largest paper producer in Romania, “Rompak” Pascani, one of the largest producers of ingredients for baking industry in Romania, “Rafo” Onesti, one of the largest refineries in the country, “Sercomf SA” Botosani, one of the largest textile producers in Romania, “Mecanica Ceahlău” Piatra Neamt, the largest manufacturer of agricultural machinery in Romania .

## 7. Conclusion

The question of FDI in the North – East Region is if these companies are involved in local clusters, research centers or if the FDI presence is only isolated island in search of only markets and labor. This raises the question, if we can really talk about the connection between innovative clusters and FDI in the North – East Region. We found this link in same economic sectors that are dominant in a county as: textiles industry in Botosani, wood industry in Suceava, Neamt and Bacau, food industry in Iasi. In terms of the relationship between FDI, local businesses and economy of scale, a particular problem is the lack of local service specialized in technological fields FDI. Such deficiencies are recorded on the lack of service providers available in the country, and the refusal of Romanian companies to use business services, especially support services for innovation. This is particularly regrettable in terms of "international best practices" which shows that innovation services providers can make the difference between success and failure in innovative clusters. An example would be the regional development agencies and chambers of commerce which not provides highly specialized services to businesses, in a target area and this feature reduces their importance in innovative clusters.

## 8. Acknowledgement

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**Section II**  
**Business Economy and Administration**

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**Subsection 1**  
**Economy and Economic Informatics**

# The Impact of Clusters on the Development and Competitiveness of the Tourism Industry in Romania

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## Abstract

*This paper propose an analyse of tourism clusters impact on regional development and competitiveness of tourism industry in Romania and a comparison with some tourism clusters from another traditional touristic european countries.*

*Tourism is an extremely important economic activity, which may play a decisive role in certain development areas, effects of tourism need to be considered, in general, from their relationship with the fundamental objectives of the whole economic system. The contribution of touritic sector is characterized by the enormous possibilities that have to produce direct, indirect and induced effects in an economy, to the creation and use of national income, its effects on inflation, investment or diversification of economic structures, its role in enhancing the quality of life.*

**Cuvinte cheie:** regional competitiveness, clusters, sustainability, cooperations

**Clasificare J.E.L.:** M21, O16

## 1. Introduction

Tourism cluster is a geographic concentration of companies and institutions interconnected in tourism activities. This includes suppliers, services, governments, institutions, universities and competitors (Capone, 2004). Beni (2003) defines tourism cluster as a set of attractions with touristic differential, concentrated in a limited geographical area with facilities and services of quality, collective efficiency, social and policy cohesion, with coordination of the production chain and of the cultural associations, and with excellent management of companies' networks that generate comparative and competitive advantages.

Clusters are a group of tourism resources and attractions, infrastructure, universities, equipment, service providers, other supporting sectors, and administrative bodies whose integrated and coordinated activities contribute to providing customers with the experiences they expect from the destination they choose to visit. If we translate this definition to romanian tourism industry we'll find a few attributes of tourism clusters: **diversification and innovation ; rise of competitiveness; cooperation; promotion; regional tourism development** that contribute to sustainable regional growth and prosperity and stimulate the growth of other clusters of high importance in the region, including the construction, retail and transportation clusters. Partnership and alliances at cluster level is, undoubtedly, the most critical area of cooperation and its must improve competitiveness and secure sustainability.

## 2. Regional competitiveness and clusters

Regional competitiveness as a concept should include as a basic principle of territorial cooperation and strengthen coordination between sectoral, national and Community. An integrated inter-sectoral and inter-institutional territory is difficult to achieve but can generate endless possibilities for analysis and intervention measures default. Since the first EU report on competitiveness, which reported worrying trends in terms of competitive advantage both in global and local, to the current strategic directions of the Union, giving priority to regional competitiveness, the key issue became subject to the formation of European policy.

New Lisbon Agenda requires that "the EU to mobilize all appropriate national and Community resources, including social cohesion" and argues that greater ownership

of the Lisbon objective is possible only by involving local and regional stakeholders and partners social (European Commission 2005). Lisbon Agenda was originally thought to help Europe to become "the most competitive knowledge-based economy" by 2010, but subsequently underwent a review by the emphasis has shifted to economic growth based on technological progress and employment. Also, the European Commission and Council have identified a set of indicators to monitor progress divided into six groups: economic environment, employment, innovation and research, economic reform, social cohesion and environment. Later, they added a spatial dimension, which integrated strategies for competitiveness and sustainability in the European Spatial Development Perspective. Analysis of factors generating regional competitiveness is to provide a current in the European Union in dealing with spatial planning and new policies at European level aimed at reducing disparities and more appropriate distribution of development funds within the region. Determinants of competitiveness refers to: using creative and innovative potential of regional / territorial / national level, making connections to regional / territorial by stimulating the cluster, natural and cultural heritage, research and innovation potential use and improve accessibility. Theory clusters / poles of competitiveness in countries such as France, Belgium, Portugal became visible after the paper's appearance M.Porter (1990), relies on the idea that competitiveness at regional level derives from the presence and dynamics of geographically localized activities, among which there fierce competition, benefiting from favorable conditions of production factors, the strong demand and strong and competitive sectors horizontally. The more localized the cluster / pole, the more intense interactions between these components of competitiveness and therefore the diamond region is more competitive.

### **3. Impact of clustering in Romanian tourism. Case study Carpathian Tourism Cluster**

The concept of cluster is adopted to the specific characteristics of tourism activity, whose product is linked to its local base and

to the joint action of an agglomerate of enterprises involved in the region's tourism product.

Porter defined agglomeration as: ...a geographical assembly concentrating inter-related enterprises, correlated institutions in a determined area linked to common and complementary elements. The geographical scope varies from a single town or state to the whole country or even a net of neighboring countries. The agglomerations assume diverse ways, depending on their deepness and sophistication, but most of them include enterprises of products and final services, specialized input suppliers, components, equipment and services, financial institutions, enterprises and correlated sectors. The agglomerations generally also include companies up and down in the supply chain, producers of complementary products, suppliers of specialized infrastructure, governmental institutions and others, devoted to specialized training, education, information, research and technical support (such as universities, study centers and workers on vocational training), and standardization agencies.

The governmental institutions with main influence over the agglomeration would be one of its members. Finally, many agglomerates include commercial and other private associations which support its members. [Porter, 1998]. To Zacarelli in 2004, a complete cluster must include some other technology-related characteristics as well as characteristics related to competitiveness, environmental and cultural sustainability, quality of life and synergy as a result of systemic relations. The variables presented, Porter adds: the habit of reusing recyclable materials or sub-products; intense competition among cluster actors and from them to other clusters; similar technological pattern among enterprises; society culture adapted to cluster activities; high correlation and synergy among activities, agents and widening benefits concerning quality of living.

Carpathian TOURISM CLUSTER ROMANIA actively supports the tourism development and promotion of the Carpathian regions. The target is to establish the Carpathian Mountains as "Tourism destination of excellence". This means for us standards and quality of tourism services and

– at the same time – preservation of the regional identity and uniqueness (nature, history, culture, tradition). Carpathian TOURISM CLUSTER ROMANIA is based on Romania’s national cluster development strategy which is supported by the European Commission. The marketing measures will be in line with the national tourism and brand strategy “Romania – Explore the Carpathian garden”.

The main objectives of the cluster are innovation and diversification in order to attract new tourists to the Carpathian region. This shall be reached by the development of modern tourism offers and the improvement of the quality of touristic service according to European standards.

The main objectives of Carpathian TOURISM CLUSTER :

1. **Innovation and diversification:** Development of innovative touristic offer and services to attract new tourists to the area of the Carpathian Mountains;
2. **Rise of competitiveness:** optimize the value chain in the local tourism industry;
3. **Quality:** improve the quality of the touristic services (European standards);
4. **Cooperation:** exchange of ideas and joint projects between the touristic regions of the Carpathian Mountains and international tourism destination;
4. **Promotion:** promote the Romanian Carpathian Mountains as “destination of excellence” within the national tourism promotion strategy “Romania – explore the Carpathian Garden”;
5. **Regional tourism development:** contribute to sustainable regional growth and prosperity.

The cluster is integrated in an international tourism network and especially intends to promote the Carpathian Mountains abroad. All cluster projects have a supra-regional character. In the launching phase, the cluster concentrates his activities on the Carpathian and Subcarpathian districts of Brasov, Buzau, Sibiu, Covasna, Arges and Prahova.

A tourism cluster is a platform for networking and strategic cooperations along the whole tourism value chain. The advantages of cooperation nets in tourism activities allow for the effective exploitation of the collective efficiencies and/or the development of external companies from the enterprises (entrepreneurial cooperation, work productive specialization, collective infrastructure, service specialization etc.) and

also makes it possible to benefit from the increased ability to negotiate collectively with suppliers of inputs and components. Carpathian TOURISM CLUSTER ROMANIA provides the following services to its members:

- Organisation of regular meetings of regional and national tourism stakeholders
- Regional, national and international matchmaking events for specific tourism topics
- Organisation of an annual Tourism Cluster Day
- Online cooperation forum to search for partners or specific services/products

Carpathian Tourism Cluster has been founded in 2010 based on the initiative of the Tourism Association Brasov (Asociatia pentru Promovarea si Dezvoltarea Turismului din județul Brasov (APDT) and the Tourism Association Monteoru Renaissance (Monteoru Renaissance- Asociatia pentru dezvoltare regionala durabila in turism – Judetul Buzau). Carpathian Tourism Cluster is an independent network of regional and national tourism stakeholders and Romania’s first supra-regional tourism cluster of national interest.

**Carpathian TOURISM CLUSTER ROMANIA** encourages the set up of working groups. Working groups are formed by interested cluster members in order to develop new tourism services and products and to boost the tourism marketing of the region. So, cluster working groups in preparation:

1. **Innovation:** Development of innovative tourism products and services for the region of the Carpathian Mountains;
2. **Quality:** HR development and quality management;
3. **Marketing:** Promotion of the Carpathian tourism regions as “Destination of Excellence”.

Carpathian Tourism Cluster Romania has the following organisation:

Fig. 1 Carpathian Tourism Cluster organisation



Carpathian Tourism Cluster Romania is a non-profit and non-governmental organisation (NGO), organised as association according to Romanian law. As a cluster member your organisation/company has the following benefits:

- Exclusive access to information, services and contacts of Carpathian Tourism Cluster
- Opportunities for strategic cooperation with other tourism companies and service providers along the whole tourism value chain
- New ideas and knowledge for the diversification and quality improvement of your services
- Access to European structural funds
- Special offer/rates for seminars and trainings
- Joint purchasing activities (bundling of buyer interests)
- Joint promotion activities (i.e. national and international trade fair participation)
- Joint national and international marketing and sales activities for the Carpathian tourism region.

This cluster like all tourism clusters promote sustainable tourism and create added value for the tourism industry in the region of the Carpathian Mountains. The function of tourism causes direct impacts that affect both the territorial system and the production of tourism itself. The environmental spoiling of a beach does not mean only the deterioration of the territorial system but also competitiveness of the function of tourism in the region. [Ivars, 2004]. Sustainability is a fundamental concept when reassessing the role of tourism in contemporary society. The World Tourism Organization defines sustainable tourism in this way: Sustainable tourism is understood as the kind that

satisfies the present needs of tourists as well as preserving the destination regions while incrementing future opportunities. It has to be conceived in a way to guide management of all available resources in order to meet economic, social and aesthetic demands, maintaining cultural integrity of essential ecological processes, biological diversity and life supporting systems. (OMT, 1998). The local development model based on sustainable tourism involves very complex relationships and can only be accomplished if the dimension reality of a certain region or territory is taken into consideration.

#### 4. Conclusions

- Analiza factorilor generatori de competitivitate regională constituie un demers permanent al oricarei regiuni si tari în ceea ce priveşte abordarea în domeniul planificării spațiale, reducerea disparităților de dezvoltare și o distribuire mai adecvată a fondurilor pentru dezvoltare în interiorul regiunilor;

- Creșterea competitivității regionale implica automat: valorificarea creativă și inovativă a potențialului regional/teritorial/național; realizarea de conexiuni la nivel regional/teritorial prin stimularea apariției clusterelor; valorificarea patrimoniului natural și cultural; utilizarea potențialului de cercetare-inovare și îmbunătățirea accesibilității;

- **Tourism cluster** has many definitions but the most relevant seems to be the following (*Eulogio Bordas*): “accumulation of tourist resources and attractions, infrastructures, equipments, service companies, other supporting sectors and administrative organism whose integrated and coordinated activities allow to provide the customers with the experience they expect from the destination they choose to visit”.

- Carpathian TOURISM CLUSTER ROMANIA is based on Romania’s national cluster development strategy, which has been founded in 2010 to: 1. promote sustainable tourism and create added value for the tourism industry in the region of the Carpathian Mountains; 2. innovation and diversification in order to attract new tourists to the Carpathian region. This shall be reached by the development of modern

tourism offers and the improvement of the quality of touristic service according to European standards.

## 5. Acknowledgement

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# An Analysis of the Relationship Between Resources Allocated to Health Care and Quality of Health Services

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## Abstract

*This paper analyzes the relationship between resources allocated to health care and quality of health services in 15 EU member states. We use quantitative secondary data describing the level of several financial, human and material resources allocated to health care and people positive evaluation for the overall quality of healthcare, as variables and principal components analysis, as statistical method. The results display significant differences in the perception of health care quality among analyzed countries. They also confirm the existence of a relationship between financial and real resources allocated to health care and respondents' evaluations of health care quality.*

**Key words:** financial and real resources, quality of health care, patients' perception, inequality.

**JEL Classification:** H51, I11, I14.

## 1. Introduction

The issues of access and quality of health care are a priority on international agenda. They are considered as key elements for improved health outcomes and efficiency in health care services delivery in any health system.

Quality is defined as “the degree to which health services for individuals and populations increase the likelihood of desired health outcomes” [1]. Consequently, any research aiming at identifying the factors influencing health outcomes and to suggest

ways to improve them can be considered quality-related research and there is a large body of literature dealing with this issue.

The studies referring directly to quality in health care are mostly concerned with micro clinical level. They focus on finding ways to improve quality at organizational level ([2],[3],[4],[5] etc.)

Fewer studies are concerned with relating the health system macro characteristics with overall quality in health care [6].

Even if it appears simple to define it, measuring quality in health care is not an easy issue. On the contrary, many attempts to measure it fail since the concept is much too complex, involving too many questions and determinants [7].

This paper analyzes the relationship between resources allocated to health care and quality of health services in 15 EU member states, taking into consideration the interaction between macro and micro level

We start from the premise that the level of the resources allocated in health care impacts upon the perceived quality of health care. Consequently, we aim at investigating if and to what extent several macroeconomic indicators related to the level of financial and real health care allocated resources influence people' perception of quality. Another objective of this study is to highlight the similarities and disparities among several EU countries, with a special focus on Romania.

We use quantitative secondary data describing the level of several financial, human and material resources allocated to health care and people positive evaluation for the overall quality of healthcare.

The statistical method used in the paper to test the relationships between health care

resources and perceived quality of health care is principal components analysis (PCA).

The findings confirm the existence of a relationship between financial and real resources allocated to health care and respondents’ evaluations of health care quality. They also point out an unfavorable situation for the Romanian health care system from the point of view of its capacity to provide high-quality services.

## 2. Data and methodology

### Variables

Health care quality is analyzed in this paper using as indicator the percentage of positive evaluation for the overall quality of healthcare retrieved from Special Eurobarometer 327 - *Patient safety and quality of healthcare*. This stands for the dependent variable of our analysis.

As independent variables we use five indicators of which two of financial expenditures on health namely, Health expenditure per capita (current US\$) and Health expenditure, public (% GDP), two indicators of material resources (Hospital beds per 100 000 inhabitants and Medical Equipment – Total density per 100 000 population: Magnetic Resonance Imaging) and one variable describing the human resources in health care (Practicing physicians per 100 000 inhabitants).

The data used are obtained from international databases and are registered for 2009, unless otherwise stated (Table 1). The data are available for 15 EU member states: Austria, Czech Republic, Denmark, Estonia, Hungary, Italy, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Romania, Slovenia, and Spain. Statistical data processing was conducted using SPSS software.

Table 1 presents the descriptive statistics for included variables.

Table 1. Descriptive statistics for included variables

	Mean	Min	Max	Std. dev.	Reference year	Source
Perceived quality of healthcare - good (%)	60	25	95	24,73	2009	1
Practising physicians per 100 000	318,8	217,0	467,1	65,18	2009*	2 **
Hospital beds per 100 000 inhabitants	549,8	319,3	765,0	155,05	2009	2
Medical Equipment – Total density per 100 000 population: MRI	0,9	0,1	1,8	0,54	2010	3
Health expenditure, public (% GDP)	6,1	3,9	9,0	1,52	2009	4, 5
Health expenditure per capita (current US\$)	2576	432	8262	2322,59	2009	4, 6

\* Data for Denmark are registered for 2008.

\*\* Data for Portugal were obtained from World Health Organization.

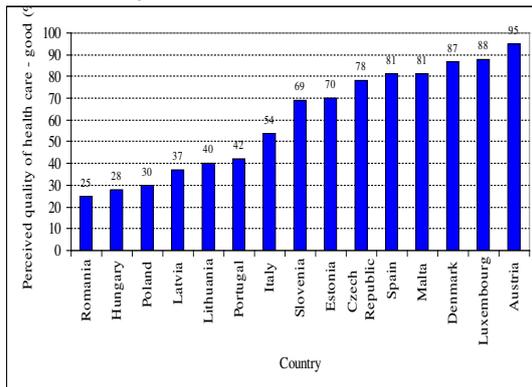
Source:

- 1 European Commission
- 2 Eurostat
- 3 World Health Organization
- 4 World Bank
- 5 HNP stats
- 6 World Development Indicators

As can be observed in the table above, the allocation of health resources is unequal among the analyzed countries, approximately two times higher in the best of than the worst of if referring to human resources, 18 times higher between the two categories when it comes to medical equipment and 19 times higher if considering the level of health expenditure per capita.

Despite the fact that using patients’ opinions in order to evaluate the quality of health care has several methodological limitations that should be taken into consideration [6], the choice for such a dependent variable is justified by the fact that the evaluation is provided by the patients’ who are the ones situated “at the front lines of care” [8]. Besides, the differences than can be noticed between countries, although evaluated subjectively, are significant and contribute to a certain understanding of the realities in EU health systems (Figure 1).

Figure 1. Evaluation of health care quality in analyzed EU countries, in 2009



Source: European Commission (2009), Special Eurobarometer-327: Patient safety and quality of healthcare.

The percentage of positive evaluation for the overall quality of healthcare ranges from 95% in Austria to 25% in Romania, the sample average being of 60% (Table 1).

#### Statistical analysis

In order to identify and describe the relationships between variables and also similarities and differences between statistical units, from the perspective of the analyzed variables, we use a multivariate statistical method, Principal Components Analysis (PCA) [9].

Before applying PCA, a preliminary analysis is performed, aiming at verifying the adequacy of data for a factorial analysis. The  $\chi^2$  test is used to test the null hypothesis that the variables in the correlation matrix of the population are uncorrelated, and the indicator MSA (Measure of Sampling Adequacy) of Kaiser-Meyer-Olkin to evaluate in which degree each variable may be predicted by all the other variables.

If Sig value is smaller than 0.05, (conventional value associated to  $\chi^2$  test), the null hypothesis is rejected and it can be guaranteed with a risk of 5% that there are significant statistical relationships between the variables. The identification of the relationships is made with KMO statistics. If KMO is higher than 0.5, the PCA can be applied.

After processing the data in SPSS we obtain the Initial Eigenvalues corresponding to the 6 factorial axes (there are 6 variables included in the analysis), the variance

explained by each factorial axis, and the graphical representations which allow us to identify and describe the relationships between variables and statistical units.

### 3. Results

The results obtained with SPSS (Table 2) show a significant value associated to Bartlett's test of sphericity, with  $\chi^2$  statistic, Sig = 0.000 that is smaller than 0.05 (conventional value), which means the null hypothesis of variables' uncorrelation is rejected, and the considered variables are adequate for a PCA. Thus, with a probability of 95%, we can say that there is a significant relationship between the statistical variables. The value of the indicator MSA of KMO (KMO=0.612), higher than 0.5, shows that the solution obtained with PCA can be accepted.

Table 2. Values of KMO test and  $\chi^2$  statistic

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.612
Bartlett's Test of Sphericity	Approx. Chi-Square	42.252
	df	15
	Sig.	.000

Source: Output obtained in SPSS with PCA

Factorial solution indicates variables' grouping in two principal components which have an explicative power of 76.311% of the total variance.

Variables coordinates on the first two factorial axes are presented in Table 3. They show variables positioning on the factorial axes. The variables Practicing physicians per 100 000 inhabitants, Medical Equipment – Total density per 100 000 population: Magnetic Resonance Imaging, Medical Equipment – Total density per 100 000 population: Magnetic Resonance Imaging, Perceived quality of healthcare - good (%) are located in the positive quadrants of both factorial axes. The variable Hospital beds per 100 000 inhabitants is located in the negative quadrant of the first factorial axis and the positive quadrant of the second while the variables Health expenditure per capita (current US\$) and Health expenditure, public (% GDP) are located in the positive quadrant

of the first factorial axis and the negative quadrant of the second.

Table 3. Variables’ coordinates on the first two factorial axes

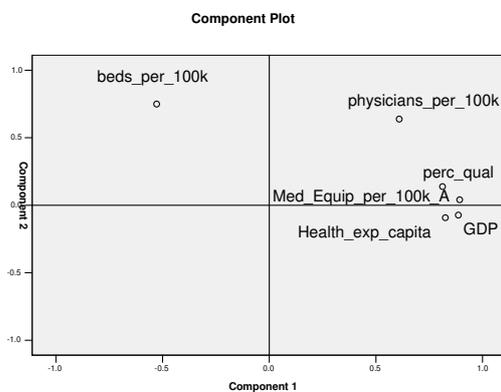
	Component	
	1	2
Practicing physicians per 100 000 inhabitants	.609	.638
Hospital beds per 100 000 inhabitants	-.528	.750
Medical Equipment – Total density per 100 000 population: Magnetic Resonance Imaging	.893	.041
Health expenditure per capita (current US\$)	.826	-.092
Health expenditure, public (% GDP)	.887	-.073
Perceived quality of healthcare - good (%)	.812	.138

Source: Output obtained in SPSS with PCA

Displaying high values of the coordinates, the variables Medical Equipment – Total density per 100 000 population: Magnetic Resonance Imaging, Health expenditure per capita (current US\$), Health expenditure, public (% GDP) and Perceived quality of healthcare - good (%) are strongly correlated with the first factorial axis showing that there are significant differences among the statistical units. Between these variables there is a strong positive relationship. The second factorial axis is explained by Practicing physicians per 100 000 inhabitants and Hospital beds per 100 000 inhabitants.

Variables’ positioning in the plane of the first two factorial axes is presented in Figure 2.

Figure 2. Variables’ positioning in the plane of the first two factorial axes

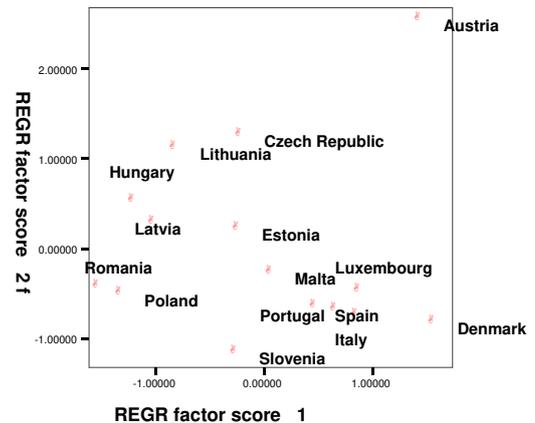


Variables’ positioning on the first factorial axis from Figure 2 shows a negative relationship between the variable Hospital beds per 100 000 inhabitants, on one side and

the variables Practicing physicians per 100 000 inhabitants, Medical Equipment – Total density per 100 000 population: Magnetic Resonance Imaging, Health expenditure per capita (current US\$), Health expenditure, public (% GDP) and Perceived quality of healthcare - good (%).

The graphical representation of the statistical units on the factorial map is presented in Figure 3.

Figure 3. Countries’ position in the plane of the first two factorial axes



The first factorial axis in Figure 3 above points out the “opposition” between countries like Austria, Luxembourg, Italy, Denmark on one side and Romania, Poland, Hungary, Latvia and Lithuania, on the other. The most significant differences among the statistical units from the point of view of the analyzed variables are explained by this axis.

Overlapping of graphical representation of countries on the factorial map (Figure 3) and variables map obtained with PCA (Figure 2) allows us to identify several characteristics of perceived quality of health care and resources allocated to health care in the analyzed EU members. Thus, countries such as Austria, Luxembourg, Italy, Denmark register high values for the perception of the overall quality of health care, Practicing physicians per 100 000 inhabitants, Medical Equipment – Total density per 100 000 population: Magnetic Resonance Imaging, Health expenditure per capita (current US\$), Health expenditure, public (% GDP), Perceived quality of healthcare - good (%) and low values for Hospital beds per 100 000 inhabitants. On the contrary, countries like Romania, Poland, Hungary, Latvia and Lithuania register low values for the positive

perception of health care and all the variables positively related with it and high values for Hospital beds per 100 000 inhabitants.

#### 4. Discussions and conclusions

The purpose of this paper was to analyze the relationship between resources allocated to health care and quality of health services in 15 EU member states, taking into consideration the interaction between macro and micro level

It started from the premise that the level of the resources allocated in health care impacts upon the perceived quality of health care.

The findings confirm the existence of several relationships between the two categories of variables. There is a strong positive relationship between material resources measured by Medical Equipment – Total density per 100 000 population: Magnetic Resonance Imaging, financial resources Health expenditure per capita (current US\$) and the share of public health expenditure in GDP and people positive evaluation of quality of health care. Also there is a negative relationship between the number of hospital beds per 100 000 inhabitants, and the variable mentioned above.

The performed PCA shows differences between the analyzed EU members from the perspective of people perception of the overall quality of health care and the factors describing the resources allocated to health care.

We can state that the higher the level of allocated resources, the better evaluation people provide for the overall quality of health care in their country.

The most significant differences are between Austria, Luxembourg, Italy and Denmark, on one side and Romania, Poland, Hungary, Latvia and Lithuania, on the other. These countries register low values for the indicators positively correlated with perceived quality in health care and high values for the ones negatively correlated with quality.

This aspect points out an unfavorable situation for Romania with a health system in continuing transformation, with high opportunity costs of each percentage in GDP allocated to different components of health care and with an economic situation which

does not allow major increases in the level of allocated resources in order to improve health outcomes and quality. This aspect leads to the need to improve efficiency by getting higher value for the invested money.

This study contributes to the existing literature related to identifying factors associated with quality of health care and suggesting ways to improving it. One of its limitations consists in using a subjective indicator for measuring quality which makes the comparison of the differences between countries to be “altered” by the cultural dimension.

#### 5. Acknowledgements

This research was developed within the project POSDRU/89/1.5/S/61879, “Postdoctoral studies in field of public health policies ethics”. The project is co-financed from the European Social Fund through Sectoral Operational Program for Human Resources Development 2007-2013, Priority Axis 1 Education and training in support for growth and development of a knowledge based society, Area of intervention: Doctoral and postdoctoral programs in support of research, beneficiary University of Medicine and Pharmacy “Gr. T. Popa” Iasi, Romania. The views expressed in this paper do not necessarily represent those of European Union or Romanian Government.

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## Academic Rankings - Are Romanian Universities Competitive?

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### Abstract

*The nowadays globalization process leads to increasing competitive pressures on higher education institutions, in particular related to their position on global university league tables, for which their research performance currently is almost exclusively the measure.*

*There is no doubt that the arrival on the scene of global classifications and rankings of universities has changed the world of higher education. Since the emergence of global rankings, universities have been unable to avoid national and international comparisons, and this has caused changes in the way universities function. In many strategies of the universities one may find the goal of obtaining a better position in some international rankings.*

*Thus, this paper aims to emphasize some features of the relation existing between rankings and the competitiveness of universities, taking into account the fact that Romanian universities are not to be found in the top 500 of the best universities of the world.*

**Key words:** education, university, ranking, economy

**J.E.L. classification:** A19, I20

### 1. Introduction

In a world in which day after day specialists speak about the role and importance of globalization, of creating a strong EU, of the economic crisis etc., one must see that a factor with a strong influence on all these phenomena is higher education.

In a world driven by competition, the higher education area does not make a discordant note. Ones of the most mediatised issues during the last years were the international rankings phenomenon and the evaluation. It is generally accepted that

evaluation and ranking are two different but related concepts. They differ in their purposes and outcome. Ranking shows a university's relative strength and weakness as compared to its peer institutions in the areas represented by the indicators. It clearly indicates a university's relative location at a scale representing its strength in the measured aspect [1].

Since the early parts of the 20th century, rankings and league tables of higher education have existed, starting in the U.S.A.[2]. An overview on existing ranking systems by the Institute for Higher Education Policy (IHEP) lists more than 30 countries in all continents with a few countries (like the UK) producing a number of competing rankings.

Whether the ranking phenomenon is a good or a bad one, time will tell, but for the moment what it may be seen is related to its advantages and disadvantages, especially if we are analysing the universities of developing countries.

### 2. Academic rankings

Lately, there are different discussions about the place that university X is occupying in the ranking Y; often the nowadays press incorrectly presents the competitiveness of a university as the place it occupies in a national or international ranking.

Thus, nationally, according to National Education Law nr.1/2011, universities are classified into three categories, namely:

- universities focused on education;
- universities focused on education and research and universities of education and artistic creation;
- universities focused on advanced research and education.

According to an assessment made in a very short time by the European University Association, only a fifth of the educational

programs offered on the Romanian market can be considered in the top group, but like any top, this one implies too the existence of relativity and subjectivity. While the B category is collecting nearly 22.1% of the total of 1075 programs, in the C category fall approximately one quarter of the study programs.

The stake of implementing such national classification is quite high (financing, reorganization of education levels etc.). Therefore, these tops, seen as a potential indicator of competitiveness, are always hotly disputed. The national ranking was based on several criteria, which put more emphasis on research and less on the teaching issues and on the extent to which graduates of these universities are compatible with in the labour market requirements, complying with the requirements of the potential employers.

In addition to national rankings, more or less disputed, there are a series of international rankings, in which, unfortunately, no Romanian university does appear in the Top 500, as one could observe in the following table.

Table 1: Few international rankings

Ranking	Site	Are there any Romanian universities?
<i>Academic Ranking of World Universities -ARWU (Shanghai Jiao Tong University, China) (2011) [3]</i>	<a href="http://www.shanghairanking.com/ARWU2011.html">http://www.shanghairanking.com/ARWU2011.html</a>	There is no Romanian university in top 500!
<i>THE QS World University Rankings (UK) (2011)[4]</i>	<a href="http://www.topuniversities.com/university-rankings/world-university-rankings/2011">http://www.topuniversities.com/university-rankings/world-university-rankings/2011</a>	There is no Romanian university in top 500!

<i>Webometrics (Spain) (2012) [5]</i>	<a href="http://www.webometrics.info/rank_by_county.asp?country=ro">http://www.webometrics.info/rank_by_county.asp?country=ro</a>	There is no Romanian university in top 500, but there is in top 1000! 538 – Universitatea Alexandru Ioan Cuza Iași 687 – Universitatea Tehnică Gheorghe Asachi 738 – Universitatea Politehnică București 774 - Universitatea Babeș Bolyai Cluj-Napoca 835 – Academia de Studii Economice din București
<i>Leiden Ranking (Centre for Science and Technology Studies, Netherlands) (2011) [6]</i>	<a href="http://www.leidenranking.com/ranking.aspx">http://www.leidenranking.com/ranking.aspx</a>	There is no Romanian university in top 500!
<i>SCImago Institutions Rankings (Spain) (2011) [7]</i>	<a href="http://www.scimagoir.com/pdf/sir_2011_world_report.pdf">http://www.scimagoir.com/pdf/sir_2011_world_report.pdf</a>	There is no Romanian university in top 500, but there is in top 1000! 709 - Universitatea Politehnică București 942 – Institutul de Fizică Atomică
<i>THE Thomson Reuters World Ranking of Universities (UK) (2011) [8]</i>	<a href="http://www.timeshighereducation.co.uk/world-university-rankings/2011-europe.html">http://www.timeshighereducation.co.uk/world-university-rankings/2011-europe.html</a>	There is no Romanian university in top 500!

Source: Author’s researches using the sites above mentioned

For the ninth consecutive year, Harvard was considered in 2011 the best university in the world, this accumulating the maximum of points in the most important rankings.

The media and the academic staff is trying to find explanation for the place Romanian universities occupies in the international tops and in the same time they are trying to find solutions in order to achieve a better score in the rankings to come.

Till some years ago, the general created image was that the Romanian higher education system was an excellent one [9], being competitive at a global level. During the last years, the numberless reforms, the news in the media concerning the corruption existing in the system, the increasing number of students declaring they want just a diploma, the lack of a proper financing of the system [10] etc. and the results of the global studies concerning the ranking of universities destroyed the positive image of the higher education system.

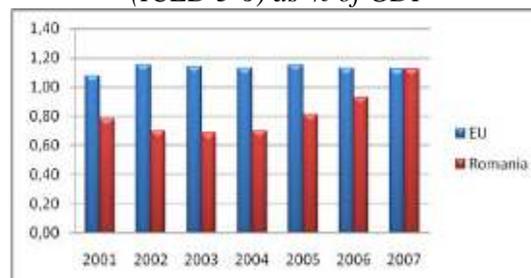
In the same time, the public trust in the Romanian universities started to reduce. The place of Romanian universities in the international rankings is explainable, given the force of Romanian universities (see, for example the number of Romanian Nobel Prize laureates).

In carrying out international ranking, there are emphasised indicators such as:

- the number of publications SCI & SSCI, Scopus etc.,
- the total number of citations,
- the number of articles / teacher,
- the number of citations in journals with high impact,
- the number of graduates of doctoral schools,
- the income for research and development,
- the results of some questionnaires on the university's reputation,
- the number of alumni who received the Nobel Prize,
- the salary of professors,
- the number of students / teacher,
- the university dropout rate,
- the number of years in order to obtain a graduation diploma
- etc.

It is important to mention that the financing of the Romanian educational system, did not pass 3.5 % of GDP, as compared to the financing of the education system in other states, such as those from which the top universities come from. According to EUROSTAT data, although the expenditure slightly increased between 2001 and 2007, overall Romania is investing less than 1% of GDP on higher education positioning itself below EU average [11].

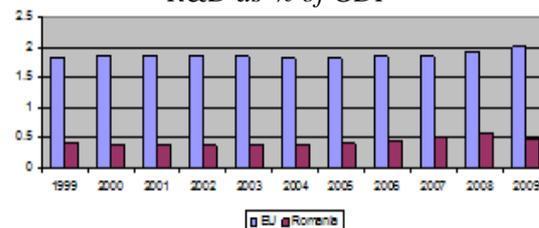
Figure 1. Public expenditure on education (ICED 5-6) as % of GDP



Source: Eurostat, Education statistics, UOE data collection (educ\_figdp)

To complete the picture one should also take into account the gross domestic expenditure on research and development which shows that in the first decade, Romania invested on average less than 0,5% of GDP while the average EU investment stood at nearly 2% of GDP.

Figure 2. Gross domestic expenditure on R&D as % of GDP



Source: Eurostat data

Moreover, the international impact of Romania's R&D output is not an important one. Although Romania is present through relatively many published papers, they have a minor impact on the international community. The echoes of Romanian scientific publications coming from the international academic community are reduced. For that matter, taking into consideration the number of scientific citations per article, Romania is placed on the 15th position from 23 countries in Eastern Europe, according to Scimago source, for 1996-2009. The specialists say that there is a growing tendency for Romanian academic staff to publish in journals which, although are present in the Web of Science, do not meet all the editorial standards of a high quality evaluation.

Another problem to be taken into account is related to academic staff salaries, which are one of the lowest in the EU [12] and even

they are at a low level, they were cut with 25%.

There were mentioned only a few of the problems of the higher education system in Romania as they are numerous.

### 3. Impact of academic ranking

It is obvious that ranking has several advantages and also a lot of disadvantages. Among the most obvious advantages, one may notice:

- ranking makes it easy for viewers to compare and contrast the performances of the universities being evaluated;
- indicates each university's relative achievement in certain aspects and thus helps a university to diagnose problems and/or suggests directions of development;
- fulfills the need for a clear indication about a university's performance;
- offers information for policymaking and for students/families/academic staff etc.

Rankings also influence national and international partnerships and collaborations.

At the same time, reliability of the ranking methodology and the validity of indicators used in a ranking system are two major issues causing debates.

Several ranking systems rely on anonymous opinion polls, which are notoriously difficult to influence relying, as they do, on subjective opinions of people who may never have even visited the institution they are ranking. Moreover, it's more than pleasant to know that a past graduate of your university won the Nobel Prize, but it is hard to see how that affects students in the classroom today.

As one may observe, the criteria used in the achievement of international rankings are based on subjective items. In addition, the same criteria are not relevant in different periods of time. It is obvious for instance that the market of publications is extremely volatile! (See how the impact factor and the score are changing)

Moreover, the total score given to a university is relative, because it reflects the subjective opinion on the quality of those who have made the methodology used in preparing the rankings.

Also it is important what kinds of quantification are using the authorized organizations in achieving rankings:

- Some rankings are using absolute values and thus they favour some large universities (ARWU, Webometrics).
- In some cases, relative values are used, in this case being in advantage the universities with higher efficiency and not necessarily of considerable size (THE-QS).

However, the rankings are measuring past performance and are not focusing on the available potential to each university; they are taking into account only relevant statistics for the chronological history of the university.

It is said that the purpose for which rankings were created was to increase the transparency in the higher education area, but in this case a question arises: how to do this, since the methodology they use, remains partly a mystery to the public?

Moreover, university performance is affected by the larger socio-cultural and politico-economic context. Whether ranking indicators are fair for all universities is open to question.

Ranking determines many universities to implement some strategies in order to increase their competitiveness, but, unfortunately, many universities set their aim of achieving the optimal level of indicators used in the international rankings, and forget to focus on:

- the quality of teaching;
- the stress of the teaching staff;
- the involvement in the regional development;
- some social issues;
- the lifelong learning etc.

Today, we hear more and more the fact that rankings favours elite universities focused on research. Therefore, some international organizations are trying to offer some alternatives. *AUBR EU Research Assessment*, *U-Map*, *U-Multirank* and *AHELO (OECD)* are not yet implemented, but they promise to consider other indicators, with higher relevance for the academic environment.

By reviewing only a few of the features of international rankings, this paper attempts to draw attention to an important aspect:

education policies should not rely only on tops/rankings!

Starting from the definition, we may observe that competitiveness means much more. A competitive university is not only situated in a top, given that in such tops are included about 1000 universities from the total of 17 000 existing in the world, but it is able to meet the needs of economic and social environment, focusing both on research and on obtaining answers that are necessary to achieve the compatibility with the labour market demands.

#### 4. Instead of conclusions

Among the conclusions, it is easily to observe that education is inextricably linked to the welfare and quality of life and that it is influenced by several factors such as corruption, historical evolution, demography etc. Some studies show that countries that have invested over time in education are now reaping the rewards of the economic development. At the same time, specialists in the educational market and fair organizers insist in promoting educational policies based on "opening doors to the private sector and internationalization" as solutions to increase the visibility of Romanian universities and their performance.

Policymakers and some of the members of academic staff are starting to be preoccupied by achieving a goal – a good place in academic rankings among the best universities in the world. The existence of rankings no doubt encourages universities to improve their performance, but at present, it would be difficult to argue that the benefits offered by the information that rankings provide, as well as the increased ‘transparency,’ are greater than the negative effects of the so-called ‘unwanted consequences’ of rankings.

In this context, according to Education Law no. 1/2011, in our country is gaining more ground the idea that, on medium and long term, universities should aim: to attract professors from famous universities, to invest in effective career centers, to involve employers in university work and to capitalize the knowledge they have through consulting activity, products, services etc.

It is obvious that the role of education is extremely important and that is why

Romania is trying to increase the access to higher education forms. According to the Memorandum on approval of final values of the objectives of Romania for Europe 2020, approved by the Government in July 2010, Romania aims at increasing the percentage of graduates of higher education compared to total population to 20.25% in 2013 and to 26.74% in 2020[10].

The fact is that currently, higher education must meet several challenges: to achieve a quality that stand to the test of international comparison, to improve the management and to be more responsible, to increase funding and to diversify the funding sources. These goals involve major changes in higher education, as we are at a crossroads: either we admit that it's time for vigorous action to identify and stimulate the quality of education, where available, and to improve the quality, there where needed, or we preserve in a state of complacency, which may plunge us into a uniform consistency, characterised by a lack of perspective and competitiveness.

#### 5. Acknowledgements

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# A Brief History of the Balanced Scorecard: Tradition and Modernity

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## Abstract

*Strategic Planning is a continuous and systematic process where people make decisions about intended future outcomes, how outcomes are to be accomplished, and how success is measured and evaluated.*

*The Balanced Scorecard represents a management and strategic planning system used on a large scale – in private companies, governmental institutions and NGOs – that aims to harmonise economic activities with the vision and strategy of the organisation, the improvement of internal and external communication and the monitoring of the performance of the organisation beyond its startegic objectives. A simple definition of the BSC involves three aspects: a communication tool, a measurement system and a strategic management system.*

**Keywords:** strategic planning, the strategy focused organization, the Balanced Scorecard, measuring performance.

**J.E.L. classification:** M41

## 1. Introduction

Balanced Scorecard (BSC) is in the sense of specialists in management, system management and strategic planning widely used in business and industry at government and nonprofit organizations that seeks to harmonize economic activities with the vision and strategy organization, improve internal and external communication and monitoring performance across the organization strategic objectives. A simple definition of the BSC involves three aspects: a communication tool, a measurement system and a strategic management system.

This evaluation system was proposed in

1992, in an article published in Harvard Business Review, has a great influence in literature and in practice today. On this model, the authors - Kaplan and Norton - say:

“Traditional accounting indicators like return on investments or dividends can provide misleading signals about the company's ability to have an upward trend in relation to the requirements of the current economic environment. Financial indicators have traditionally been very suitable for the industrial age, but become obsolete in the context of skills and competencies that companies today are trying to measure“.

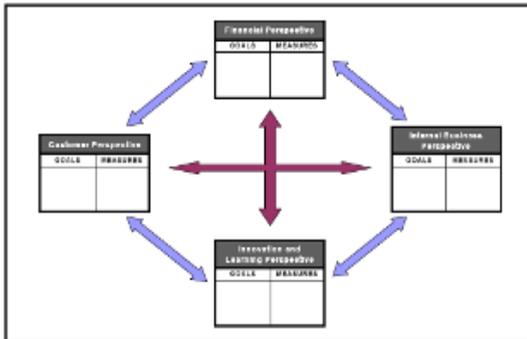
The basic idea of this model is to place several traditional financial variables with non-financial indicators, likely to generate future financial performance. Traditional indicators provide information about the company's past performance, while non-financial indicators can be measured, for example customer satisfaction, innovation and improvements to various process in the company. Combining the two types of indicators allows managers to get a balanced on company performance.

## 2. The importance of using Balanced scorecard

In the model it was designed, Kaplan and Norton, is not a general system of indicators to measure intellectual capital, the argument being that a comprehensive system of indicators could leave out certain aspects of each company related to the objectives, its processes and the context in which it acts.

The Balanced Scorecard is represented graphically in Figure 1:

Figure 1: Presentation by the Balanced Scorecard Business performance



As shown, the Balanced Scorecard performance of the company’s presentation proposes four perspectives:

1. customer perspective - answer the question „How do customers see us?”
2. internal perspective - answer the question „In what areas need to excel?”
3. innovation and learning perspective - answer the question “can continue to create value and to improve it?”
4. financial perspective - answer the question “how shareholders see us?”.

Within each of the four perspectives, the company will set targets and establish a number of specific indicators, financial - the financial perspective and, in particular, non-financial - for the other three perspectives, these indicators are useful for measure how each company exceeds its initial objectives.

The content of each perspective is presented in detail below:

1. Customer perspective: Today many companies are focused on customer strategies. Objectives that a company may determine; in terms of customer satisfaction may be related to the following: new products - how fast the company responds to consumer needs, quality, performance services to customers, and the price of products.

2. Internal perspective: This perspective includes all internal operations that the company must perform to meet customer expectations, in this perspective is given the interest of all processes (life cycle of business, product quality, productivity, employee competence) and technologies used the company. Since these results are strongly influenced by the work of employees, to determine the extent to which business objectives are met, requires that

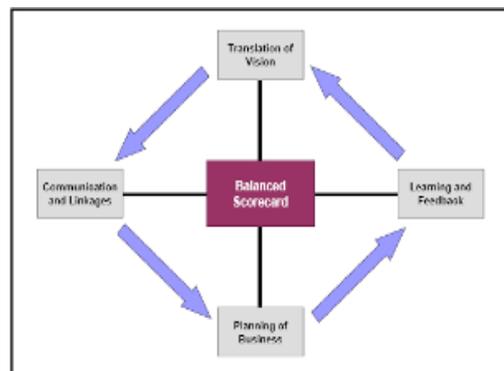
employee performance is determined by the lowest organizational level. In this context, information system plays an important role in obtaining all necessary data model, helping to identify the origin of any problems arising.

3. Innovation and learning perspective: current socio-economic context requires companies to continuously improve products and production processes, and on this basis, be able to penetrate the market with new products and services completely new and thus to determine profit growth.

4. Financial Perspective: Financial objectives that companies must follow are usually related to the development of profit and shareholder value. Although these financial indicators have been criticized because they offer a short term and are oriented to the past, however, they consider fundamental Kaplan and Norton as financial performance is always related to operational performance.

In 1996, Kaplan and Norton offered an advanced version of Balanced Scorecard model, presenting it as a management tool, so important that it becomes part of the company's strategy formulation. This new concept has come of age in 2001, when the two authors have explained that the Balanced Scorecard is a management tool particularly important and can only indirectly be used as a means of measuring the company’s intangible assets and intellectual capital. Place that this model plays in company strategy is shown in Figure 2:

Figure 2: Develop corporate strategy through the Balanced Scorecard model



However, it cannot be neglected that the Balanced Scorecard plays an important role in providing non-financial indicators of corporate performance evaluation, something

on which all atomistic methods for assessing intellectual capital. Interest awarded the Balanced Scorecard as a method of measuring the intangible assets increased in the late ‘90s, as a result of the evaluation of intangible assets is essential in the strategic development of the company.

Braam points out that the diffusion of innovative practices of management and managerial accounting, such as Balanced Scorecard, can lead to a discrepancy between the “label” concept implemented and its contents. In other words, it is possible that some organizations that claim only use balanced Scorecard, while ignoring the substance implementation just considered defining characteristics Balanced Scorecard (linking indicators to strategy, causal relationship between indicators, etc.).

Therefore, assessing whether the Balanced Scorecard is used in practice depends on the definition and clarification of the concept, i.e. the unambiguous identification of the characteristics that define a Balanced Scorecard.

The relatively new, we can mention the contribution of authors in the organization department of strategic management (OSM) and benefits from implementation such a department.

Innovative ideas about performance management through a strategic management department coordinates the planing, implementation and piloting strategy into strategy maps and Balanced Scorecard led to the bppk „Alignment”.

Authors such as Bontis, Petty and Guthrie have shown that this model can be used for evaluating intellectual capital. Comparison made between Balance Scorecard and intellectual capital valuation methods reveal other similarities such as recognition strategy as an essential component of performance management need to find a concise and fully expressing the company’s situation, attention to intangible assets and knowledge.

However differences between Balanced Scorecard and intellectual capital valuation methods can be summarized in table 4:

*Table 1: Benchmarking Evaluation Balanced Scorecard and intellectual capital method*

<b>Balanced Scorecard</b>	<b>Assessment of intellectual capital</b>
Logic: economic and financial	Logic: organizing knowledge
Watch the effects of a new strategy through different indicators (not just financial and economic)	Aims to create intellectual capital by identifying the determinants of value, both internal and external (intangible indicators)
Use performance indicators	Use performance indicators and indicators "status"
It is a monitoring tool	It is a tool for development
Its effects are internal	Its effects are both internal and external (recovery value of intellectual capital)
People create income	People create value

Moving from theory to practice, the question perhaps becomes: What are the informational advantages and disadvantages of the practicable proxies to fair value, value, both when applied consistently, and when applied pragmatically on an item-by item basis? This takes us back to the academically traditional debates on the pros and cons of the various theories of income measurement and asset valuation.

The credibility regards a reasonable evaluation, the using of market information in all possible situations for evaluating and justifying the subjective arguments. Starting from these concepts, the users of the accountancy information had demanded the elaborating of a model for a general appliance of the fair value.

In essence, therefore, this concept in context of new economy gives a significant push towards current values in general and towards fair value in particular, but also strongly insists that fair value , as such must be genuinely based on market expectations, i.e. again, not entity- specific.

In terms of local literature on the Balanced Scorecard, authors like Ionascu et. al, Diaconu et. al., Caraiani et al., Albu and

Albu, introduced in text books university concept of Balance Scorecard, while Vasilescu, Anghel et al. and Mihai discuss the concept in magazines dedicated to professional accountants. A common feature of these materials is given by inclusion in the category of modern Balanced Scorecard, and probably desirable, managerial accounting and management control without a prior investigation of the suitability of the instrument for different business environments, especially for the local.

### 3. Conclusions

Traditionally, companies have measured performance only by financial perspective, for example by measuring the evolution of profit or cost effectiveness.

The leading companies in the study and Kaplan and Norton have been convinced that the dependence of performance measurement in financial terms would affect the ability to create value.

The group discussed a series of choices, but decided on the idea of a scorecard to measure performance and provides the possibility, including the following aspects: organization-customer relationship, internal business processes, employee activities and concerns course ownership.

Note that the Balanced Scorecard is not the only measuring instrument and performance management practices design to overcome deficiencies and to support implementation of the budget strategy. Conversely, under the idea that measuring instruments and performance management are dependent on several factors such as environment, organizational structure, organizational culture, etc.

According to Otley D.T., contemporary managerial accounting practices include a variety of similar tools Balanced Scorecard but presents its own particularities, sometimes around issues other strategy. Balanced Scorecard but stands in relation to alternative tools of measurement and performance management through its global success, due to several methodological features.

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## The Living Logical System Paradigm (SLV) – Economic Process and Economic Subject

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### Abstract

*The Paradigm of the Living Logical System (LLS) puts into debate the logical and ontological bases of the orthodox economic models concerning the knowledge of the economic processes.*

*The restraining of the living logical system concept operates with a series of new concepts concerning the subject.*

*Within the current material we attempt to define the concept of economic process, and to define the concept of economic subject. Aside from this endeavor we also consider to define the following concept: cultural process, social process, process of the economic organization, cultural subject, social subject, institutionalized subject. The definition of these concepts is necessary within the required framework of the LLS.*

**Key words:** living logical system, economic process, economic subject

**J.E.L. Classification:** B41, B52

### 1. Introduction

The restraining of the *Living Logical System* concept operates with a whole series of new concepts in defining the species of this genre.

The objective of this paper is to define the following concepts: *cultural subject, social subject, economic subject, institutionalized subject*, with the purpose of increasing the comprehensibility of our endeavor within the paradigmatic framework of the Living Logical System.

Together with this desire, we believe that it is necessary to define the following concepts: *cultural process, social process,*

*economic process and the process of the economic organization.*

This approach of the categories of subjects correlated with the categories of processes generated by them is justified because the action subject is the cause for the process (the action subject is the cause, and the process is the effect). In this term of ideas, to speak about the cause of an effect without knowing the effect does not make logical sense and it is precisely because of this that we will treat our subject as such.

### 2. About the process and act

In his paper *Economic Studies – Logical, epistemological and methodological analysis contributions* (Dinga, 2009) we are made attentive to the fact that between process and act there is no qualitative difference. In other words, both the process and the act are produced within a time frame and as a result the usual definition of the process, ergo the temporal development (evolution) is associated with an act, seems to lack perseverance. This happens because it is introduced within the act, as a specific difference, a property which is not at all specific, because it is found in a process (we speak about the temporal dimension). As a result of this, one mentions that, from the logical perspective, *this is an act or equivalent process.*

Note: *In the following, in order to illustrate the concept of process we use the concept of act.*

**3. Definitions: act (process), social act (social process), economic act (economic process), act of the economic**

### **organization (process of the economic organization).**

Let us try to identify the proximal genre of the social (social process). We believe that this could be the action of a cultural subject (which possesses conscience). Through cultural subject we understand any entity from the universe which has this characteristic (even if it is conscience). For now, *the human being* is the only being we know which has conscience, meaning that it is a *cultural subject*.

*The action of the cultural subject* (the action of the human being) *refers to any act* (or activity, defined as a convergent ensemble of acts) *which have the human being as a subject*.

One can observe, concerning the proximal genre, thus characterized, several important aspects (Dinga, 2009):

- *Is not relevant to the nature of the act:* it can be an intervention/modification, an act of reflection, of imagination, an act of moral positioning, etc;
- *Is not relevant to the object of the act:* the act can be exercised on any entity, be it external or internal to the subject;
- *The structure of the action subject is irrelevant:* the subject of the action is the human being, individual or aggregate;
- *The act is of cultural origins:* it represents the exteriorization of an intention.

#### *The definition of the act (the cultural process)*

On the basis of the aspects presented above, we believe that we can conclude on the act (cultural process) as follows: *the act is that which involves the intervention/modification, reflection, moral positioning, etc. of the cultural subject (the human being) in its environment.*

#### *Obs.*

- *As the subject of the act is the cultural subject, the act is of cultural origins;*
- *Through the change of the cultural subject we understand it's internal and environment.*

In the following, in order to obtain the definition of the social act, ergo for the identification of the specific difference of the social in relation with the proximal genre, we will do as such: we will try to identify the sufficient predicates of this species.

In fact, looking for the specific difference mean the particularization of the common established in defining the proximal genre. We have though, the following distinctions:

- *The social act refers to the intervention of the subject of the act* within a society and / or nature; in other words, the act of social type realizes (or tries to realize) a modification within the society and/or nature, in its broader sense;
- *Is relevant in the structure of the action subject:* the action subject is the social subject;

#### *Defining the social act (the social process)*

Based on the above, we believe that we can conclude on the social act (social process) or the social, as a phenomenon attribute, as such: *the social act is that attribute of an act which implies the intervention of the social subject in society and/or nature.*

We believe the proximal genre of the economic act is the social act.

In the following, in order to obtain the definition of the economic act, ergo for the identification of the specific difference of the economic in relation with the proximal genre, we will do as such: we will try to identify the sufficient predicates of this species.

In our opinion there are two sufficient attributes:

- *The economic act refers to the intervention of the subject of the act* within a society and / or nature; in other words, the act of economic type realizes (or tries to realize) a modification within nature, in its broader sense;
- *Is relevant in the structure of the action subject:* the action subject is the economic subject;

#### *Defining the economic act (the economic process)*

Based on the above, we believe that we can conclude on the economic act (economic process) or the economic, as a phenomenon attribute, as such: *the economic act is that attribute of an act which implies the intervention of the economic subject in society and/or nature.*

We believe the proximal genre of the economic organization is the economic act.

In the following, in order to obtain the definition of the economic organization, ergo for the identification of the specific difference of the economic organization in relation with the proximal genre, we will do as such: we will try to identify the sufficient predicates of this species.

In our opinion there is one sufficient attribute:

- *Is relevant in the structure of the action subject:* the action subject is the institutionalized subject.

*The definition of the act of the economic organization (the process of the economic organization)*

On the basis of the above, we believe that we can conclude on the act of the economic organization (the process of the economic organization) or economic organization, as an attribute of the phenomenon, as such: *the act of the economic organization is that attribute of the economic act which involves the intervention of the institutionalized subject in nature.*

#### **4. Definitions: cultural subject, social subject, economic subject, institutionalized subject.**

Several notations:

- The act represents the exteriorization of the intention of the action subject and takes the form of an effect of the cause;
- The cultural subject (human being) is the cause of the act;
- The social subject is the cause of the social act;
- The economic subject is the cause of the economic act;

- The institutionalized subject is the cause of the act of the economic organization.

*The definition of the cultural subject (human being)*

In our opinion, the cultural subject has the following sufficient attributes:

- *Has a dissipative character;*
- *Has a conscience;*
- *Has a cultural purpose;*
- *Is theoretical and practical;*
- *Is contingent.*

*Axiom:*

- *The cultural purpose is to realize the entropic exchange with the internal and external environment.*

*The cultural subject represents that action subject which satisfies the sufficient attributes above.*

*The definition of the social subject*

We consider that the proximal genre of the social subject is the cultural subject.

In order to obtain the definition of the social subject, thus to identify the specific difference of the social subject in relation with the proximal genre, we will try to identify the sufficient attributes of this species.

The sufficient attributes are:

- *It is a cultural subject;*
- *It is multiple or composed;*
- *It is practical;*
- *It has social purpose.*

*Axiom:*

- *The social purpose is the realization of the entropic exchange with society and/or nature.*

*The social subject represents the subject of the action which satisfies the sufficient attributes above.*

*The definition of the economic subject*

We consider that the proximal genre of the economic subject is the social subject.

In order to obtain the definition of the economic subject, thus to identify the specific difference of the economic subject in relation with the proximal genre, we will try to identify the sufficient attributes of this species.

The sufficient attributes are:

- *It is a social subject;*
- *It has an economic purpose;*

Axiom:

- *The economic purpose is the realization of entropic exchange with nature.*

*The economic subject represents the subject of the action which satisfies the sufficient attributes mentioned above.*

The definition of the institutionalized subject

We consider that the proximal genre of the institutionalized subject is the economic subject.

In order to obtain the definition of the institutionalized subject, thus to identify the specific difference of the institutionalized subject in relation with the proximal genre, we will try to identify the sufficient attributes of this species.

The sufficient attributes are:

- *It is an economic subject;*
- *It has an organizational purpose.*

Axiom:

- *The organizational purpose is the realization of entropic exchange with nature.*

*The institutionalized subject represents the subject of the action which satisfies the sufficient attributes mentioned above.*

## 5. Conclusions:

The definition of the economic process:

*The economic process (the economic) is that attribute of a social process which involves the intervention of the economic subject in nature.*

The definition of the economic subject:

*The economic subject is a social subject which has an economic purpose.*

Axiom:

*Economic purpose is the realization of entropic exchange with nature.*

Consequence:

*The economic process (the economic) is that attribute of a social process which involves the intervention of the social subject in nature, with the purpose of the realization of the entropic exchange between these and nature.*

## 6. Acknowledgement

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## Using BPMN in Modelling the Trading Process

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### Abstract

*The worldwide concerns regarding safety and counterfeit products conduct to new rules and regulation on the worldwide trading market. Customs are setting short accepted delays, situation that creates a higher need of paperless trading. This is why an improved process and software tight relation accross the different roles in a trading chain (customer, supplier, Customs etc.) is needed. The first step in assesing the objective consists in process modelling. The present reasearch paper represents a guide for creating a business process model and it is based on using BPMN (Business Process Modelling Notation) for modelling all types of flows (physical, financial, information, documentary flows). By using BPMN, business patterns for the international trading are proposed.*

**Keywords:** BPMN, supply chain, Model Driven Architecture

**JEL Classification:** M210

### 1. Introduction

The information exchanges between the different actors from an international trading environment (suppliers, customers, importers etc.) have increased. It is very important for them as, for example, the time lost during container transport due to waiting for documents generates capital cost. Additionally, Customs play an important role in national economy: companies will remain domiciled in the country concerned if there are easy administrative procedures for them; otherwise, they will move to another country. This is something very important since some

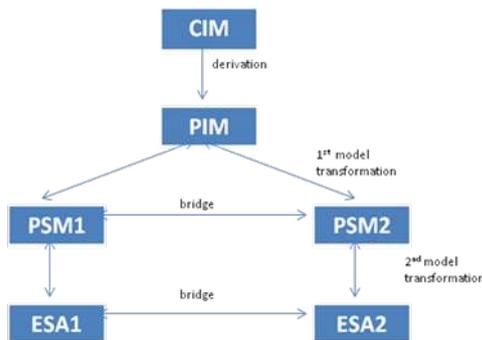
of the taxes collected come back to the country where the firm is domiciled. Another aspect is the evolution of the Customs regulations in order to ensure safety of exchanges and to fight against terrorism, or counterfeiting products. These are the reasons for which the interest for paperless trading is growing faster.

The problems appear between the information systems of the different actors. A model driven approach beginning with company modelling is recommended [2]; this approach is based on MDA (Model Driven Architecture), a development process that is based on several levels (Fig 1): CIM (Computation Independent Model) that models an organization, PIM (Platform Independent Model) that models the subset of the organization that will be concerned by the software development, and the PSM (Platform Specific Model) that takes into account the specificities of the development environment. The last level is the ESA (Enterprise Software Application). The logic of MDA is to allow automatic model transformations between the PIM and PSM levels and also between PSM and ESA levels.

This reasearch focuses on modelling the process at CIM level. In the second part of this paper the architectures, methods and formalisms in the domain of enterprise modelling are shortly presented. In part 3, a pragmatic guideline to generate successfully the business process model with BPMN is presented, taking into account all types of flows (information, documents, physical flows, financial flows) spread between the different stakeholders of trading; this guideline uses business pattern designed specifically for international trading purposes. An example illustrating the exchange between a commercial company

and one of its partners is presented in part 4 and finally part 5 concludes and gives some perspectives related to future works.

Fig 1. MDA process in 4 levels



## 2. Architectures, methods and formalisms

Modelling the company processes can be seen as an prerequisite in achieving integration; it can also help to solve interoperability problems beginning with a higher level of abstraction than code. Vernadat [3] defines it as the art of externalising company knowledge and know-how, which represents the company in terms of its organisation and functions (activities, information, resources and organisation units, system infrastructure and architecture).

The first objective is to create a rough picture of the existing organisation (“as-is” model) and then to propose evolutions (“to-be” model) to optimise performance of the organisation. Several “to-be” models can be compared, possibly by using simulation tools. Then, the way to go from the “as-is” to the “to-be” organisation has to be prepared, taking into account the problem of change management.

The Object Management Group (OMG) proposed two generic formalisms that provides good guidelines for processes modelling: UML® and BPMN. UML® is basically more software-oriented, while, in practice, a lot of reluctance about UML® can be noticed among non-specialists who are today attracted by BPMN. That is surprising because, for example, an UML® activity diagram seems more understandable than a BPMN diagram. That reality must be taken into account, and BPMN is here chosen at CIM level, even if that will need a subsequent transformation in UML®, which is not detailed in this paper.

The main objective of BPMN is to provide a standard notation that is easily understandable by all business stakeholders and thus independently of the tool used. The basic elements of representation of BPMN are the following: *Flow Objects*: Events, Activities, Gateways; *Connecting Objects*: Sequence Flow, Message Flow, Association; *Swimlanes*: Pool, Lane; *Artifacts*: Data Objects, Group, Annotation.

## 3. Modelling business process using BPMN

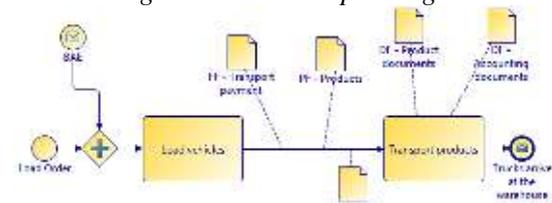
### 3.1 Modelled flows

Modelling a business process consists in defining a set of coordinated tasks or activities, all conducted by people and/or equipment in order to accomplish some desired end-result identified by the company.

Usually, the flows modelled with BPMN are essentially information and documentary flows, which is a pity. To overcome this lack, this proposition aims to represent other flows (physical flows: goods, material, equipment..., financial flows) clearly on the BPMN diagrams. The proposition is to use BPMN as the main and, perhaps, unique model at CIM level for quality management, production management, computerization. Since BPMN has rich graphical elements, it offers several possibilities to represent those flows. The major difficulty lies in the choice of the best alternatives to have understandable models. If one considers two activities in a process that are related to goods moving, the physical flow can be represented using a data object that mentions the type of goods and quantity.

For the documentary and financial flows, the use of a data object is sufficient insofar as it offers the possibility of indicating if this flow is compulsory or not for the start of the activity. These different types of flows are represented on an example of a BPMN diagram in Fig 2.

Fig 2. BPMN example diagram



Source: Modelled with TIBCO Software

The process corresponds to the transport of goods from the quayside to the warehouse where goods will be stocked. For this, two main activities were identified: the first is the activity of loading the trucks and it starts once the message containing the BAE and the load order has arrived. The second activity is the transport and it is completed when trucks arrive at the warehouse.

Different flows appear in this process; the physical flow indicates for example the quantity of goods transported, while the financial flow “Transport payment” and the information flow “Vehicles loaded” indicate that the action of transport cannot start before they have been completed. Two other flow-type documents are connected directly to the activity of transport; these documents must accompany the goods and could be demanded when there is a Customs’ check.

### 3.2 Modelling steps

The main steps proposed to achieve the “as-is” process at CIM level are the following:

**Step 1:** This consists in interviewing the stakeholders in the company in order to identify the main offered services and products, the organization (human resources, hierarchy, roles), the different processes, the customer types, the means to exchange the information, the various actors’ functions and the circuit of decision-making.

**Step 2:** Once the information has been collected, a report is drafted that will be afterwards validated by the stakeholders of the company.

**Step 3:** The aim of this step is to give a first synthetic and global vision to better understand the flows without entering into the detail of who emits and receives them.

**Step 4:** This is a translation in BPMN framework. At this level, the pools will correspond to the internal and external actors of the company. In each pool, lanes will be identified that correspond to the organizational units which are mostly roles or internal departments.

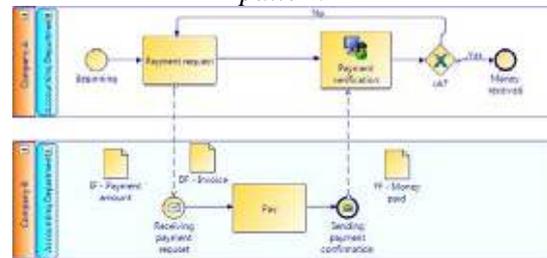
### 3.3 Supply chain business patterns

There are some workflow patterns (like basic control flows, branching patterns, structural patterns, cancellation patterns), that

form practical rules for the correctly using BPMN.

But here the purpose is different: in the supply chain domain there are many similar organisations and flows. This is why building generic models is very important, as they can be adapted to particular problems. A business pattern is a generic description of a business organization part used to produce solutions related to the business itself. Several business patterns have been proposed, for example for “transport payment” (Fig 4), which is described hereafter corresponding to the formalism of representation recommended in this reference [1].

Fig 4. “Transport payment” business pattern



Source: Modelled with TIBCO Software

The pattern of “transport payment” aims to describe the procedure of payment of diverse types of expenses. The pattern can be used in the various cases of expenses payments in the framework of an activity concerning logistics. It can be related to the transportation, storage, Customs declaration, Customs clearance etc.

The process begins when Company A sends the invoice and asks Company B for the payment and indicates the amount of its services that can correspond, in our case, to transportation, storage, Customs declaration. The accounting department of Company B proceeds to the payment and sends the payment confirmation. A verification of the amount paid is carried out by the accounting department of Company A. Once the amount matches what was requested, the process is finished. Otherwise, the accounting dept. will notify and ask for the payment a second time.

### 4. Case study

The case study concerns a Commercial company importing textile products from China, storing these goods in its warehouse

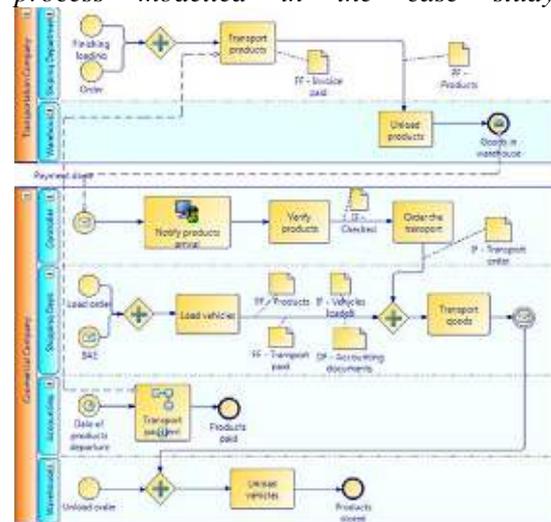
under a specific Customs system allowing it to postpone the payment of taxes and finally dispatching these goods to its own stores. A scenario representing the most frequent cases was chosen, in order to provide a global understanding of the complete supply chain. Once this scenario had been validated, the flows began to be identified with the help of the table as shown in step 3.

In the BPMN model obtained in step 4 (Fig 5), the pools correspond to the actors of the project who are: the transportation company and the commercial company. In each pool, the lanes are represented as follows: for the transportation company: the shipping department and the warehouse and for the commercial company: the controller, the shipping department, the accounting dept. and the warehouse. According to the fixed perimeter, the business process begins at the exit of the goods from the harbor and finishes at the arrival in the store where goods are going to be sold.

Some similar activities were identified when modelling the business process; for example the payment of transport explained previously. In fact, it occurs the first time when paying the maritime transport costs and a second time when paying the Customs taxes. The generic business pattern called “transport payment” has been used to suit the different payments made.

Based on the guideline detailed in this paper, the modelling of a business process has been completed. Once this “as-is” model, in Fig 5, is validated by all the stakeholders of the company, it will be used to establish the “to-be” model (not detailed in this paper) by performing all the necessary modifications. After all, the “to-be” CIM can be derived to obtain the “to-be” PIM as indicated in Figure 1:

Figure 1: Extract from the whole trading process modelled in the case study



Source: Modelled with TIBCO Software

## 5. Conclusions

The company modelling is the first step that has to be made in the Model Driven Interoperability method, at CIM level. This research proposes the use of BPMN whose formalism is enriched in order to take into account all types of flows. In addition, business process patterns have been developed in the framework of the supply chain in international trading.

The additional features given to this BPMN formalism makes it possible to highlight the relations between the process view and the other domain specific views (product, information, document). But, from this process view, all the manipulated flows are presented without any structure. The enrichment with ontologies and/or some UML® diagrams seems to be an interesting topic to be investigated in order to obtain a full description of the system at CIM level. This full description is needed for transforming the models at lower levels (PIM, PSM). The aim of these multiple model transformations is to generate code that can be used for example for Service Oriented Architecture (SOA).

## 6. Acknowledgements

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# The Organizational Change from the Perspective of Neoinstitutionalism

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## Abstract

*In the last couple of decades, there has been a substantial revival of interest in institutional analysis, being outlined three major theoretical paradigms: rational choice new institutionalism, historical new institutionalism and sociological new institutionalism. In the present paper, we focused on the last paradigm mentioned, coming from outside the economic science, from sociology. Why this option? We thought it was inspired from time to time to take a look to others books with the intention to complete our creation. Dominant thesis that emerged from this is that the formal organizational structure is shaped by institutional forces, rational myths, knowledge, and by the legal system. The sociological approaches provide an alternative to the rationalist and individualistic ideas and by essential economic explanation that dominate contemporary theory. The central concept around which our paper is built is the one of institutionalization, meaning the institutional reproduction. Institutionalization was defined as the processes of habitualization, objectification and sedimentation by which a stable pattern achieve cognitive and normative fixity and become taken for granted. Throughout the paper we combined structural perspective and agency perspective to discern the mechanisms by which the institutional change of any kind to mimetic, normative and coercive takes place. Finally, we launched a challenge for future research on the conceptualization / construction of that institutional project focused on values, symbols, myths of sustainability and cooperation.*

**Key words:** Institutions, organizations, institutional entrepreneurship, legitimacy, isomorphism, discursive strategies

**JEL Classification:** A13, D02, D23

## 1. Introduction

Over the past couple of decades, institutional theory has become one of the most prominent theories in organizational analysis. Focused in the 1980s on the mimetic process whereby organizations eventually adopt the same kind of behavior within a field of activity, its emphasis has shifted over the past decade to issues of institutional change and agency.

Institutional theorists assert that the institutional environment can strongly influence the development of formal structures in an organization, often more profoundly than market pressures. Innovative structures that improve technical efficiency in early-adopting organizations are legitimized in the environment. Ultimately these innovations reach a level of legitimization where failure to adopt them is seen as "irrational and negligent. At this point new and existing organizations will adopt the structural form even if the form doesn't improve efficiency.

To study the ongoing and cumulative institutional and organizational change, first we should make a conceptual delimitation between institutions and organizations.

For the institutions the most widely used definition is the one who pithily described them as “rules of the game” [1]. Institutions exhibit both a formal nature (constitutions, rules, regulations, laws, rights) and an informal nature (sanctions, customs, traditions). We can describe them as they are societally determined and govern social, political, cultural and economic exchanges and interactions. The institutions define the range of choices, regulate risk and

uncertainty and determine transaction and production costs and hence the feasibility and profitability of engaging in economic activity. They evolve incrementally, linking the past with the present and future and provide the incentive structure of an economy and set the tone of societal development.

The organizations, on the other hand, are “the players” [1]. They refer to a group or association, formal or informal, in which there are defined and accepted roles, positions and responsibilities structured in some relationship to each other in order to achieve some specific objectives. Organizations exist to secure and advance the interests of their members within a certain institutional framework, while constantly seeking to influence that framework so as to achieve greater advantages and benefits. They are found in all sectors of society – private (family, commercial entities and corporations), civil (associations, membership-based groups) and public (government and its various organs, government-owned enterprises). They are also found at all levels, extending from the micro (family, community, community-based organization) to the mezo (local, regional), to the macro (national) and international level (e.g. United Nations, World Trade Organization, multilateral organization).

Following Douglass North’ view, we see a clear distinction between institutions and organizations, and we realize that is hardly conceivable a play without rules or the rules of the play without the players. So the words ‘institution’ and ‘organization’ cannot be used interchangeably and if it is this often lead to misunderstandings or misguided interventions.

Why is important to be aware about the importance of institutions, or about the institutional theory when studying the organizational change? There are rich series of arguments that emphasize the salience of symbolic systems, cultural scripts, and mental models in shaping institutional effects, but remain somewhat vague with respect to the mechanisms by which culture and history cemented the social order and constrained organizational choices. This is the fertile terrain that was exploited in an interdisciplinary manner by the researcher

that called their program as new organizational institutionalism.

Keeping in line with the main thesis of new organizational institutionalism, our focus is on the way the process of institutionalization takes place and enables some social, economic or cultural patterns achieve normative and cognitive fixity, and become taken for granted by the majority entities from a society. In this respect, firstly we show the „initial formulations” of the new organizational institutionalism and finally the issue of institutional isomorphic change on the organizational level.

## **2. 'The Initial Formulations' of the new organizational institutionalism**

According to Powell and DiMaggio [2] 'the initial formulations' of the new organizational institutionalism belongs to Meyer and Rowan [3], Zucker [4], DiMaggio and Powell [5] and Scott and Meyer [6]. These expositions show continuity with the forerunners, but also a distinct break. To appreciate, in part, the 'neo-' label that is often attached to this tradition, it is useful to recall the dominant lines of sociological theorizing and research on organizations up to the mid-1970s.

Meyer and Rowan [3] drew on Weber's analysis of rational-legal authority in modern economies, and DiMaggio and Powell [5] also start from a Weberian view of rationalism as the major force in industrializing and modernizing societies, and echo Weber's idea of such rationalism becoming an 'iron cage'. This new orientation proposed that formal organizational structure reflected not only technical demands and resource dependencies, but was also shaped by institutional forces, including rational myths, knowledge legitimated through the educational system and by the professions, public opinion, and the law. The core idea that organizations are deeply embedded in social and political environments suggested that organizational practices and structures are often either reflections of or responses to rules, beliefs, and conventions built into the wider environment.

Hence Meyer and Rowan argued that in modern societies, rules about how organizations 'ought' to operate and the kinds of structures they 'should' have arisen from a

variety of sources. Among these, Meyer and Rowan discuss the effects of complex relational networks (interconnections among organizations that facilitate the spread of ideas and understandings), the collective organization of the environment (the rise of powerful states that can pass and enforce mandates that affect organizations), and the leadership of local organizations (non-government organizations that have power and/or legitimacy to promote prescribed organizational arrangements). Organizations experience pressure to conform to these rules in order to maintain their own legitimacy; thus, formal structure, Meyer and Rowan suggest, can be viewed as the result of conformity to such rules or 'myths.'

Like Meyer and Rowan, DiMaggio and Powell argue that the creation of institutional templates serves to drive processes of isomorphism, thus resulting in a high level of structural homogeneity among organizations. Their specification of different sources of isomorphism - mimetic, normative and coercive - elaborated and clarified distinctions pointed to in Meyer and Rowan's work. Perhaps more importantly, their notion of organizational field helped to draw attention to the array of interacting organizations that give rise to, shape and re-shape institutionalized definitions. They define a field as [3, p. 148], 'those organizations that, in the aggregate, constitute a recognized area of institutional life: key suppliers, resource and product consumers, regulatory agencies and other organizations that produce the services or products'.

Zucker [4] considered the phenomenon of institutionalization and conceptualized it as a process by which individual actors transmit what is socially defined as real and, at the same time, as a variable of how much an action can be seen right in a given social reality. This author also defends the position that generally the institutionalization process occurs as a sub-product of the creation of other structures, but that once institutionalized, the structure or activity is maintained without any need for further actions.

We hold the belief that institutionalization is a compulsory process that forces social structures to become assimilated to other structures who are facing the same

challenges, an idea that will be explored under the denomination of isomorphism.

### **3. Legitimacy and isomorphism. The Mechanism of Institutional Isomorphic Change**

In order to enable the understanding of the gradual institutional change within the organizational environment we consider here the three stages of the institutionalization process proposed by Tolbert and Zucker [7]:

1. Pre-institutional / Habituation – Includes the innovations and changes made in response to specific organizational problems that results in structures at the pre-institutionalization stage, limited in terms of operation and, generally, not permanent. Takes into consideration the solutions adopted in other organizations with the possibility of the occurrence of mimetic behaviour.

2. Semi-institutional / Objectification – Consists of the development of social consensus between decision makers in the organization on the value of the structure from obtaining and analyzing information and its dissemination in other organizations of the same field (interorganizational monitoring), implying the diffusion of the structure. At this stage, the leaders (defenders of change) play an important role, carrying out the tasks of theorizing that aim to attribute general cognitive and normative legitimacy.

3. Full institutionalization / Sedimentation – Is characterized by the virtually complete propagation of its structures for the whole group of theorized actors as suitable adopters and the perpetuation of structures for a considerably long period of time.

These sequential stages of the institutionalization process leads us to a factor that is closely linked to it, respectively legitimacy which can be defined as a generalized perception or supposition that actions of an entity are desired or suitable within some system of norms, values, beliefs and socially constructed definitions [8]. Generally legitimacy is a product of institutionalization or contributes to it, but in some cases it is not connected to it, seeing that illegal elements may be institutionalized such as corruption, fraud and organized crime without being legitimized.

According to Scott [9], legitimacy was primarily recognized as being centrally important in social life by Weber, who identified its sources in tradition, charisma and rational-legal devices. Also according to Pfeffer [10] reaffirmed the idea of legitimacy and adaptation of organizational goals to social values. In the search for legitimacy and social acceptance, organizations seek to make their actions, structures and practices become closer to the patterns held to be socially correct [9]. This conformity, for organizations, would be more efficient in the sense of guaranteeing their survival through improvement and recognition by society than performance itself, the reason why it is utilized in turbulent and risky times.

Suchman [8] proposes the following interrelated typology of legitimacy:

1. Pragmatic legitimacy – Based on the interests of the actors who are more closely linked to the structure or policy;

2. Moral legitimacy – Reflects a positive assessment of the organization and its activities, based on the socially constructed values;

3. Cognitive legitimacy – Considering that the acceptance of the structure is inevitable from the point of the determined cultural framework. The actors no longer imagine its non-existence.

Also according to Suchman [8], the three types of legitimacy co-exist in most of scenarios and are interrelated. As it moves from pragmatic to cognitive, passing the moral, legitimacy becomes more difficult to obtain and manipulate because the latter two factors depend on a more consistent cultural framework. In some cases, these types are reinforced each other while in the opposite case they come into conflict with each other.

The phenomena of the institutionalization and social legitimacy are deeply influenced by the external and internal factors of the social environment. In order to become a ‘natural’ structure or a ‘right’ policy in Jepperson’s terms [11], there is a need for all segments of the structure to become homogenized. DiMaggio and Powell [5] emphasized that, ‘once a field becomes well-established there is an inexorable push towards homogenization’.

‘Isomorphism’ – is the most suitable concept that explains the homogenization process. It is fundamentally a term deriving

from abstract algebra. Isomorphism encompasses the mapping between complex structures where the two structures contain equal parts, and is a constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions’ [5]. The institutionalized legitimacy can be ensured only by the socially acceptable isomorphic structures and policies. DiMaggio and Powell [5] identified three institutional isomorphic processes:

1. Coercive isomorphism – It is a process caused by the formal and informal pressures and influences made on the organizations by other stakeholders upon which these organizations are dependent. In addition, organizations are deeply influenced by the cultural expectations of the society within which they should function. The pressure can appear in a form of force, persuasion or invitation. A good example of coercive isomorphism is the establishment of education standards for the secondary and high schools. The imposition of a mandate by the government may oblige schools to establish certain steps to conform to set standards.

2. Mimetic isomorphism – ‘Uncertainty is also a powerful force that encourages imitation’ [5]. The ambiguity of goals, symbolic uncertainty set by the social environment, success of other structures may cause the mimetism (modeling) of organizations to established ones. The mimetic process is not always intentional. The organization may not even be aware that it is modeling other more successful or socially acceptable structures.

3. Normative isomorphism – It primarily stems from a professionalization. Due to the internal and external competition, members of one profession may collectively struggle to define the requirements a person should possess to ‘join their club’.

The institutional isomorphic change on the organizational level is greater when the presence of some predictors can be recognized. In practice, these predictors may be: The more dependent on another organization, the more alike it will become; The greater the centralization of resource supply, the more it will change to resemble the organizations it is dependent upon; The more uncertainty the more an organization

will model its structure after successful firms; The more ambiguous the goals, the more an organization will mimic a successful one to establish legitimacy ; The greater the reliance in using academic credentials to choose staff, the greater will be similar to other organizations.

In the present paper we envisaged the organizational change like a process that reveals 'natural' structure or a 'right' policy and take place gradually. Looking to the real life we inexorably reach to some questions: Who are the actors that drive the whole process? Are those actors acting as catalysts for structural change and giving direction to change? Answers to these questions can be identified in an extension of the present work which capitalizes on the concept of institutional entrepreneurship.

#### 4. Conclusions

Organizational change from the perspective of institutional theory is both a matter of innovation, design and construction on an existing base by developing alternative or additional structures, value systems, and symbols. Change is happening very slowly but at the same time, it is seen as possible and likely when not involving complete replacement of an institution with another institution, with very different values. Especially when it is driven by key actors, the change is not unidirectional, occurring amid endless succession of processes of institutionalization, de-institutionalization followed subsequently by re-institutionalization.

Actors have the power of "agenda setting" and to set priority to issues submitted for discussion. However, preferences are rooted in rational behaviour, identity, roles, they are not autonomous and therefore are not autonomous from the social context in which they occur. This statement highlights the fact unequivocal: from the emergence of future discussion topics on the agenda until the sedimentation of institutional arrangements is a very long way. At the end of the paper we invite the reader to recall the stages of the processes of institutionalization (followed / preceded by deinstitutionalization and re-institutionalization) intended to give an overview of the institutional changes needed to occur at the organizational level to

transform into reality the goal of sustainability and to achieve the replacement of competitive mentality with the one based on cooperation.

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## Determinants of Internal Migration in Romania: A Microeconomic Analysis Using a Social Survey

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### Abstract

*Internal migration is appreciated in the literature at national, regional or individual level. This paper focuses on the micro level and uses as main tool a social survey in order to determine the main determinants of this phenomenon within Romanian borders.*

*Data for this preliminary study was collected using an online questionnaire addressed to members belonging to different working or educational entities. The survey comprises questions related to various aspects investigated on the existing literature and also some final questions related to the personal experience of the respondents.*

*The main results confirm some of the previous findings, such as married people, with dependents, aged 50+, employed, homeowners, etc. are relatively less willing to migrate. Further, the physic costs of moving are more important than the money costs, physical distance is viewed as a factor with a moderate impact and contracted migration overwhelmingly dominates the speculative type.*

**Keywords:** migration, determinants, social survey, Romania, SPSS.

**J.E.L. Codes:** R23, C80

### 1. Introduction

Migration is a means to improve the allocation of human resources and, along with education and training, is a form of investment in human capital.

Either internal or external, this phenomenon is of great importance nowadays due to two main perspectives: its factors of motivation and its consequences in the economy. Its determinants can be both objective and subjective whereas its main consequence reflects on the evolution of

regional disparities. Moreover, migration can be affected by regional disparities and, in turn, regional disparities can affect migration, i.e. generating a causal relationship.

This paper employs a **non-probabilistic quantitative investigation approach** with the main objective to establish what motivates Romanian people to change residence within national borders. Data collection was carried out using a web questionnaire, during the period August 12, 2011 – February 5, 2012 and included a total of 251 volunteer respondents.

The main features of this research technique are:

- the sample used is not representative (small number of respondents);
- I do not need a sampling frame;
- I cannot compute the sampling error;
- I use a circumstantial sampling formed by volunteers.

The remainder of the paper is structured as follows: section 2 makes a review of the existing literature on the main determinants of internal migration in order to offer valid arguments for my study, section 3 performs a general presentation of the social survey, mainly the variables employed, while section 4 carries out a comprehensive analysis of the collected data; finally, section 5 offers an advance on further research.

### 2. Theoretical background on internal migration

Migration can take two forms: *speculative migration* and *contracted migration*. The former consists in searching for a job in another place, while the latter is provoked by already finding a job in another place (Silvers, 1977). Molho (1986) considers that speculative migration is part of the job-search process whereas contracted migration is the result of this process.

Etzo (2008) considers temporary and

permanent migration. *Temporary migration* implies commuting from one place to another whereas *permanent migration* implies changing address to another residence. Longer moves take place mainly for job-related reasons whilst shorter moves take place mainly for family reasons (Korkiasaari, 1991 in Nivalainen, 2004).

Sjaastad (1962) divided the private costs of migration into two categories: *money costs* (expenses of movement, food, lodging, transportation, etc.) and *non-money costs* (foregone earnings and psychic costs of changing environment). Money costs are very difficult to know, unless micro data is available or certain distances are given. Non-money costs can be broken into *opportunity costs* and *psychic costs*. The former costs represent foregone earnings while travelling, searching for and learning a new job. Additionally, one should not ignore time spent during these activities. The latter costs, very difficult to estimate, arise from leaving familiar surroundings, family and friends, and from uncertainty.

The **gravity models of migration** include as main variables the physical distance and the population size. The former impact negatively on migration as costs and distance go hand in hand. The latter affects positively on migration as regions with large populations experience both high in-migration and high out-migration.

According to the neoclassical approach, migration decreased with age and increases with educational attainment. Elder people find it more difficult to migrate because of higher costs of moving, especially psychic costs, and shorter periods of enjoying the benefits. Moreover, younger people migrate more because they have a longer period over which they can benefit from the returns to migration investment, i.e. an increase in net gains. Highly-educated people have more possibilities to find job throughout the national territory as they possess a higher capacity to assess opportunities in different labor markets (Borjas, 2000) and their human capital is easier to transfer to distance places (Shields and Shields, 1993).

Persons that have a house in their own property are less eager to migrate as this change implies selling or renting it. The same lower incentive to migrate is specific to those persons that have dependents or are married.

**Wages and migration.** If wages in a certain region rise, the gain from moving into that region increases whereas the gain from moving out of the region decreases, thus in-migration is favored while out-migration is disfavored by a rise in wages (Parikh and Van Leuvensteijn, 2002).

**(Un)employment and migration.** The employed migrate less than the unpaid unemployed, while paid unemployed constitute an uncertain category. Any rise in the unemployment value (e.g., an increase in unemployment benefits) or the employment value (e.g., a reduction in wages) dissuades migration and boosts unemployment (Dohmen, 2005). In general, the unemployed migrate more as they bear lower costs compared with the employed.

Borjas (2008) distinguishes between tied mover and tied stayer when referring to family migration. *Tied stayer* is that family member who sacrifices better employment opportunities in another place because his/her partner is better off in the current location. *Tied mover* is that member who accompanies his/her partner in spite of her/his better opportunities in the current residence.

DaVanzo (1978) demonstrated that: families whose heads are unemployed or looking for work are more prone to migrate than those whose heads are employed or do not search for another job; and among job-searchers, the unemployed migrate more because of lower opportunity costs of moving, less job-specific capital and a greater responsiveness to opportunities elsewhere. Also, recent migrants are more sensitive to migration because they should have more information about job opportunities and a greater capacity of acquiring it, i.e. learning-by-doing effect. Hence, recent migrants are also “eligible” to repeat migration.

Among households, the most eager to migrate are young families with no children.

### 3. Presentation of social survey

The social survey carried out comprises 25 questions related to:

- personal characteristics (first 6): age, sex, marital status, educational level, homeownership, and number of dependents;
- labor market condition (next 7): labor

- market status (employee/ unemployed/ self-employed/ inactive or student), length of experience, job satisfaction, intention to change job, unemployment allowance and duration of unemployment;
- financial satisfaction (1);
  - where to migrate (1): inside the country, or outside, don't want to move or undecided;
  - internal migration issues (next 10):
- availability of professional reconversion and / or residence change,
  - importance level given to physical distance between actual residence and possible future residence,
  - importance level given to monetary and psychic costs of moving,
  - choosing between contracted migration and speculative migration,
  - the three most important criteria appreciated in the possible new location, to choose between regional differences in average gain, unemployment rate, employment rate, vacancies, house prices (including rent), relative amenities (business environment, local taxes, public services, recreation activities, infrastructure, climatic conditions, pollution, etc.), personal and family situation, or other;
  - to choose between being tied mover or tied stayer or none,
  - residence change real experience: alone or with the family? and why?, for studies, for employment or other reason, was the move a good decision and why or why not?; if not, what was decided?.

The entire questionnaire is available at [https://docs.google.com/spreadsheets/viewform?hl=en\\_US&formkey=dHRLMzAydFJwSWg0YVYJxdWE0VDhQQIE6MQ](https://docs.google.com/spreadsheets/viewform?hl=en_US&formkey=dHRLMzAydFJwSWg0YVYJxdWE0VDhQQIE6MQ).

#### 4. Data analysis in SPSS

The majority of respondents are 20-29 year-old (59%), unmarried (59.8%), women (79.7%), have at least a university degree (97.6%), do not have a house in their ownership (53.4%), do not have dependents (69.3%), are employees (74.9%), work in the services sector (45%), have more than a 5-

year experience (44.2%), are satisfied with their current job (56.6%) and are not willing to change it (48.6%), 63.7% are relatively happy with their financial situation, 56.6% are willing to reconvert professionally and also to change their place of residence, 40.6% give a moderate importance to the physical distance between the current residence and another possible residence, 56.2% consider more important the psychic costs of moving than the monetary ones and an astonished percentage of 95.2% would migrate only if they find a job beforehand.

Moreover, 40.6% give a good appraisal to the regional differences in average gain as a key issue in the migration decision, 59.4% are in favor of differences in relative amenities whereas 61% base their decisions on their personal and familial circumstances. Unless the financial situation worsens, 86.9% and 81.3% of the volunteers would accept to be tied movers and, respectively, tied stayers.

As for the migration experience, 31.5% of respondents have never migrated, 47% have migrated for studies, 15.1% for employment issues and 10% have followed their family. As for those who migrated at least once, 74.9% argued that the benefits have arisen as time went on, 16.8% immediately and the rest consider migration as a bad decision in which they did not accomplish their purposes and/or incurred high costs (8.4%). Moreover, these last individuals who were not satisfied with their decision said that 77% of them continued to live in the same place, 19.7% decided to move to a new place whereas only 3.3% returned to their home residence.

At the question *Where to move?*, 45% of respondents would choose to go abroad, 28.3% do not want to migrate for the moment, 14.7% were undecided whether to move and/or where, and only 12% would choose an internal destination.

Because those who are unemployed or those who have only a primary and secondary education degrees represent each only 2.4% (6) of all respondents, I decided to ignore them and treat them as lost entities in order to optimize more my analysis.

15.7% of men and 11% of women would make an internal change of residence, whereas 49% of men and 44% of women would go abroad. Further, 26.7% of possible domestic migrants are men and 73.3%

women.

Table 1 is a contingency table which shows the percentage distribution of respondents according to their migration preferences, sex and age group. Thus, 37.5% of men opting for internal migration are aged 20-29, another 37.5% are aged 30-39, 12.5% are 40-49 year-old and another 12.5% are 50 year-old or older. Similarly for internal migrant women, 72.7% are aged 20-29, 18.2% 30-39, 9.1% 40-49 and none is 50 or older. Overall, 63.3% of total possible internal migrants are aged 20-29, 23.3% 30-39, 10 40-49, and 3.3% 50 and more. Instead, 15.8% of people aged 20-29 opting for internal migration are males and 84.2% are females, and so on. For the rest of the table, interpretations are similar.

Table 1. Contingency between to decision to migrate, sex and age groups

Destination	Sex	Age group			
		20-29	30-39	40-49	≥ 50
Internal	Male	37.5	37.5	12.5	12.5
		15.8	42.9	33.3	100
	Female	72.7	18.2	9.1	0
		84.2	57.1	66.7	0
	Total	63.3	23.3	10.0	3.3
		100	100	100	100
External	Male	48.0	20.0	24.0	8.0
		18.2	16.1	54.5	40.0
	Female	61.4	29.5	5.7	3.4
		81.8	83.9	45.5	60.0
	Total	58.4	27.4	9.7	4.4
		100	100	100	100
No move	Male	38.5	30.8	23.1	7.7
		13.2	20.0	27.3	50.0
	Female	56.9	27.6	13.8	1.7
		86.8	80.0	72.7	50.0
	Total	53.5	28.2	15.5	2.8
		100	100	100	100

Source: Own elaboration based on SPSS results

Table 2 is another table of contingency which relates the migration preferences with the marital and the homeownership status of the respondents. Thus, 66.7% of married respondents with at least one house in their

ownership would migrate to another national residence or 75% of total homeowners are married people who would make an internal move. Additionally, only 9.5% of single/divorced/widow with a house would migrate internally and an overall percentage of 73.3% of all respondents would change residence within the country. Instead when considering an external move, percentages of married homeowners fall by 2.1 p.p., of single+homeowners increase at 36.9% and of overall homeowners goes from 26.7% to 48.7%. If I consider the category of non-migrants, I observe a percentage of 81.3% for married homeowners, 38.5% for single+ homeowners and 57.7% overall. Therefore, I can draw the following conclusions: the majority of married migrants are homeowners while the majority of single/divorced/widow migrants are not.

Table 2. Contingency between the decision to migrate, marital and homeownership status

Destination	Marital status	Homeownership	
		Yes	No
Internal	Married	66.7	33.3
		75.0	13.6
	Single, divorced, widow	9.5	90.5
		25.0	86.4
	Total	26.7	73.3
		100	100
External	Married	64.6	35.4
		56.4	29.3
	Single, divorced, widow	36.9	63.1
		43.6	70.7
	Total	48.7	51.3
		100	100
No move	Married	81.3	18.8
		63.4	20.0
	Single, divorced, widow	38.5	61.5
		36.6	80.0
	Total	57.7	42.3
		100	100

Source: Own elaboration based on SPSS results

From table 3 I want to see what type of migration does people prefer according to their age and sex. Hence, 91.3% of men aged

20-29 opt for contracted migration and only 8.7% for the other one. The same holds for the other age groups except for the eldest one who prefer in its entirety the first form of migration. To note that females, no matter their age, are more firmly decided to migrate only with a job in hand. Additionally, 14.9% of “contracted” migrants are men aged 20-29 and 85.1% are women; 19.4% are men aged 30-39 and 80.6% are women and so on.

Table 3. Contingency between migration type, age and sex

-percentage-

Age	Sex	Migration type	
		Contracted	Speculative
20-29	Male	91.3	8.7
	Female	96.0	4.0
30-39	Male	92.3	7.7
	Female	19.4	33.3
40-49	Male	96.2	3.8
	Female	80.6	66.7
50 and more	Male	90.9	9.1
	Female	38.5	50.0
50 and more	Male	94.1	5.9
	Female	61.5	50.0
50 and more	Male	100	-
	Female	40	-
50 and more	Male	100	-
	Female	60	-

Source: Own elaboration based on SPSS results

When putting together the educational level and the appraisal to physical distance, 50% of the lower-educated respondents give a great importance to distance, while 16.7% consider it rather insignificant; instead, 37.1% of highly-educated respondents consider distance as having a reduced importance and only 22% exhibit a high interest. Thus, educated people do not see distance as a major barrier when evaluating their territorial mobility.

Table 4 links the working experience with the type of migration, contracted or speculative. Thus, 10.8% of respondents that would migrate only with a job in hand have less than 1-year experience, 40.1% have 1 to 5-year experience and 49.1% have more than a 5-year experience. Instead, those people with less than 1 year of experience prefer in their great majority to migrate only after getting a job (92%); the percentages are even higher for the other categories of experience,

e.g. 96.6% for those with less than a 5-year experience. The same hierarchy holds for “speculative” migrants.

Table 4. Contingency according to the type of migration and experience

-percentage-

Migration	Experience in the current activity		
	< 1 year	1 - 5 years	> 5 years
Contracted	10.8	40.1	49.1
Speculative	92.0	96.6	93.7
Total	16.7	25.0	58.3
	8.0	3.4	6.3
Total	11.2	39.3	49.6
	100	100	100

Source: Own elaboration based on SPSS results

Table 5 puts together the desire to change the current job and the availability to reconvert professionally and/or change residence. Thus, 61% of those who plan to change their job in the near future are open to both professional reconversion and residence change. 50.8% of respondents with double availability plan to change their current job while 49.2% refuse to do it. Additionally, 12.5% of those who reject both options plan to change their job while 87.5% want to keep it. Overall, it seems that people are indeed quite mobile both professionally and territorially.

Table 5. Contingency between job change and willingness to reconvert professionally or change residence

-percentage-

Job change?	Professional reconversion or residence change			
	Only to reconvert	Only to change residence	Both	None
Yes	18.0	17.0	61.0	4.0
No	51.4	48.6	50.8	12.5
Total	13.9	14.8	48.4	23.0
	48.6	51.4	49.2	87.5
Total	15.8	15.8	54.1	14.4
	100	100	100	100

Source: Own elaboration based on SPSS results

Table 6 compares job change and financial satisfaction. Thus, 43% of those who want to change job are unsatisfied with their financial status, 55% are more or less satisfied whereas only 2% are very satisfied. 60.6% of total unsatisfied plan to change their job next year while 39.4 do not. For respondents rather happy with their condition (first two groups),

the ratio is in favor of no job change.

Table 6. Contingency between job change and financial satisfaction

Job change?	Financial satisfaction		
	Very satisfied	Relatively satisfied	Unsatisfied
Yes	2.0	55.0	43.0
	22.2	38.7	60.6
No	5.7	71.3	23.0
	77.8	61.3	39.4
Total	4.1	64.0	32.0
	100	100	100

Source: Own elaboration based on SPSS results

Last table, 7, I can observe that employees who want to reconvert professionally and also to change residence represent a proportion of 55.9% and those who refuse both options are 14.4%. From all volunteers choosing only the professional change 81.1% are employees, 10.8% are self-employed, and 5.4% are inactive. For all categories, the availability to make both changes is superior to all the others.

Table 7. Contingency between labor market status and willingness to reconvert professionally or change residence

Labor market status	Professional reconversion or residence change			
	Only to reconvert	Only to change residence	Both	None
Employee	16.0	13.8	55.9	14.4
	81.1	68.4	73.9	79.4
Self-employed	13.8	27.6	44.8	13.8
	10.8	21.1	9.2	11.8
Inactive/student	7.1	10.7	71.4	10.7
	5.4	7.9	14.1	8.8
Total	14.7	15.1	56.6	13.5
	100	100	100	100

Source: Own elaboration based on SPSS results

## 5. Future research

The current study is part of a more complex analysis on internal migration determinants from the microeconomic perspective. Thus, further, I plan to extend my sample size and to amplify the questionnaire length, in order to obtain more representative outcomes.

## 6. Acknowledgment

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# Simulation Modeling Approach in the Research of Tax Influence on Enterprises

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## Abstract

*This thesis is aimed to analyze the indirect taxes' influence on industrial firm's activity. In our country this problem requires a special attention. These taxes have a dominant share of fiscal burden. By-turn, fiscal burden is very important to assess the competitiveness level of inland industrial firms. But the taxing reduction will involve a decrease of national budget revenues. All these determine the opportunity to enhance the state attention on this sector's reformation.*

*Within the thesis, the author has studied the link between indirect taxes and economic units. The author has assessed that the fiscal regime is one of the main factors to enhance the national industry position.*

*In the study there have been suggested new methods to optimize the indirect taxes shares. Also, the author has elaborated as analyze instrument an original model. This model has allowed the prognostication of firms' activity in the environment of indirect tax systems reformation.*

**Key words:** industrial enterprises activity, competitiveness level of inland industrial firms, national budget revenues, optimize the indirect taxes, fiscal policy in the global crisis

**J.E.L. Classification:** H21

## 1. Introduction

The establishment, distribution, perception and the use of taxes are state functions, which guide and coordinate the politics of imposable income establishment and appreciate the influence of these on the results of the activity of

economical agents.

The mathematic concept of tax transposition, from the methodological point of view, is based on the theory of marginal utility of goods, value and prices. For the research of cost formation, of the selling price and the relation of these on the prices of stability, is necessary to take into account the indirect taxes, which modify the end user stability price.

The consumer market where the made goods are being sold, is characterized by two counteragents: the economic object “producer”, who forms quantitative the global supply; and the generalized consumer, who forms the global demand. The increase in solvable demand is determined by the level of income and the value of use of the commercialized good.

The fiscal politic influences actively the rates of the consumer market. On one hand, it modifies the solvable demand through the indirect taxes, on the other hand, it forms the premises of future activity of the economic subjects, depriving them of a part of means for development. In this sense we are to conclusion that the indirect taxes, by the influence of the levels of sales, provoke damage to the enterprise; and direct taxes provoke damage to the problems concerning strategic development.

Taxes influence directly the evolution of reproduction processes, which is the main circuit of capital. Tax influence over the economic activity will be examined from this point of view.

## 2. The main principles of research of tax influence to enterprise behavior.

Theoretic bases for indirect taxation are quite complicated. In the first place, a stability point is to be found between fiscal interests and the

principle of social equity. These taxes are paid by the population, including the poorer social categories, who gain their means of existence from the state's budget. At the same time we have to mention that we do not agree with the opinion that states neutrality of indirect taxes towards economic activity. In conditions of price stability, the application of these taxes leads to the distribution of the potential benefit of the producer, in favor of the state, not to mention the cases, when the application of indirect taxes provokes the overcoming of the stability price.

The results of the research prove that there is a causal connection between the relation of tax distribution and the level of economic development, having established that in the total level of taxes, with the decrease of living standards, the indirect taxation share increases. This rule is common for Moldova and is explained by the fact that direct taxes are much harder to accumulate to the budget. In conformity to some estimations, the share of indirect taxes, in the total of taxes of a developing country is about 60% to 70%, as compared with the developed ones where this share is about 30% to 40%. Taxation systems from foreign countries are based in indirect taxation, considering it a factor of boost to affairs. These conclusions have a larger application in practice, thus the theoretical problem is much more complicated, because in the case of an absolute or partial monopoly, the companies have the possibility to transpose a part of the direct taxes into the end user price, therefore transforming direct taxes into indirect.

In case of an efficient activity, companies, cannot transfer to consumers the recovery of indirect taxes and are forced to cover them from their own revenue. So the change in the level and composition of taxes, as a consequence of a radical tax reform, is felt by the economy, population and enterprises and generated great discrepancies between the proposed goals and the realized ones.

Therefore, the exaggerated tax weight negatively influences supply and demand, and satisfaction of personal and production needs leads to decrease of the population's income and to the increase of the level of poor production. The classical requirement concerning the co

balance between the direct taxation and the indirect one, presumes that of the state prefers indirect taxation, it is obliged to protect the consumer from the negative influence of prices. The analysis of the theory of tax transposition allows to conclusion that the problem of tax weight transfer influences directly the stability of the taxation system.

Thus the main goal is the elaboration of such a regime of imposition, which could ensure an optimal coordination of the interests of all subjects and more precisely: the state, the economic agents and the population. In this sense, in the limits of modeling, we are to demonstrate how the tax level influences the production realization.

For the validation of the model, we are to use the Model enterprise (hypothetical data), thereby, the model proposed contains a generic character and its application to a certain enterprise is a different research. This approach allows determining general algorithms peculiar to this economic phenomenon without any dependence on the specific of the concrete economic object.

Taking into account those exposed, we are to continue to the description of the problem. The influence of taxation on supply and demand, on the market, is manifested through direct and indirect taxes.

Such direct taxes reduce the net profits of economic agents; influence the capacity of these to extend their economic activity. As a consequence, they stop the growth in perspective of the supply. The taxes on individuals reduce the capacity of these to create solvable demand. Respectively, the global demand is reduced. On the other hand, after accumulating the income in the budget, the taxes are redistributed in the form of expenses, which at their turn form the income for the vulnerable social strata in the form of pensions, compensations etc.

Indirect taxes, however, influence directly the structure of the global demand through the increase of the stability price.

### **3. Modeling approach. The case study.**

For the **modeling of the 1<sup>st</sup> factor “solvable supply”** we are going to set up our indicators as follows:

RM – the amount of the good sold at stability price (MDL);  
 RMD – the rate of profit which needs to be invested in development;  
 M – the global supply on the consumer market (units);  
 MS – the solvable supply on the consumer market (units)  
 S – the reproductive expenses in the structure of the unit good (MDL);  
 RIND – the indirect tax rate, balanced to the reproductive costs in the product’s structure;  
 RID – the direct tax rate, balanced to the level of profit. Conforming to the last initiatives of the president of the country, we equal to 0.

At the same time for the **modeling of the 2<sup>nd</sup> factor “solvable demand”** we are to use the following indicators and note them as presented below:

P – the total solvable demand of the consumers;  
 D – the global income of the consumers;  
 RI – the savings tendency, balanced to the global income;  
 MS – the solvable supply on the consumer market (units);  
 PE – the stability price.

Then:

$$P = D \cdot (1 - RI) \quad (1)$$

$$PE = f(M, RIND, P) \quad (2)$$

$$MS = P / (S \cdot RIND \cdot RMD) \quad (3)$$

$$PE = P / MS \quad (4)$$

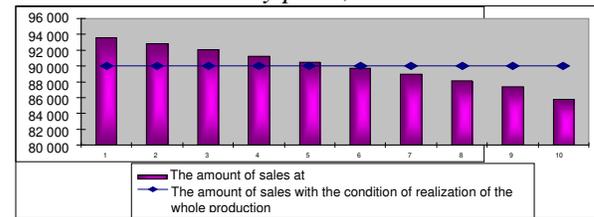
After the modeling of the stability price we return to the initial model. In this certain case, as an output parameter we calculate the commercialization of production by the stability price. From the initial model, we use the level of overall supply and demand.

To determine the influence of the indirect taxes on the realization of goods, we compare the commercialized levels at different rates of the indirect tax. To further increase the accuracy of calculation of the impact of indirect taxes on the company’s profit in the effectuated calculations, we reduce and increase only the rate of the indirect tax, leaving all the rest of the data untouched.

We present an example of calculation of influence of the indirect taxes on the sales of goods at the initial rate of the indirect tax, applying formulas presented earlier. Presuming that the global income of the consumers

constitutes 100000 lei, in the base of the formula (2) has been calculated the stability price with a level of 31.2 lei, in this case the volume of the sales at the stability price was an amount of 93600 lei. In conditions of realization of total production, the price would be 30 lei per unit, and the amount of sales of 90000 lei. By diminishing the indirect tax rate with a percent we obtain the dynamic of the sales volume, which is presented in figure 1.

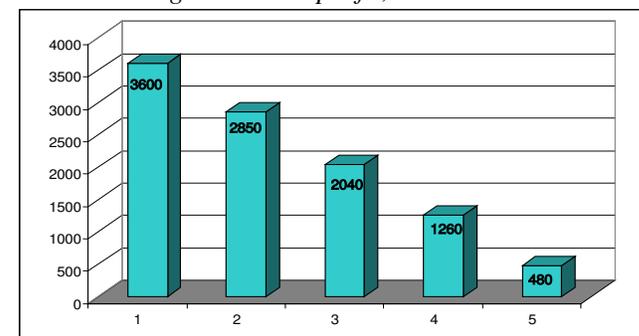
Figure 1. The dynamic of the sales volume at the stability price, in lei



Source: Elaborated by the author

The study of the calculation made and presented in figure 1 attests that the enterprise loses profit until the indirect tax rate doesn’t lower by 5%. Every next point of decrease changes the company’s profit further (the enterprise registers profit). The data presented below, in figure 2, indicate the amount of the lost profit by the economic agent.

Figure 2. Lost profit, in lei



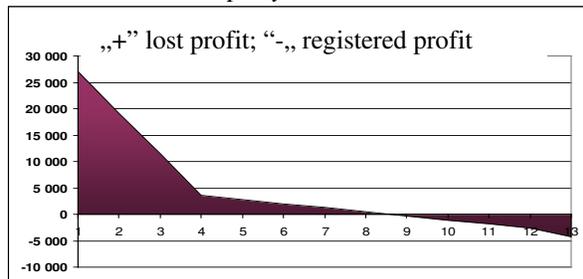
Source: Elaborated by the author

As a result it has been found that the decrease by one percent of the rate of the indirect tax ensures a growth of company’s profit by 780 lei, and every increase of these taxes (by one percent) diminish in the same measure the profit.

Following the calculations made, by the model described earlier, we obtain the results of the influence of indirect taxes over the

enterprise's activity, majoring and lowering the indirect tax rate by one percent. These results were exposed in figure 3.

Figure 3. The influence of indirect taxes on the company's income



Source: Elaborated by the author

#### 4. Conclusion

Summing up the results of the calculation of the elaborated mode, we state that by diminishing the sums paid for indirect taxes, the economic agents have the possibility to invest, supplementary, in the development of their activity larger amounts of money, as a result, obtaining more profit. In our opinion, the reinvestment of this profit will lead to a considerable increase in profitability in case of the investments as much as in material assets (on long term), as in current assets.

As a result of the effectuated research concerning indirect taxes and their effects over the producers, we find that the majority of the prices for the goods, depending on the level of indirect taxes can decrease, under certain conditions, the demand for these goods. As a result it will decrease the level of sales and respectively the level of profit. Thus it will affect the further development of economic agents.

It is necessary to mention that, from the conceptual and economic point of view the

taxation system is a mechanism of insurance for the economic and financial stability, manifesting itself as a donor of financial resources, as an instrument of promoting for the economic policy and as a resource of great force of the public authorities. In our opinion, for the assurance of a good entanglement of economic policies, which will assure the durable development of the state, it is needed an adequate taxation mechanism which would allow the increase in industrial production.

The taxes applied in exaggerated levels deprive economic activity of profits and makes it not worth continuing. The application of high tax rates for indirect taxes not necessary increases the income to the budget. At the same time, when there aren't taken into account the traditions and the way to live of the population in a certain country, the differences in indirect tax rates influence negatively the fiscal incomes.

Taking into account the regressive character of indirect taxes, as well as of its negative effects, which are fully felt by the national producers, we propose a diminishment of fiscal pressure through this type of taxes. A reduction in indirect taxes would fall, as well, into the tendency of harmonization of fiscal law in the Republic of Moldova with the European one.

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# The Limitations of Standard Economical Theory from the Perspective of Development, Sustainability and Rationality in Resource Allocation

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## Abstract

*In this paper we wish to fix and underline the nature, causes and effects of the so called "theoretical limitations" of standard economics related to environment, without losing the focus on the impact – both present and potential – that this may have over the natural and social systems.*

**Key words:** market failure, transaction costs, property rights, development, rationality.

**J.E.L. classification:** B 13, P 14, Q 32, Q 52.

## 1. Introduction

In order not to produce confusion of any type, first we must clarify two important aspects: *the narrow sense* given to the economical science is represented by the standard economics which identifies with the neoclassical school of thought and mainstream economics; the other aspect regards the purely theoretical causal relationship between economy and environment and must be pointed that this is the desired interpretation and not the debates between economists and environmentalists *per se*.

The neoclassical economists adopted, with several exceptions, a general neutral attitude on environmental matters, which has its implications over today's society. The existence of market failures embodied in an inefficient resource allocation together with an incomplete attachment of economic value to some natural resources, may lead to social

and environmental disequilibrium with considerable potential impact over economy, society and last but not least, environment. The main causes results from the existence of significant *transaction costs* together with the difficulties of defining *property rights* in this matter. One of the effects of the existence of market failures is the presence of uncompensated negative *externalities*.

Based on these assumptions we will tackle the subject of the standard economical theory limitations from the perspective of market failures. Thus, in the first part we will focus on the causes, following, in the second part, by a discussion of the derived effects.

## 2. Market failures

Keeping the perspective from which the subject is analysed, the market failure phenomenon emerges when the market fails to attach economic values, present or potential, to environmental goods and services or/and in the case when property rights are not properly defined and assigned to these goods and services, following thus an inefficient resource allocation. The presence of transaction costs, the absence of adequate defined property rights and negative externalities, are some of the factors that fuel the emergence of the phenomenon.

### 2.1 Transaction costs

What kind of role does the transactional costs play and what implications appear by failing to include them in the economic processes? In spite of the fact that there is no consensus regarding the way in which they

should be defined, many authors agree upon the idea that these mean in fact the costs for using the mechanism of the price or the exchange of property rights. They can be transaction costs on the market, associated with the negotiation process, preparation and application of contractual obligations, *management and political* transaction costs. The last two categories include those costs for adjustment and maintenance of the organisations, and accordingly of the institutions [9].

Apart from their classification, we should also mention that the magnitude and typology of the transactional costs depend on the institutional environment [3]. In this respect, the higher the transaction costs become, the more probable it will be that the parties of an exchange will invoke informal restraints for establishing the transaction. In extreme cases, as a consequence of too high costs, it can be considered that the transaction will not take place any more. We understand thus that the extension of the costs determines the exchange volume that means, on a production level, an influence on the output level. “In our real world, transaction costs determine property rights, ownership, the extent of trade, specialisation and productivity. If transaction costs decrease, property rights will be more clearly defined, more goods and services will be traded, the benefits of specialisation will increase, and greater economic gains will be realised” [2].

Consequently the role of the transaction costs is a central one in the discussions regarding the property rights and failing to include them in our equation (zero transaction costs – the neoclassical assumption regarding the transaction of environmental goods) can have undesired consequences, hindering a better definition of the property rights, and from here the emergence of externalities, that perfectly describe the imperfections of the market.

## **2.2 The problem of defining property rights in connection with the environment**

The concept of property rights occupies a central role in economic literature, with a broad spectrum of definitions, classifications and analyses being offered on the subject. From a *judicial* point of view, rights

represent certain social norms through which human relations are established and observed. In other words, the property right gives the owner the right to possess, use and distribute the good thus giving him the freedom to deploy the good with exclusive and absolute rights, however, within the boundaries of the law. On the one hand, society recognises and respects property owned by an individual if s/he legally owns the property rights to that property; on the other hand, the owner of the property right has the right to defend his possession, within the law, meaning that s/he can take action against any other individual who has violated or abused the rightful owner’s property.

From an *economic* perspective property rights are at the root of all market exchanges therefore, allocating property rights in society affects the efficiency of the resources [4]. In reality, “what are owned are socially recognized right of action” [1].

To anchor the role played by property rights in our discussion about ecosystem goods, or natural resources we must **classify** property rights from the analysed perspective: thus, natural resources can be: part of private property, state-owned, public property, and with open access. Possession rights and the right to use the resources, derived from the first category, are conferred to an individual, community or private corporation. The owner has full management rights over the resources according to his will, including granting or forbidding economic or non-economic agents the access to use the resources for their benefit. In this way, economic decisions in relation to resources are decentralized; the coordination of individual plans is made through the market. An important asset that private property has over public management, in the case of resources, derives from the fact that “owners possess both the necessary information to put into practice an efficient allocation of resources and the necessary stimulus to manage these resources effectively” *our translation* [5]. When the market is not intervened in, the price becomes the most important piece of information sent from producer to consumer, so that the ones at the other end, the consumers, will have the opportunity to streamline the quantity and rhythm of consumption. This effect comes naturally into play only in a free market,

where the property rights of each natural resource are *clearly defined* and *easily transferable*. We can draw a final conclusion from here, namely that the problems related to the management of natural resources are not the result of deficient functioning of the market or its absence but the result of an inefficient defining of property rights.

**State-owned** natural resources are obviously managed exclusively by government institutions which control access to them and regulate their use [10]. Unlike the situation of public goods, where the state plays the role of mediator, in this case, we talk about a double role: that of player and another one of arbiter. Therefore, the state, as an independent organism, in a Popperian sense, can be tempted to play foully. The illegitimate behaviour of the state can have unfortunate, even devastating effects in connection with the management of natural resources under its administration, because the government, Ronald Coase said, “is, in a sense, a super-firm (but of a very special kind) since its able to influence the use of factors of production by administrative decision. [...] The government is able, if it wishes, to avoid the market altogether, which a firm can never do” [3]. Furthermore, in a certain context, we can talk about an authoritarian state or something even worse.

State monopole can be the result of state authoritarianism with multiple effects at the market level: (i) a price set arbitrarily cannot, as we discussed earlier, send those pieces of information so necessary for taking decisions production- and consumption-wise; in this case, an artificial price cannot reflect with precision the amount of resource(s) left in stock after the transactions; (ii) in a monopolist market it is very difficult, even impossible for business ideas to flourish.

We will further consider **goods** that are part of **public property**. As a general rule, access to these resources in order to use them is free. However, there are cases when exploiting public property is subject to regulations and certain commitments. In other words, the community whose task is to manage those public goods can choose to exclude outsiders, preventing them from using the resources. The problem of public goods is not about *who* should manage these resources but rather *who* they should be managed by. Due to the fact that all

individuals have access to these resources, no one supports the costs of the damages caused by their actions and there is a tendency to exploit these resources by plundering (Gerald Hardin in *The Tragedy of the Commons* vividly describes this possible scenario). In this situation, it was unanimously agreed that the problem resides in the need for rationing the use of resources. However, the ways to meeting this objective can differ significantly. „It is clear, De Soto declared, that the only solution to the tragedy of the commons is for them to become private property.” *our translation* [5]. In a remarkable article written in the mid-1980s, James Gwartney illustrates the effects of public property, writing about buffalo in the western part of the American continent. He wrote that “each hunter knew that a buffalo that was not captured today would probably be captured tomorrow by someone else. Since exclusive ownership was absent, so too was the motivation to exploit the buffalo in a manner that provided for the future posterity of the animal. The outcome: mass slaughter and virtual extinction of the species [7].

From this, we infer that the problem of public property is to do with the efficiency with which it is managed. A series of arguments reinforce this: *firstly*, it is said that property rights of common goods generate low productivity because nobody is stimulated to work hard to increase the efficiency of these resources. It is considered that this phenomenon works according to the „first come, first served” principle which stimulates a chaotic competition to gain as many resources as possible before anybody else, thus nobody thinks about conserving or investing in those resources; *secondly*, people who own a part of the communal rights will be tempted to exert their rights, completely ignoring the consequences of their actions. This type of property rights system raises, therefore, transaction costs [9].

When the community, whose responsibility is to manage **public goods**, is so large that it makes it impossible or difficult for it to control the goods, these goods become **open access resources**. The fundamental difference between the two, in the context of property rights, is the *nature* of these resources. It is the case of ecosystem goods such as the air, the water in the oceans, the ozone layer etc. that cannot be privately

owned just as they cannot be part of the property of any nation. As a consequence, the possibility of excluding an individual from exploiting these resources is practically non-existent. In the absence of this possibility of control, these resources run the risk of being plundered and exploited unjustly and in an unsustainable way. This also happens, as we have already shown, because individuals are not motivated to invest in or conserve the goods.

From the point of view of the *efficiency* of the economic process we conclude that this increases if the resources are part of the property of an agent. The more certain rights in connection to resources are defined the more the motivation to manage them efficiently increases. As a result, we mean to stress the fact that the role of property rights is to create stimuli for an efficient employment of resources, influencing economic behaviour [9]. From a different point of view, the role of property rights “is that of guiding incentives to achieve a greater internalisation of externalities”[6]. If transaction costs following the exchange of rights between two agents exceed the gain derived from their internalization then an externality (positive or negative) appears. Thus property rights develop in order to internalize the externalities when the gains obtained through internalization exceed the costs.

This spectrum of analysis helps us emphasise one of the main ideas of our discussion, namely, that market imperfections, in a real world, are determined by a degree of inefficiency in calculating transaction costs and the faulty application of property rights. In this context of market flaws, Ronald Coase has underlined the importance of clear and efficient delineating of property rights, claiming that, without a correct application, markets will prove incapable to reflect the total costs and all the benefits resulting from a transaction, thus generating externalities. Externalities are, therefore, associated with market flaws when economic activities in a market do not reflect transaction costs and do not attach property rights in an efficient manner.

### **2.3 The problem of externalities in the environmental context**

By externality we understand a secondary uncompensated effect caused from an economic activity (of production or consumption) which affects other entities (individuals, economical agents, communities, etc.) uninformed in that economic activity. This effect may have positive or negative implications. On the “negative” side, these effects may be considered a negative externality if they meet two preliminary conditions: *first*, when the taken activity of one agent causes a loss of welfare of another, and *second*, when the loss of welfare is uncompensated, otherwise, the effect being internalised [11]. A good example of negative externality is pollution. From the economical point of view, pollution generates an additional cost and produces a loss of utility or satisfaction to the entities involved, being the result of a production process initiated by an economical agent, let's say A, attached to another economical agent, or individual, or community etc., named B. The identified problem does not consist in identifying the existence of the nature of these costs, but consist on the fact that generally they are not compensated.

As mentioned above, the associated effect of pollution is a loss of utility or satisfaction (or welfare, if judged in a broader view). If the problem is approached in the line with the neoclassical view, the solution lies in finding a equilibrium state, or a point of optimum, in which, both the polluter and the polluted are better off: the polluter, because the value of compensation costs, expressed in monetary units, do not exceed the gains obtained from the taken economical activity; the polluted, may be better off when the loss of welfare is compensated with a value large enough so that he or she accepts the presence of the polluter.

However, on the subject of externalities, one of the main critics derives from the fact that precisely the Paretian optimum is faulty. It is well known that standard economical theories, elaborated genuine elegant theoretical constructions, but the spectrum of analysis remained static and abstract. To reduce the analysis to some few variables, it is argued to be “Achilles’ heel” of neoclassical economy, since a static analysis, such as the case of a photography, regardless of the instrument used or the “photographers” ingenuity, is limited to

capture only a frame, or a limited part of reality. By contrast, a film brings a dynamic perspective, given that it consists from a succession of intimately linked and inter-dependent frames. In the same manner we can describe reality, where, a largely enough number of different economic agents simultaneously generate external costs between them and in society. In this case, it is not difficult to realise that problem of uncompensated negative externalities is of a completely different magnitude; this being the reason for which the Paretian optimum does not fit the analysed problem.

### 3. The „limitations” of the standard economical theory

In the light of our discourse we can set forth, punctually, the limits of the standard theory regarding the environmental issues. Thus:

- According to the standard economy the complete and objective defining of the property rights is performed in *the absence* of the transaction costs. This is why the right of using resources will be assigned automatically to the agent that offers a greater usage value. But the scenario of zero transaction costs belongs to a theoretical field. In reality, these costs appear, are positive, and the adjustment of the prices on the market cannot take place instantly, as the neoclassical economic theory suggests. The effect of the instant adjustment of the prices to the new market conditions is reflected in disequilibrium at the level of the offer and demand. According to this line of thought and extrapolating the analysis to the level of the markets of goods offered by the environment – as long as they exist – the establish that in this case the offer is inelastic (the environment goods are given and not produced). This inelasticity can be translated in high transaction costs, emerging thus the inefficiency of the market [9].
- From the property rights’ perspective, it is considered that they precede the act of transactional exchange on the market. When the property rights are taken into account and are positive, it results an imperfect definition and application of the rights that is, another cause for the

emergence of the market’s imperfections. We should highlight here that the phenomenon of the market’s failures and implicitly the presence of externalities, modelled by the standard economical theory, is in close connection to the existence of transaction costs.

- On the theme of externalities, the difficulties arise not from their identification, but from their internalization. There are two ways through which the costs may be internalized: through the taxes, subventions etc. and through the market’s mechanisms. The desired effect of the measures, regardless of their nature, is that of creating responsibility for those who provoked the costs. But the solutions of the standard theory regarding the issue of the externalities, through the mediation of the Pigovian taxes, suffers from a certain degree of inconsistency and this for at least two reasons: *firstly*, the logic of the Paretian analysis, which is being invoked, requires *a priori* the definition of the property rights, although the externalities are a result of the lack of rights or of a inefficient definition of those rights. In other words, if we suppose that the rights are from the beginning well defined, then the models that regard the issue of externalities are not justified, because these will not exist anymore. Secondly, at a theoretical level, the externalities describe a physical interdependence between the polluter and polluted. Given the complexity of the social construction, we may think that in reality it is almost impossible to identify and isolate the interdependence between two individuals [12]. In respect to the internalization of the externalities through market mechanisms, the standard theory suffers from the same inconsistency derived from the fact that, as well already mentioned at the first point, the transaction costs are *a priori* regarded to be zero.

### 4. Conclusions

We conclude that, if a well defined market of environmental goods and services is what we need, then clearly it must be created. The best way to achieve this aim is through establishing property rights in a coherent

manner, together with the creation of those social institutions to ensure their compliance. The State is invited to play its role of “night watchman”, with strict responsibilities with regard to property rights and to ensure a proper functioning of the market.

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# Heterodox Economics – A Dynamic Phenomenon

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## Abstract

*All that has been proven to be thorough from the previous strains of thought has been continuously polished and integrated in what we call the dominant economic theory. Yet, there have been countless debates and contradictions regarding the economic ideas in mainstream (which includes classical and neoclassical economics and Keynesianism), the majority of the opponents arguing that these do not offer sufficient explanations for the understanding or anticipating macroeconomic phenomena and also, do not solve the problem of major differences between social classes.*

*The most impetuous objections regarding the above have led to the appearance of different strains of economic thought, philosophies and theories that have merged under the umbrella of heterodox economics, a reactive movement, which denies the validity and viability of the ideas within the dominant economic theory.*

**Key words:** heterodox economics, mainstream economics, complexity theory.

**J.E.L. Classification:** B00, B24, B25, B41, B50.

## 1. Introduction

The dichotomy between orthodox and heterodox economics is found both in formal speeches (scientific publications, textbooks) and in informal ones (congresses, discussions among fellow members of the academic community). Beyond this dichotomy, current economic researches reveal a new approach to economic phenomena, which are more and more seen from a holistic perspective. Recent opinions of scientists converge to the conclusion that the systemic approach constitutes the efficacious principle of the

universe. In our own view, we are witnessing a paradigm shift, regarding the installations of a new vision of the economy, a progress of economics occurred not as a revolution, but as a progressive improvement on the methodological line. We are not dealing with an abandonment of the classic theories, but with a preservation of what has been proven to be thorough within orthodox and heterodox theories, an enrichment of the legacy of economics.

## 2. Heterodox economic theories

Among the official currents<sup>[1]</sup> which compose heterodox economics we acknowledge: Marxism, Socialism, Sraffianism, Institutionalism, Evolutionary economics, the Austrian school and Feminism. Other authors further add to this list the bioeconomics and ecological economics (as sub-branches of Evolutionary economics), econophysics, thermoeconomics, neuroeconomics, post-Keynesianism, Georgism and binary economics. The last forty years have distinguished themselves through the renaissance of the heterodox strains of thought, the majority of which emphasize on the importance of history and institutions.

In an attempt to define the heterodox economic theories, we will undertake an incursion throughout time. The first stop will be made at the inevitable Kuhnian paper *The structure of scientific revolutions* which remains of reference for the science philosophy. As any other original creator, Thomas Kuhn has his own notional system<sup>[2]</sup>, the first order efficacious concept being that of *paradigm*. The author distinguishes within a paradigm between the firm part – „the hard core” and another, more flexible one, which plays the role of a „safety belt”. While the „hard core” remains still „through the methodological decision of its protagonists”,

the „safety belt” formed out of auxiliary assumptions „has to withstand the assault of tests”.

Starting from the Kuhnian thesis, Imre Lakatos makes a demarcation between *the minor heterodox theories*, compatible with the hard core of the orthodox theory and *the major or radical heterodox theories* which bring into question this „hard core”. By definition, all new theories are heterodox, since they do not integrate themselves into the dominant paradigm because of their inner novelty. These new theories are subject to testing, from which they either become orthodox, with the validation of the assumptions, or remain in the category of heterodox theories.

The syntality<sup>[3]</sup> of heterodox economists is basically determined by the collective dissatisfaction regarding neoclassical rationality (which is considered to be exaggerated and unrealistic). The critiques in this respect are directed towards the pronounced mathematization of economics, which is accused of ignoring the essentially social character of the economy and of simplifying, in an unrealistic way<sup>[4]</sup>, the transactions, decisions and interactions within it.

In order to name a school of thought or another, the economic researchers often use a plethora of terms; prefixes such as „neo”, „new”, „old” or „post” and adjectives formed by derivation from the names of great economists like Ricardo, Marx, Walras, Keynes, Schumpeter, are used to define certain doctrines. Moving next, to the highest level of generalization, the used terms are „mainstream”, „orthodox” and „heterodox”. The distinction between the orthodox economic theories and the heterodox ones is relative and conventional; it is often related to the economic context, to the state of the economic thought at the time being, thus presenting significant variations throughout time.

The attempt to undertake a clear-cut demarcation between orthodox and heterodox economics often proves to be troublesome, the border line between orthodox and heterodox serving as subject for numerous debates. The countless controversies which have occurred on this matter have made it impossible to precisely define the orthodox economic theories and so, the heterodox

ones. The advocates of the dominant theory defend their point of view with an argument based on the appeal to authority<sup>[5]</sup>. They underline that their theory is sustained by the most numerous group of scientists and practitioners. The heterodox economists take a critique stand regarding orthodox economics in order to emphasize their own originality and to highlight that the partisans of mainstream economics sustain their theory rather through conformism than critique reflection.

### 3. A definition only in the negative sense

The heterodox authors reject in an extremely radical manner the most part of theories and methodologies of the neoclassical economics, considering that explaining the economic reality through a mathematical, abstract approach is abusive. The neoclassic nature and manner of validating scientific knowledge are being brought into question here, the atomistic, individualistic perspective from mainstream being more and more disapproved. The holistic approach that incorporates the human being into society and recognizes the mutual influences which take place between the individual and the social institutions gains ever more territory in the contemporary economic thought.

Two principal demarches of radical heterodox economists are being outlined here, emerging from their will to reject the ontological and methodological bases of orthodox economics: *the Austrian approach* which contests the methodological and ontological position of orthodox economics for purely epistemological reasons and *the „anti-economic” approach* which brings into question the orthodox normative discourses, rejecting the scientific validity of its theoretical statements. Although the two approaches differentiate themselves by motivation and conclusions, the majority of the critiques brought to standard economics are formulated in a similar way by the exponents of the heterodox theories:

- *in the methodological plan*: orthodox economics is simplistic and unrealistic: through mathematical abstraction facts lose their pertinence. In the desire to impress economics with a scientific status, the neoclassic representatives often betrayed an

excess of quantitism, scholarly and coldness, trying to explain realities which did not need a scientific explanation. Economics needs mathematics, but „the object itself is far too complicated to be fully accessible to mathematics”<sup>[6]</sup>. An economic reality trapped in mathematic models risks to be excessively abstract and biased: „The purpose of a model is not to be realistic. After all, we already have a completely realistic model – the world itself. But this «model» is far too complicated to be comprehensible. The purpose of a model is to offer explanations regarding certain aspects of reality. If by simplification the model determines incorrect answers, then this lack of realism becomes a flaw... [otherwise] the lack of realism is a virtue: isolating the effects, simplification facilitates understanding”<sup>[7]</sup>. The orthodox methodology has to be abandoned in favour of an authentic economics which aims to construct realistic models which provide confirmable predictions by the confrontation between them and economic facts. Be that it takes the literary or quantitatively shape, a model is a way of thinking, and the appeal to abstraction has the same reasons: to explain a large number of economic facts through a small number of sentences<sup>[8]</sup>. Axiomatization can and has to be only a precious tool of logical analysis, but not a purpose itself. Economics is a science of observation, of methodical contemplation on reality and data, facts and knowledge, and reality must be perceived as it is. It is pretty difficult, if not impossible, to discover universal objective laws in social sciences, and the validation of the afferent theories has to take into account a highly complex reality. Methodologically, heterodox economics opposes holism to individualism; certain economic dimensions can be properly captured only with a macroeconomic or systemic approach, which takes into considerations the emergent effects within the economy;

- *in the ideological plan*: the advocates of neoclassic economics formulate incorrect predictions and prove to be inefficient in anticipating economic and financial crises. The orthodox economic theory is more a religion than a science, containing a series of dogmatic statements which are subject to debate through a scientific demarche. The neoclassic suppositions and conclusions are classified by heterodox advocates as false,

unrealistic, ideologically situated, orthodox economic being nothing else, in their opinion, but a scholarly false translation of the liberal ideology in its demarche of justifying capitalism;

- *in the approach plan*: the economy is part of the socio-cultural system, therefore its approaches have to harmoniously integrate in the sociological, anthropological and historical analyses, for a true interpretation of reality. For a correct modelling of the individual behaviour and the interactions between individuals, economic science must also integrate the results of cognitive and social psychology.

#### 4. Where does complexity theory stand?

The junction point of the theories from the mainstream with the heterodox ideas is, in terms of complexity theory, the orientation towards the future. The economists from both categories admit that in formulating predictions and modelling behaviours, and also in elaborating monetary and distribution of revenues policies, the essential factor which dominates and influences decisions is *uncertainty*.

Neoclassic economists have focused on eliminating uncertainty as much as possible. Through estimations, simplifications and calculations, they have tried to determine the coordinates of an „equilibrium” state, to which all participants within the economy should aspire. For this purpose also, efforts have been undertaken in order to elaborate certain linear models that use as reference points and universal rules which can be applied (and imitated) in any moment in which a change occurs.

On the other hand, heterodox economists have been aware of the difficulty (if not, the impossibility) of achieving such a state, provided that every individual is left to act freely on the market. People make decisions without being aware of an equilibrium point which they and/or their competitors „must” achieve. Thus, they propose the state’s intervention for the adjustment and adaptation of the situation in the economy at the point where a change occurs, this being considered the most proper solution for avoiding inconsistencies; the state, through the researches and statistical studies which it undertakes, has possession over the most

relevant information in order to take an appropriate decision.

The complexity paradigm concentrates both approaches into a new view which keeps the mathematical tools, but makes them more efficient, using computational modelling in order to analyze non-linear events on different temporal series, elaborating guiding predictions regarding the relation between certain apparently random phenomena and their evolution. At the same time, the complexity view admits the limited quantity of information which the individuals have to base their decisions on, but does not see this as a disadvantage; but it considers that, through the interactions which constantly take place between individuals, the knowledge disseminates itself and reaches all the participants. From these processes the structure of social institutions are being designed, structure which will sustain the emergent behaviour of the system and its adaptation to the new change.

## 5. Conclusions

Being characterized by a contradictory evolution and permanently widening its area of research, economics has always left the impression of a scientific building yard. This permanent renewal in the positive plan is the result of testing and verifying through economic policy; without validation in the normative plan, without „resisting” the tough test of the economic reality, any type of theory remains pure ideology. The demarche to draw borders between the theories from the so rich and vast realm of economics often proves to be troublesome, if not impossible. Source of theoretical debates, the demarcation orthodox-heterodox itself does not have a clear feature.

The comprehension of current economic phenomena which occur worldwide cannot find an explanation under the auspices of a single economic theory. The economist nowadays is often put in the situation when he has to oscillate between the traditional conceptions and methods of analysis of the market and the modern tendencies to explain economic processes.

This oscillation however, does not have to be seen as a variation of thought between extreme points, but a perpetual update and improvement of knowledge by integrating

both the theories and the ideas which made the object of former textbooks and the thinking and tools which are in the possession of specialists nowadays. We consider that in order to adopt a holistic appropriate view to penetrate the essence of the economic phenomena, economists have the duty to corroborate the contemporary approaches with the classic paradigms in the economic field and not only, in a fundamentally transdisciplinary and multilateral mix. Or, to put it differently, in the words of the great economist Friedrich von Hayek: „[...] nobody can be a good economist if he is only an economist [...]”<sup>[9]</sup>.

## 6. Acknowledgements

This work was supported by the European Social Fund in Romania, under the responsibility of the Managing Authority for the Sectoral Operational Programme for Human Resources Development 2007-2013 [grant POSDRU/107/1.5/S/78342]

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- [3] Syntality = behavioural characteristics of a group perceived as parallel to or inferable from the personality structure of an individual; the sum of the essential features which confers a social group a particular identity; the personality of a group (definition according to [www.dictionary.com](http://www.dictionary.com)).
- [4] By considering all individuals as being rational and in search of the optimum state in any situation.
- [5] The appeal to authority is a type of argument in logic which consists of sustaining the value of truth of an assertion based on authority, knowledge and the position of the person who makes the assertion. It is a method used in obtaining descriptive knowledge, but it is considered to be a logic error in the context of logics, because the validity of an argument does not result from the credibility of the source. If there is a critique that contradicts the assertion of an authority, the simple fact that the assertion

has its origin in that authority is not an argument for ignoring the critique (adapted after: [http://ro.wikipedia.org/wiki/Apelul\\_la\\_autoritate](http://ro.wikipedia.org/wiki/Apelul_la_autoritate), last viewed on 18.03.2012.

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## Marxian-Radical Economics. A Heterodox Approach

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### Abstract

*Marxism emerged from the confrontation between the German philosophy, classic English economics and the French socialism. It was a philosophy, a scientific method, a new vision of economics, an economic policy and an economic system alike.*

*The Marxian economic strain of thought was assimilated not only by its advocates, but also by the critics of this radical current: in defence of capitalism, Keynes and Schumpeter both start from Marx's work.*

*Starting from the work of classic economists, Marx assumes the valuable scientific elements from the dominant economic theory, but emphasizes the historical, gnosiological and class limits of the classic doctrine. Although he uses the instruments provided by the classics, the German scientist defines his own personal notional system and comes to excel in terms of abstraction. Operating with his own concepts, Marx builds up an infallible logic, which is impossible to turn over if one does not affirm the starting point of the analysis itself – the labour theory of value.*

**Key words:** heterodox economics, radical economics, Marxian.

**J.E.L. Classification:** B14, B24, B25.

### 1. Introduction

Marxism occurred as a critique reaction to classic economics; it represented both a doctrine and a socio-economic system, but also a widespread phenomenon of the twentieth century.

Ever since 1844, before discovering classic economics, Marx formulates in his *Economic and philosophic manuscripts* a harsh critique of the capitalist society based on alienated labour under three aspects<sup>[1]</sup>: the

product of labour does not belong to the worker, the organisation of the labour is unknown to him and labour does not represent the meeting of a need, but a means to satisfy essential necessities situated outside the work sphere. The author does not stop at a simple critique, but transcends into therapeutics with the proposal to abolish the private property over the means of production and to eliminate commercial and money production.

As Marx deepened into the study of classic economics and discovered the labour theory of value, he announces his desire to know „the anatomy of the bourgeois society”, in order to lead a more efficient battle against the capitalist system.

### 2. Essential contributions brought by Marxism to the evolution of economic theory

Two great economists have influenced Marx in his assertions on economics: Ricardo and Quesnay. Although neither the advocates nor the opponents of a Marxian work ever recognized this influence, Marx owes to Ricardo his initiation in the art of theorizing and the starting point for his own arguments, and to Quesnay the assimilation of his fundamental concept on the economic process as a whole<sup>[2]</sup>.

Starting from the principles of historical materialism<sup>[3]</sup>, the great economist lays the foundation of a new methodology – *dialectical materialism*, based on which the evolution of the world and the socio-economic relations must be seen only through their contradictory unity. His critique stance will become his own intellectual matrix; gifted with analysis tools and a personal method, Marx set out to desecrate the economic science and the capitalist society, thus beginning as a classic but ending as a heterodox<sup>[4]</sup>. Armed with this

personal method, Marx starts a true revolution in terms of methodology in economics, with the help of which he historically and lawfully explains the evolution of capitalism, but also its fundamental concepts. If the classic economists assimilated economic laws with natural ones, postulating the irreversibility and perennality of the capitalist society, Marx succeeds in economically integrating history, bringing into foreground of analysis the *manner of production*, permanently subjected to changes and evolution, investigated both as a dialectical unity of production forces and in term of production relations<sup>[5]</sup>.

Explaining the dialectics<sup>[6]</sup> of the relation between a phenomenon and its essence, the German scientist rises the scientific abstraction to its highest levels, showing that the main purpose of a science is to scrutinize beyond appearances in order to identify the cause of things.

The Marxian radicalism also resides in explaining economic categories based on the *labour theory of value*. The Ricardian successes in this respect have proven to be only partial because of the contradictions between the theory of value and obtaining profit, between the theory of value and the middle profit and between the theory of value and the existence of absolute rent. The distinction made by Marx between the labour force and work and between value and price of production manages to solve the contradictions to which the classic economist had arrived. While classics saw a *quantitative relation* in value, Marx defines it as a *social relation*, thus revolutionising the labour theory of value created by his predecessors.

Granting a maximum of importance to the sociological aspects of economic phenomena, Marx fundamentally changes the traditional paradigm of thinking; he defines economics<sup>[7]</sup> as the science which studies the social relations of production on different levels of development of the human society.

The Marxian doctrine gains a solid scientific base through the theory of surplus-value. Marx sustains his theory with solid arguments in order to defend himself against any attempt to disproof. The surplus value occurs as an unearned gain which goes to the capital possessor by virtue of the property right over the means of production, the

theory of surplus-value essentially being a theory of exploitation<sup>[8]</sup>.

Manifesting preoccupation for the study of the reproduction of individual and social capital, Marx analyzes, for the first time, the process of economic growth, setting the ground for subsequent research on this subject. Inspired by the Marxian work, the radical French economists will much later recognize Marx's merit of being the pioneer of the analyses of the phenomenon of economic growth: „The Marxian theory is today the single synthetic and global theory of growth which is available<sup>[9]</sup>”.

Marx's reproduction model shows that, theoretically, the market evolves towards achieving economic equilibrium. His theory on over-production crises proves however that, practically, the capitalist manner of production is fundamentally instable. If the classics identified as causes of crises „technical” aspects, Marx considers that conflicts in the social relations of production as the general cause of over-production crises.

Unlike Keynes, who nominated the paths and courses of action, Marx did not offer a therapeutic solution for economics so that through it, the theoretical bone structure of his original research to be put to work<sup>[10]</sup>. His theory came to life through his disciples who followed the suggestions which arise from the critique analysis of the capitalist society, therefore engaging to verify his doctrine. Beyond the horrors of the communism imposed by Lenin and Stalin, what remains characteristic<sup>[11]</sup> from the Marxian economic analysis are the study of long-term evolution on economic systems, the ideas on the nature of technical progress, economic cycles and the capacity of using labour.

### 3. The continuers of the Marxian ideas

The Marxian ideas were taken over by Engels who, besides having the merit of preoccupying himself of the supervision and publication of two of his mentor's and friend's books, also had personal contributions in the methodological plan<sup>[12]</sup>, (we especially refer here to the role of dialectics and the position of the state in the new manner of production).

A notable contribution on the theoretical level of this doctrine was brought by

Vladimir Ilici Ulianov, also known as Lenin, through his thorough analysis of the monopolistic-imperialist phase of the capitalism of his time – the capitalism at its last stage. The author develops the Marxian theory of reproduction, emphasizing on the role of the production of the means of production in order to produce other means of production in the process of economic development. Lenin manifested preoccupations for problems of the genesis of socialism and of the functioning mechanism of the socialist economy. For the transition period from capitalism to socialism, Lenin develops a program which stipulates the development of the technical-material base by industrialization, the socialist transformation of agriculture and the achievement of a cultural revolution. Socialism proposed a new system of repartition, which its adepts considered to be more equitable, more democratic, humanitarian, the first order efficacious criteria being labour.

Among the continuers of the Marxian ideas, we consider it to be inevitable the reminding of Stalin, Troťki, Rosa Luxemburg, but also Mao Tse Dong.

An attempt to thoroughly debate the methodological problems of the socialism economics was carried out by elaborating an economics textbook. The Stalinist paper *Economic problems in socialism in the USSR* contains many erroneous theses<sup>[13]</sup>, rejected by the social theory and practice: not considering means of production as being commodities, the necessity of eliminating the surplus of the kolkhoznik production within the system of the circulation of commodities, the dissolving of the international unique market and the forming of two parallel and opposite markets. Both theorist and man of action, Stalin advocated for the development of the industry and especially the production of weaponry, he himself being a torturer who masked his violence by sustaining noble causes such as the interest of the people.

Opposed to the Stalinist bipolarity socialism-capitalism, Mao Tse Dong brings his own vision of *The three worlds*, making a classification of the world states in *developed countries, developing countries* and *the third world*, of the undeveloped. Taking into account the physiological needs of the huge human mass represented by his people, the

Chinese communist advocated for the development of light industry but also the agriculture, in opposition to the Stalinist vision of expansion.

The Marxian doctrine has been revised repeatedly, taking the form of socialism, in a democratic-social formula, of French or Swedish socialism.

The French socialist Jean Jaurès supports his theory both on the Marxian materialism and on the Kantian idealism. Often qualified as being „humanitarian”, the socialism promoted by the French philosopher proposes an evolution through socialist reforms: deconcentration of the capitalist property, encouraging the union of the proletariat and intensification of social security measures.

In the view of the French Marxian economists<sup>[14]</sup>, the state is subdued to monopolies and through its leverages, such as inflation, the taxes and dues system, public investments and state orders, it can decide on the profitability of certain sectors or the cheapening of the capital on account of the revenues of the working class. The solution proposed by the French socialists is to eradicate the state-monopoly capitalism and to replace it with a democratic socialism which is self-managing through democratic reforms.

#### 4. Conclusions

Marxian economics set out to decipher and study the contradictory functioning of the capitalist economic system.

Inspired by the classics Ricardo’s and Smith’s theories on value and repartition, Marx considerable distances himself from the dominant economic theory at that time which assimilated economic laws to natural ones, the scientist stating that all economic categories and laws have a historical character. The radicalism of the Marxian doctrine resides in the completely different view on economic laws which govern value, the repartition of revenues, economic crises and economic growth.

Beyond the horrors which the Stalinist dogmas caused, inspired from the Marxian doctrine, Marx’s work remains a reference point in the evolution of economics as a science. The German scientist exerted substantial influences on the economic way

of thinking from the last two centuries, especially through the unique tools of analysis, a new methodology and a new vision.

Endowed with excellent abilities of leading reason towards logical conclusions, Marx takes the scientific abstraction on its highest peaks.

The radicalism of the Marxian doctrine goes as far as to set out to desecrate capitalist economics, seen as a historical science, emerged with the appearance of the production of goods and which will perish with its progressive disappearance.

## 5. Acknowledgements

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- [4] Pohoată, I., *Doctrină economică universală. Predecesori și fondatori*, „Gh. Zane” Academic Foundation Publishing House, Iași, 1993, pp.166-167.
- [5] Economic relations which are established among people in the production process of material goods, according to <http://dexonline.ro/>, accessed on 20.03.2012.
- [6] Dialectic, also called dialectics, originally a form of logical argumentation but now a philosophical concept of evolution applied to diverse fields including thought, nature, and history.
- Among the classical Greek thinkers, the meanings of dialectic ranged from a technique of refutation in debate, through a method for systematic evaluation of definitions, to the investigation and classification of the relationships between specific and general concepts. From the time of the Stoic philosophers until the end of the European Middle Ages, dialectic was more or less closely identified with the discipline of formal logic. More recently, Immanuel Kant denoted by “transcendental dialectic” the endeavour of exposing the illusion involved in attempting to use the categories and principles of the understanding beyond the bounds of phenomena and possible experience. G.W.F. Hegel identified dialectic as the tendency of a notion to pass over into its own negation as the result of conflict between its inherent contradictory aspects. Karl Marx and Friedrich Engels adopted Hegel’s definition and applied it to social and economic processes. According *Encyclopædia Britannica Online*. Encyclopædia Britannica Inc., 2012. Web. 10 Mar. 2012 <<http://www.britannica.com/EBchecked/topic/161174/dialectic>>.
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## Using Data Warehouse and Data Marts for Financial Accounting Data

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### Abstract

*In the current economic condition, performance of an organization depends on and is conditional on the quality and timeliness of decisions made by managers. Making the best decisions implies a large amount of data that enables the development of complex analysis. Obtaining this amount of data is possible because of a powerful system, providing users fast in presenting data and provide opportunities for complex analysis and tentative.*

*Thus, data warehouses and Tuesday in support of economic organizations to store such large amounts of data, to ensure analysis and extraction tools necessary and relevant information for decision making.*

**Key words:** data warehouse, On-Line Analytical Processing (OLAP), multidimensional analysis, decision support.

**J.E.L. Classification:** C80, C82, M15.

### 1.Introduction

Due to use software solution that they have available, managers have understood that the data stored in operational systems, including databases, are a gold mine of information to be exploited. Data warehouses have been developed to meet the increased demand for complex analysis, which could not be

adequately achieved with operational databases [10].

With operational databases are made daily operations and also provides multiple users simultaneously access the data stored. Data stored in operational databases are usually detailed, historical data do not show because they were undergoing a process of normalization has lower performance when conducting complex queries. When users need to make an analysis on the behavior of the entire organization, pre-operation to achieve the integration of data from different operational systems.

### 2. Data warehouse

Data warehouse is "a class of specialized databases" [3]. The role of a data warehouse is to ensure information needs of users and are designed to support decision making within a company.

Enterprises in most economic sectors faced with customers increasingly demanding changes faster and with increasing competition. Thus, organizations are required to predict changes in economic and competitive changes. For this they need to have accurate and timely. All organizations have data, they are provisional in their operational systems or external sources. Thus, data warehouses will assist these companies to assist them to achieve their sector-specific objectives, making decisions

based on data they have and how they interpret.

Professor Dinu Airinei believes that "data warehouses are the product of advanced technology and economic environment. On the one hand, the economic environment is increasingly competitive, global and complex and requires information developed to support strategic decisions and on the other hand, developments in information technology solutions provide efficient management of large integrated data "[1].

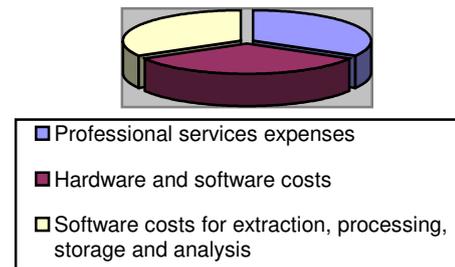
Data warehouse technology includes a set of concepts and methods that provide users with information useful for decision making. The building of a data warehouse shows the need to improve the quality of information within the organization [11].

Leader in building data warehouse systems is WH Inmon, who said his reference in the paper "Building the Data Warehouse" (1996) "A data warehouse is a subject-oriented, integrated, time-variant and nonvolatile collection of time in support of management's Decision making process "[5].

Due to the large volume of data in data warehouse requires the use of appropriate techniques and data mining tools such as dynamic multidimensional analysis, mathematical methods to suit a lot of data and statistical methods in order to achieve forecasts. These techniques and tools for statistical data analysis and extraction of knowledge is called data mining or data mining.

According Vilana A [11] a data warehouse consists of databases containing from 1 to over 10 Terabytes sometimes repositories containing tens of Terabytes. So great a volume of data and is as cost on average between 3 and \$ 5 million. These costs can be divided into three parts: 1/3 is the professional service costs, third is the software necessary for the operations of extraction, processing, storage and data analysis and the latter is necessary for the acquisition of data storage hardware systems [7]. Studies show that in the first 12-18 months of data storage volume may be doubled and this growth leads to successful implementation of data warehouse but can not bring their problems if systems were designed from the start sufficiently flexible.

Figure 1: Breakdown of costs for creating a data warehouse



Source: based on the processed

Systems that implement such repositories should provide greater flexibility to allow simultaneous connections to different servers store the data set. Also, when the choice of architecture should consider possible changes that may occur (changes in performance, capacity and connectivity). Processes which can become cumbersome system to function effectively if it occurs every time new servers are added to the system.

To avoid these problems may be used to achieve data center which is called data marts. These subdepozite are made at modest cost compared to data warehouses have less lasting achievement and include only relevant data necessary for analysis.

### 3. Data mart

A data mart contains a subset of volume data in the organization, a specific group of users [6]. The data mart is usually on aggregate. Typically, departmental servers are implemented on cheaper required based on UNIX or Windows / NT.

According to Microsoft [8] Data Mart (Market Data) is a smaller version of the data store (data warehouse), which aims to retain only data that could be used only for a target group of users.

According to John Wang [4], Tuesday is a data warehouse limited in scope (horizon) and facilities in a restricted area.

Tuesday's change led to thinking company that creates data warehouses:  
- Some companies folosec Tuesday as a intermediate piece to store data that are then in a centralized data warehouse, such as a data warehouse can evolve over time and include as much information necessary for the activity;

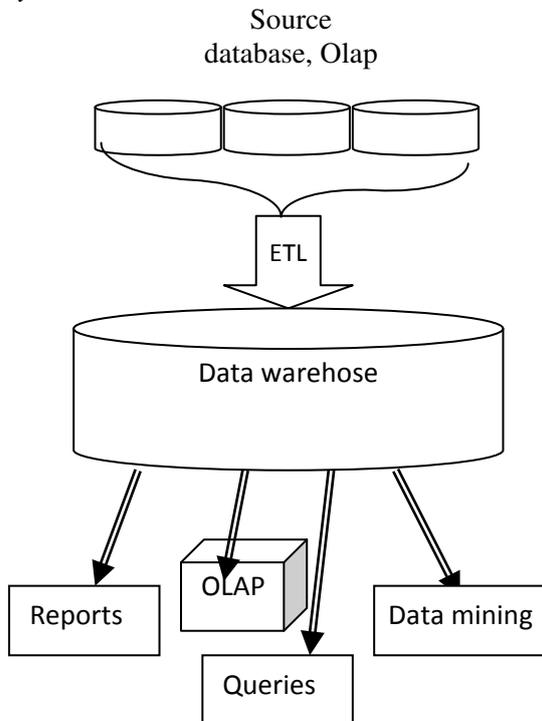
Some companies consider that their desfășoare can and just work on repositories without data warehouses and some smaller;

Other companies use Tuesday to move data to and from repositories aimed at achieving performance analysis based on certain criteria (regular, departmental, etc.).

For a better view of these concepts, in the following figure presents a system architecture data warehouse / OLAP and the following figures will present the changes to support this architecture to make way for Tuesday's.

Thus, the first figure we have a system architecture classical data warehouse / OLAP without the presence of a data mart.

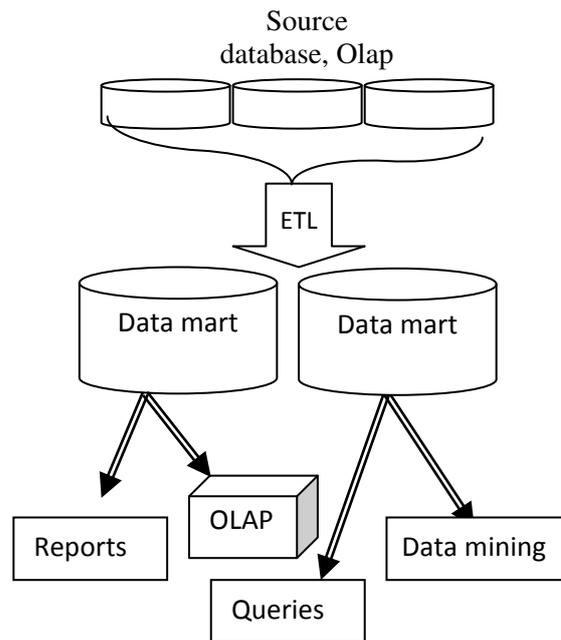
Figure 2: Architecture of a classical system data warehouse / OLAP



Source: Made by the author

The following figure shows a traditional Tuesday / OLAP und Tuesday is observed as the replaced data warehouse.

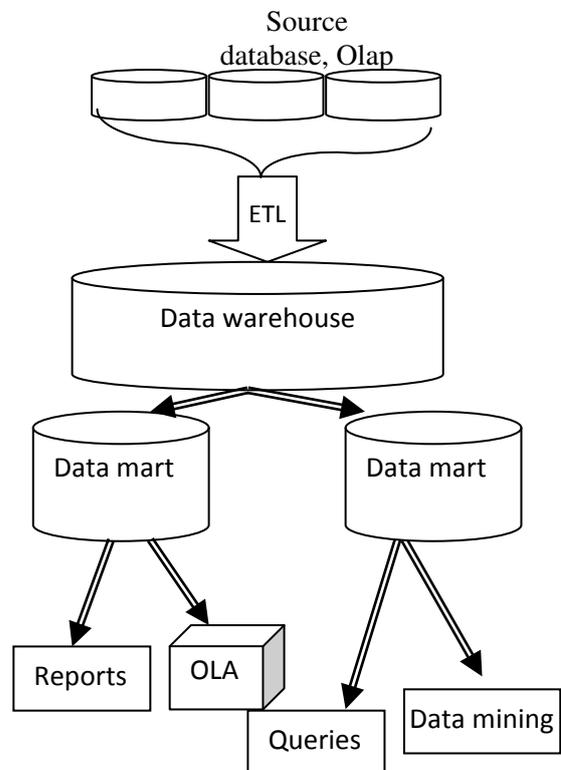
Figure 3: Arhitectura a classic Data mart / OLAP



Source: Made by the author

The diagram below illustrates a typical system architecture Tuesday / Tuesday OLAP that is populated with data from the data store.

Figure 4: Architecture of a typical system Tuesday / OLAPși populating the data warehouse data



Source: Made by the author

Any of the above solutions has advantages and disadvantages for organizations implementează. Astfel, regardless of the solution to that call, Tuesday's have similar characteristics to those of data warehouses except volume data. This is the reason why if Tuesday's, queries will be easier to implement.

The great advantage of repositories is their ability to do analysis on large volumes of data and these analyzes can be viewed from several points of vedere. Oricum, data warehouses have the great advantage of being able to analyze large areas information.

#### 4. Comparative aspects of data warehouse and Data mart

There are two major differences between Tuesday and data storage. The first difference was shown above, namely the amount of data, respectively, on the mart contains a subset of data warehouse data.

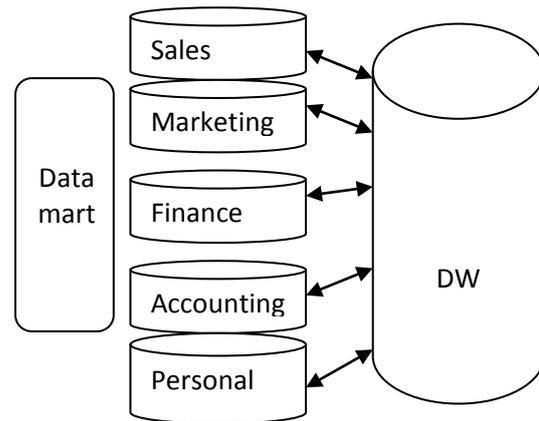
Such data are made Tuesday to meet certain requirements particulare. Depozitul database is designed as a strategic approach to planned, and Tuesday is designed as part of tactical plans to meet individual specifications [9].

The company can design Tuesday's without taking into account the overall strategy. If not, Tuesday's will be uninterrupted and will be very hard to integrate the data warehouse later.

The second difference is that since the data mart are more crumb than the data store. Since Tuesday's requirements are more accurate than the deposit, the user can afford to merge data known in advance as required and store query results that thinks he will run to make extraction as quickly and efficiently.

End user's Tuesday seem as repositories through their interaction with the data warehouse environment. Tuesday's are targeted to specific needs and requirements such as providing service to a department specific data (Figure 5) or a subset of data within a certain period of time.

Figure 5: Interacting data mart with data warehouse environment.



Source: Made by the author

Tuesday's have a similar structure to the data warehouse. The key difference is that Tuesday's are more focused on appearance company. For example, a data mart can store data about a specific department, data on a certain period of time, data for certain products, etc..

Tuesday's are much easier to control than data warehouses. Data volume is lower and the data model is reduced by a few tables. However, Tuesday's must be designed properly, the same database structure as the extended data model.

Tuesday's modeling should focus more on end-users than for modeling the data warehouse. End-users should be involved in shaping particular sites Tuesday that they will be those who would use them.

Designers Tuesday dimensional modeling sites recommended for development. Dimensional modeling (which is a powerful technique for modeling) is suitable for development sites that support Tuesday dimensional data analysis. Such analyzes may include OLAP tools for data analysis, organization and turning them into cubes for data access.

#### 5. Conclusions

Most industry experts believe that Tuesday are an important step in the evolution of technologies relating to data warehouses and data analysis. Construction of distributed data warehouses (Tuesday) is growing. In the future, other techniques will be able to use parallel processing, automated delivery of information very large database, very good support expanding objectual online analysis

applications leading to more powerful and easier to use.

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## The Impact of Information Technology Integrated Into Decision Making Process

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### Abstract

*In recent decades, all studies have shown that information, based on modern information technologies, have gained particular importance is seen as a strategic resource necessary for the development of the resource, which is sometimes considered more important than raw materials or energy. The impact of information technology on various areas of human and economic life is so great that it speaks of a new phase in the evolution of society, namely: information society.*

*Field studies show that information technology industry is one of the largest in the world and more than that have a tendency to increase in continuity.*

**Keywords:** informatic/information technology, decision, business processes, information society.

**JEL Classification:** C80, C88

### 1. Introduction

Humankind is undertaking a historic process of transition to new society and new economic system. Historic progress is and will keep producing future radical changes in the core of economic science rapidly reflected upon specialists' economics training

level as well as upon people's way of thinking [1].

The world we live in is undergoing continuous, perpetual transformations which are sometimes deep and dramatic, and the information avalanches we are currently facing comprising all enterprise fields do not avoid the field of financial-accounting data either.

Information society concept, widely accepted today, was and is the subject of many works, of which we may mention "The Information Society" by Moore, where the author highlights four important features:

Information is based resource organizations and individuals, as responsible resource company and individual welfare;

Information is based on a new economic sectors, the continuous development;

Information is a resource unfit for consumption, may be used without being consumed; Progress ITC (Information Technology and communications) has an impact on the fundamental activities of human society such as business, education, business management, trade. Academician Draganescu Information Society proposes a structure on which applications are highlighted groups characteristic of the e-Business, including business services and integrated systems, e-Learning, e-governance, e-Commerce.

The special meeting of 23-24 March 2000 held in Lisbon Special European Council of

the European Commission received from the initiative entitled "eEurope - an information society" for all seen as a political initiative that represents a guarantee for the EU to take full advantage of the future developments related to information society. This initiative was adopted as an action plan [Feira 2000] will be updated in 2002, in Seville by the strategic document "eEurope 2005 - An Information Society for All".

This initiative was designed to accelerate the deployment of digital technologies in Europe and provide the necessary skills to use widely. Being involved in realizing these objectives set by the EU e-Europe initiative aims as new countries associated in Central and Southeastern Europe, including Romania, to achieve the objectives set by the strategic document "e-Europe 2005 - An Information Society for All".

In continuing in this paper I will stop on two technologies integrated information namely: Enterprise Resource Planning (ERP) and Customer Relationship Management (CRM).

## 2. ERP-type systems (Enterprise Resource Planning), a new stage in the progress of technologies' integration

Of all the informatic systems used for financial-accounting data, special attention should be paid to ERP-type systems as they place complete and complex solutions at users' disposal in terms of integrating the entire performance of a company.

ERP systems have become available in company applications in the context of the informational boom and the extraordinary uprise of information and telecommunication technologies since the early 90's.

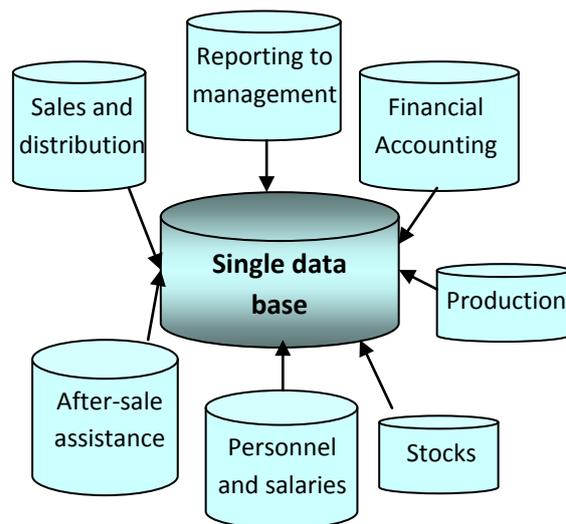
An ERP (Enterprise Resource Planning), "regarded as the most truthful expression of the interdependence between economy and informational technology, represents a software multimodular infrastructure which provides management and coordination support for the various structures and processes in a company with a view to accomplishing business goals"[2]. The main goal of an ERP system (integrated management system of business processes) is reaching better communication within a company, improving the cooperation and interaction among various departments such

as those in charge of planning production, acquisitions, sales and customer relations.

A company's ERP-type system means the planning of the four major factors in successful business: human, financial, technical and resource factors (the four M's – Man, Money, Machines and Materials), according to <http://www.cio.com/research/erp/>. [7]

The ERP systems developed until now are made up of several constituent elements: nomenclatures, cash inflows-payments, salaries, human resources, planning-production, project management, production monitoring, consumption's and costs' planning and monitoring, and also the financial-accounting constituent part or general accounting.

Figure 1: Conceptual scheme of an ERP system



Source: adapted by the author [4]

The main functions of this constituent are the following: the automation of financial-accounting information records taken from primary documents; the accomplishment of full book-keeping at analytical and synthetical level. More often than not, this constituent achieves only the functions of financial accounting, that is getting the synthesis accounting papers required by the legislation in force (balance sheets, VAT reports, fees and taxes to the budget) and the book-keeping ones (accounting reports, day books, account cards, cash books, sale and acquisition books, trial balances etc.). This constituent can be associated with an analysis

module in the form of an instrument panel (typical of a MIS or even EIS system) which provides synthetical, operative information on a company's performance, necessary to its manager during decision making. According to accounting data, several indicators are calculated which illustrate the financial outcomes of a company such as: revenues and spending for products/services, status of financial availabilities etc.

“The Financial-Accounting Module is the central element of any ERP application. All the system data are centralised in the financial-accounting module, providing the support of various legal reports. To small companies, the investment in a financial-accounting solution is the first step; yet, along with their development, resorting to an ERP solution to integrate all business processes becomes an obligatory requirement”, stated Raluca Ioana Komartin, Managing Director, LLP Bucharest in the review called “Market Watch”, February 2010, no. 122”. [8]

Beside the data integration and accomplishment of full reports about organisations' performance, as main advantages of an ERP implementation, the Financial-Accounting Model's major benefit is the automation of specific operations up to 95% according to the application's customisation level. Operations' automation is possible due to the high repeatability level of financial-accounting operations and involves the application of patterns already present in the application or predefined when implementing. Along with the increase in the operation speed, automation makes it possible for the people who do not have too much accounting knowledge to work in such an application anyway and it also does not allow human errors in certain operations.

The Financial-Accounting Department is very important in any organisation because each organisation's goal is to raise profit and it is exactly what this department does, taking care of the money in all organisational departments.

The main advantages of using an ERP within a company are [3]:

- Uniqueness of information, information is entered once into a database very large;
- Requires use of "best practices" in the industry;

- Allows customization;
- Functionality is provided on a reliable file structure;
- Provides users with tools for ad hoc queries and reports;
- Provides a reliable file structure;
- Provides users with tools for ad hoc queries and reports;

Provide and allow interaction with other modules.

ERP systems provide information necessary for the analysis and management activities and five major benefits of ERP systems [7]:

- Information on-line / real time for all departments of an organization;
- Standardization and accuracy data at the enterprise level;
- Applications include best practices in the industry;
- Increased efficiency that a record company;
- Analyses and reports obtained can be used for long-term planning.

The success of ERP packages' implementation in a company also depends on how much they allow the integration of several other system categories, such as Customer Relationship Management (CRM), Supply Chain Management (SCM), Business Intelligence (BI).

### **3. CRM (Customer Relationship Management)**

Is a solution for customer relationship management to ensure their: support to develop business strategies and ability to connect front-office functions and back office business solutions in a component, which is specialized on customer needs. It also has the ability to store and analyze information in order to anticipate customer needs and have a profitable and long-term relationship with customers.

Traditional relationship between companies and their customers suffered significant changes due to transition from traditional business to electronic media.

Basic role of a CRM system is efficient management of information on society and information partner relations with them, ie, including: invoices issued and received, receipts and payments.

Customer Relationship Management System is seen as a strategy used for selecting and retaining clients, because their value is optimal for the firm, it involves a business philosophy that puts customer focus, by all processes, success is assured if the team leaders, strategy and organizational culture are appropriate and act simultaneously.

At the same can be seen as a process to implement a strategy that is in the foreground the customer, seen as "our lord".

Customer Relationship Management is a complex system that implements the business strategy of an organization which aims to establish long term relationships with profitable customers, information management is achieved through a single database providing complex customer records and oversees sales . [5]

There are three aspects of CRM, each of which can be implemented separately [6]:

1. *Operational CRM*: automation or support of customer processes involving sales or service representatives.

2. *Collaborative CRM*: Direct communication with customers not involving sales or service representatives

3. *CMR analytic*: analyze customer data for a wide range of purposes.

1. *Operational CRM*: provides operational support work processes "front office" including sales, marketing and services. Each interaction with a customer is generally added to a history of each customer, and employees can draw customer information database as needed. Focus on customer value is key to a successful CRM strategy. Different clients should be treated differently. Variables that customers position, actual and potential value are driving the strategy.

2. *Collaborative CRM*: covers the direct interaction with customers. This may include a variety of channels such as Internet, email or automatic takeover telefoanelor. Poate generally be equated with "self service".

The objectives of Collaborative CRM can be expanded, including reducing costs and improving services.

3. *Analytical CRM*: analyzes customer data from a variety of purposes, including:

- Design and execute marketing campaigns to optimize marketing effectiveness;

- Design and implementation of specific customer campaigns, including customer acquisition, reserves;
- Analysis of customer behavior to assist in making decisions about products and services (price, new product development, etc..)
- Management decisions, eg financial forecasting and customer profitability analysis;
- Risk assessment and protection against credit card fraud made.

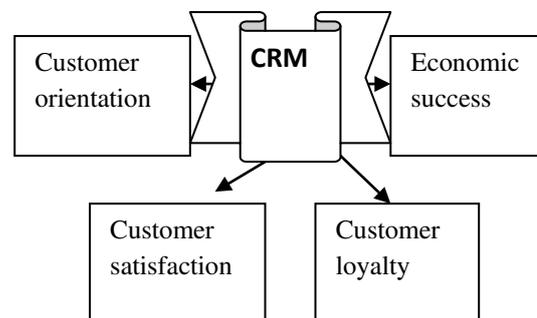
The main benefits from implementing a CRM solution are [4]:

Impact on data quality costs: use data integration solutions can produce a significant return on investment. Benefits from using data integration solutions are better identify customers, improving modeling, improving customer retention, improving to attract new customers.

Competitive Advantage: CRM is seen as a strategy to manage customer relationship and interaction with them in the most profitable way for both. There are few providers operationalo CRM solutions that enable the implementation of traditional CRM strategies. These strategies are supported solutions typically focus on how to be more efficient services, sales and marketing departments, thus increasing the profitability of the organization and its customers.

Schematically, the chain's success in customer relationship management can be presented by the following figures:

Figure 2: Chain CRM success



Source: Figure produced by author

#### 4. Conclusions

As a general conclusion we can say that information technology has penetrated, with

all its instruments, in all economic fields, and not simply present case but as a leading actor in economic processes.

General information technology are used most often to obtain information which will then be processed for various business processes.

In most situations, information technologies used are not found in their "pure" but in a form that adapts and is more complete and more complex depending on the economic situation.

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# The Matrix of Romania’s Underground Economy. Working without Legal Documents

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## Abstract

*According to financial analysis conducted by the authorities, working without legal papers or "in black" is one of the main components of the underground economy matrix and one of the main crimes generating "dirty money".*

*The most common manifestation of the "black" employment refers to under declared employment, which is exercised at the limit of the relevant laws, with negative repercussions both upon the state budget and health insurance budget and therefore the general consolidated budget.*

*The causes of "black" employment are extremely varied, have a multifactorial determination and take the economic situation of the employee and employer at any given time, the level of their training and last but not least, the legal framework and enforcement regime.*

*According to a recent World Bank study, 45% of Romanian employees receive at least part of their salary in an envelope, and as in the public sector there is no black or gray employment, that the private sector, at least 60% of employees receive money for which they do not pay taxes.*

*In this study we tried to highlight some of the causes and factors that determine and influence at the same time "black" employment and features some of the manifestations of the informal economy in Romania.*

**Key words:** “black” employment, tax evasion, underground economy.

**J.E.L. Classification:** E26, E62, M40, M41

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## 1. Introduction

Now, more than five years since joining the European Union the underground economy problematic is at least as important to the national economy as 20 years ago, especially after the long period of transition that followed the global economic crisis, with multiple negative consequences on the level of living standards.

Broadly, the underground economy involves the carrying out of very different activities, most of them illegal activities such as tax evasion, money laundering, drug trafficking, corruption, prostitution, trafficking in currency and / or forged artwork, insurance fraud, trafficking in plants and / or animals protected by law, weapons smuggling, etc.; to them add some legal activities which are not considered by national accounting (work within the household, volunteer services, services mutual aid between neighbours / friendly one, household activities, etc..) and activities that are not declared for payment of tax and social obligations (tax fraud work without legal papers, etc..).

In Romania, in recent years, easing of income and the redundancies carried out and, respectively, announced by the government during 2012, illegal employment has recorded and shows, still, an increasing

trend, being present in many forms, in many areas. Under these conditions, many people are willing to compromise just to have a job.

## 2. "Black" employment. Concept. General features

According to the European Communities' Commission, undeclared work is defined as "any paid activity that is lawful in terms of nature but not declared to public authorities, taking into account differences in the regulatory system of Member States" [1]. This definition of undeclared work links with tax and / or social security fraud, covering various activities (from informal household services to clandestine work by illegal residents, but excluding offenses).

Thus, we can say that illegal employment is the work carried out in no compliance with the rules required by labor law, social security and tax [5].

The forms under which, this component of the underground economy matrix manifests itself are many, between them:

- Unnormed activity, without payroll and payment of obligations to the state budget, without clocking and standard documents for evidence of time and type of work;
- Work partially uncovered and not subject to taxation, through double registration, the so-called in "hand" payment;
- Exhausting workload (the worker is working for as long as the owner asks, not eight hours, as is legal);
- Casual work, seasonal, without filling in specific documents;
- Work in the known trial period or periods of apprenticeship, which are not covered in the documents.

The most common manifestation of the "black" employment refers to under declared work. Which is exercised to the limit of the relevant laws? With negative repercussions both to the state budget and health insurance budget and therefore the general consolidated budget [3].

The experience of the territorial labor inspectorates showed that "black" employment is favored in all sectors where cash is handled, context in which the commercial activities, in the widest sense of

the term, are the favourite area of manifestation.

The motivation for the practicing of black labor is also very varied, among the elements that determine the behaviour of citizens are: economic situation at a time, law, tradition, living conditions at the time.

To these are added and other labor issues that require significant compromises for the insurance of subsistence, including: periods of economic recession, the existence of underdeveloped areas, economic transition, economic readjustment, etc...

Usually, among those who practice "black" employment we find:

- People with low wages and low education level;
- Minors, students, unemployed people, retired people;
- Low skilled or unskilled people, forced to accept a job in any circumstances (often, such persons are not employed in the formal labor market);
- People experiencing difficulties regarding their social integration;
- Foreigners without papers in order;
- People who are employees, but who also carry out other paid activities for people other than the employer (or the employer, outside office hours)...

One can say that, in the short term, black labor allows the person practicing it to supplement his income, who uses it to reduce spending, both categories actually avoiding tax and social expenses.

In the long run, employee interests are affected in terms of his social security. Thus, if we relate to the employee, "black" employment can present numerous disadvantages, including [8]:

- No salary safety (the employee cannot act the employer in court for unpaid wages or violation of rights);
- Do not receive the minimum wage (in many cases);
- Do not receive wage increases due to seniority and working conditions;
- Do not have standard reduction of working time due to the existence of special working conditions;
- Have no legal right to paid annual leave as well as other leaves legally regulated for special events (marriage, death, birth of a child) and/or time off for study;

- Do not receive compensation for maternity and parental leave or sick child care;

- Do not receive free medical care, medication free or compensated;

- Are not paid daily allowances for travelling for business purposes and/or detachment, as well as transport allowance;

- Transfer do not receive compensation;

- Do not enjoy protective rights of health and safety at work, work equipment, protection and antidote food to which they would be entitled depending on the nature of the activity;

- Are not insured for predictable and unpredictable risks (disability, illness, accident, maternity, death);

- Are not entitled to compensation for temporary disability (due either to common diseases or accidents outside work or occupational diseases or accidents);

- Do not receive benefits and support for disease prevention and rehabilitation of work capacity such as compensation for temporary switch to another job, compensation for reduction of working hours and quarantine, various prosthetic aids, free or partly free spa treatment and vocational rehabilitation;

- Do not receive old age, early, partially early, disability or survivor pension;

- No granting of aid in case of decease;

- Do not receive unemployment benefits and support allowance;

- Are not entitled to free courses for professional reconversion, qualification and requalification and other active measures in order to exercise a legally regulated activity or employment for a job;

- Are not paid vouchers;

- Do not enjoy legal protection for women and children;

- Do not exercise collective constitutional rights such as freedom of association in trade unions, collective labor contract negotiations;

- Restricted right to bank loans, etc.

Although to a lesser extent, "black" employment involves risks for the employer, as well. Among these are:

- Civil penalty for violation of Art. 4 of Law 130/1999 (employer does not record civil conventions in the special register or does not establish through the collective management body's decision the areas of

work suitable to the atypical employment rapport, on civil agreement);

- Civil penalty for violation of Art. 15 of Law 130/1999 (the employer receives a person to work without concluding a contract of employment or a civil convention);

- Civil penalty under Law 19/2000 on pension rights and other social insurance;

- Civil penalty under Law 76/2002 for non vacancies;

- - Criminal liability according to law 130/1999 on measures to protect people in employment, 76/2002 on unemployment insurance system and employment stimulation, 87/1994 to combat tax evasion;

- Liability in tort for all damages caused to the third parties by employees, material responsibility consisting in the calculation and payment of contributions to the state with all legal influences (late payment penalties, penalties and interest). Following those inserted above we conclude that many forms of legal liability should be able to discourage employers tempted to taking the risk employing "illegally".

Also, it should not be neglected that long term, the organization's competitional performance will be mitigated by the questionable quality, creativity and commitment of some illegal employees for a firm to which they are not bound by anything.

### 3. Causes for “black” employment

The causes of "black" employment are extremely varied, have a multifactorial determination and take the economic situation of the employee and employer at any given time, the level of their training and last but not least, the legal framework and enforcement regime.

We appreciate as significant the following causes [8]:

- The demand for jobs is greater than the supply, especially after the redundancies made in the budgetary system and the private sector as a result of the crisis, the disappearance of large state enterprises or their restructuring. Add to this the large number of graduates seeking work because of the schooling that ignores market demand;

- Tax burden, respectively the high level of taxes and social contributions - currently, the share of social contributions in the gross wage (employer and employee) is at least 43.5%, it can get, depending on how dangerous the work performed is at over 60%, a level which virtually cancels the effects of introducing the flat tax;
- The existence of underground economy;
- The fact that the vast majority of employers are adepts to the policy of obtaining important short-term profits at the expense of the company's development strategies in the medium and long term;
- Economic and financial instability of private enterprises in the SME category;
- Incomes which are low for a substantial part of the active population and very low for retired persons and pressing need for their filling up to the acceptability of the individual;
- The large number graduates of different forms of education seeking work, as a result of enrolment figures which do not take into account the labor market demand, but are dictated either by the desire to maintain at any cost the institution of schooling, either from commercial reasons;
- System of enforcement only for the employer, not the employee;
- Excessive bureaucracy for recording documents;
- The desire to deceive the state. Many opt for illegal employment just to benefit from unemployment benefits at the same time;
- Ignorance of the law in force which is associated with failure to acknowledge the full consequences arising from failure to conclude an employment contract;
- Poor labor legislation, in particular concerning the employment of specific categories (day-laborers in agriculture, construction, catering);
- Few employers who offer of employment resulting in the acceptance of the supplying of undeclared work;
- Lack of consistent policies to encourage foreign investors (government should not create jobs, but the conditions, the legislative framework necessary for foreign businessmen to invest);
- Administrative constraints, such as limiting the accumulation of income or prohibiting a second job (e.g. civil servants);
- Tolerance towards this phenomenon by state institutions;
- misconception of the employers in business development (business focus on quantity and quality of production and less on human capital);
- Vulnerability to a wide of socio-professional categories (many Romanians had difficulties in finding work according to training and experience);
- Free time, mainly due to expansion of part-time employment practice (half-time, part time);
- Low level of retraining.

#### **4. Statistical data regarding “black” employment in Romania**

The labor situation in Romania, both now and at all stages of economic transition shows that although most of those employed at a job or retired produce income that can not ensure the beneficiaries' subsistence cases, these social groups manage additional financial resources than those officially declared through which they ensure their existence. The same is true for people who have unemployed status and whose income from unemployment benefits is at the limits of survival.

Analyzing the nature of unemployment, specific to the Romanian economy, it is notable that while the duration of unemployment benefits is limited, many people seem able to maintain themselves for long periods of occupational inactivity. Very often it was found that virtually unemployed persons are working in some format, often occasionally or a few hours a day.

In Romania, unemployment seems thus related to underground economy growth by enrolling in the black economy of non-taxable persons.

Estimates on the size of undeclared work in Romania [4], it increased steadily until 1999, moment which was the peak year of employment on underground labor market. For that year, estimating employment of illegal labor market turnover reached 1071 thousand people, representing 13% in that time as a share of official labor market in

Romania. Employment situation of the illegal labor market was relatively high in 2000, when although declining, was 11.4% of official labor market, respectively 938 000 people.

Black labor continues to dominate the Romanian economy. According to statistics, young people accept much easier to work illegally, enjoying the fact that they can receive a salary, even if it is not safe, is still a source of income. Romania entering the European Union has not diminished this phenomenon, specific too many other Community countries.

In Romania, illegal employment is common. Unions claim that over 30 percent of the national economy is based on illegal work [1]. Statistics provided by the Demographic Research Center contain data even more dramatic. If we consider the number of people active in our country which, according to studies, is 10,500,000, the number of illegal employees, amounted to 4,700,000, shows that in Romania, over 5,000,000 people work without benefit of an employment contract. And the figures are not far from the truth.

Romanians were forced to accept work under the table to have a standard of living more or less acceptable. Despite Labor Inspection controls, many employers continue to practice illegal employment, based on the fact that people need money. In 2006, labor inspectors have applied fines in the amount of 26,128,400 lei for undeclared employment. Given the scale of the phenomenon, the amounts are small compared to number of those who - by will, by necessity - working without the benefit of a legal contract...

In 2011, 106,486 checks were made, after which 82,762 were applied sanctions, including 17,294 fines of 125,545,100 lei (29,196,534 Euros - a sum more than double the fines in 2010) and 65,468 warnings [10].

More than 2,000 criminal cases were drawn, during 2011, following control actions designed to detect and combat illegal employment, tax evasion, according to a press release from the Ministry of Administration and Interior (MAI). Thus, in almost half of cases criminal investigation was ordered. Inspectors found in the companies controlled about 28,000 people

working illegally. Of these, nearly 100 were minors aged between 15 and 18 years [9].

## 5. Conclusions

Methods to combat this activity have a significant impact sphere and are linked to combating unemployment and creating sustainable jobs, properly paid employment through:

- organizing training courses tailored to real market with a strong practical character;
- preventing illegal immigration which has the effect of distorting the labor market and especially creating a very favorable environment for illegal labor recruitment;
- protecting young specialists in areas such as chemistry, physics, law, finance, to avoid attracting them within the underground sphere;
- Providing incentive pay.

Based on the identified causes we can outline a series of solutions to mitigate and / or stop this phenomenon, including:

- Reduced taxation;
- Intensifying the actions of control along with severe penalties for those who use illegal labor;
- Promote information on legal provisions to educate both employers and employees;
- Promoting and publicizing the risks and consequences involved in this phenomenon.

There are, among economic analysts [3], also voices that support the beneficial effect of this segment of the informal economy, through the employment in this sector of a certain number of people, the state is relieved (at least partially) of payment of money that would otherwise be caused by them. However, the presentation of the causes and forms of manifestation of undeclared work, we conclude that it is a form of tax fraud because by not declaring (hiding) all or part of income, indicating that socio-economic implications are much wide.

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## Particularities of the Romanian Money Laundering Phenomenon

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### Abstract

*By analyzing the components of the underground economy matrix, we can say that its financial support is "money laundering" a comprehensive, dynamic phenomenon which lies in the desire of criminals to hide practiced illegal activities behind their sources of income, in order to allow a normal development in society.*

*In this study we tried to highlight some of the features of the phenomenon of money laundering, as well as some preoccupations concerning combating this phenomenon in Romania, member country of the European Union. In this regard, we analyzed the reports of the National Office for Preventing and Combating Money Laundering (N.O.P.C.M.L.) for the period 2006 - 2011, and numerous documents and papers produced over the years in this area, either by the researchers of this phenomenon, either by institutions / national and international bodies empowered for that purpose.*

**Key words:** underground economy, laundering "the dirty" money.

**J.E.L. Classification:** E26, E62, M40, M41.

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### 1. Introduction

Underground economy, parallel economy, informal economy, tax evasion, tax fraud,

working "illegally", laundering "the dirty" money, trafficking in counterfeit currency, drug trafficking, arms trafficking, human trafficking, corruption, organized crime etc. . are the subject of numerous articles in publications recognized at international, regional or national level, of several studies in the research projects conducted by teams of researchers from research centers / institutions of prestige, the reports prepared by authorities at national, European or global studies of economic, legal and / or social taken by many experts [2, 10].

If the underground economy issue is the topic of many specialists, the analysis of money laundering as a separate component the underground economy, are the main concern of institutions / organizations specialized in this issue, rather than specialists working individually or in small teams.

Another aspect found in the sights of specialists who study the phenomenon of shadow economy is the relationship underground economy - corruption - dirty money laundering.

Money laundering, as a form of the underground economy is a global phenomenon [8, 10], with a strong technical character while fighting it is an essential part of the general framework for combating economic and financial crime prevention, from early forms, culminating with another contemporary issue - financing.

Also, dirty money laundering is the last link of the criminal chain by which money from underground activities shall be reinstated in the formal economy.

Regarding the relationship between underground economy and money laundering, Nicolae Hoanță said: "The financial resources released by the underground economy are eventually used mostly to finance the surface economy, the operation known as money laundering" [7].

For this study I relied mainly on data in the report of the N.O.P.C.M.L. for the period, but also on information provided by other state institutions.

## 2. Money laundering. Concept

Directive CCE no. 308 of 10 June 1991 defines "*money laundering*" [1] as the next action, when committed intentionally:

- „Conversion or transfer of property about which the one who made it known to arise from a criminal activity or from participation in such activity, in the purpose of concealing or disguising the illicit origin of the goods or to help anyone involved in such activity to evade the legal consequences of his acts;
- Concealment or disguise of the nature, source, location, disposition, movement or ownership of the goods or rights with respect to them, knowing that they come from a criminal activity or participation in such activity;
- Acquisition, possession or use of property knowing at the time of receiving these goods, that they come from a criminal activity or from participation in such activity;
- Participation in one of the acts referred to in the previous three paragraphs, association to commit the act, attempt to commit that to help incite or advise someone to commit that to facilitate its execution”.

According to *Law no. 656/2002 on Preventing and sanctioning money laundering and to establish measures to prevent and combat terrorist financing* [4] by money laundering we understand:

- "Exchange or transfer of property, knowing that they originate from the proceeds of crime, in the purpose of concealing or disguising the illicit origin of such property or to help the person who committed the offense from which the goods come from to evade prosecution, trial or execution of sentence;
- Concealment or disguise of the true nature of the origin, location, disposition, movement or ownership or rights over their property, knowing that the goods come from crime;
- Acquisition, possession or use of

property, knowing that they originate from crime”.

In his book, "The Washing Machine: Money, Crime and Terror in the Offshore System" [3], the British investigative journalist Nick Kochan, classifies them by money launderers in the following categories:

- International corporations involved in fraudulent transactions;
- Corrupt governments and politicians;
- Organized crime which practices drug-trafficking, weapons, human beings etc.;
- Terrorism.

Some specialists in the N.O.P.C.M.L. define money laundering as: "Money laundering is the *de facto* financial part of crime through which comes profit. The process through which criminals attempt to conceal the origin and actual possession of income from their criminal activities. If successful, this work will allow them to maintain control over their income and, ultimately, will provide a legitimate cover for their income source. Money laundering is a process which gives an appearance of legality for the profits obtained illegally by criminals who, without being compromised further receive amounts obtained. It is a dynamic process in three stages, which requires, first - the transfer of funds obtained directly from infractions, secondly - hiding the traces of money to avoid any type of investigation, thirdly - availability of funds for criminals, hiding again the occupational and geographical origin of funds" [5].

## 3. Particularities of the Romanian money laundering phenomenon

Over the time it was found that in Romania, the typologies of money laundering are closely linked to the main areas vulnerable to economic and financial crime [2], namely:

- Tax evasion;
- Illegal VAT refunds;
- Fictitious or overvalued exports;
- Marketing and / or smuggling of petroleum products, alcoholic products and / or tobacco;
- Fraudulent privatization at the expense of state interests;
- Deception in banking, finance and insurance;

- Unlawful seizure of bank loans from their original purpose for which they were granted;
- Corruption and / or blackmail;
- Offshore companies;
- Organized crime.

According to data presented annually by the NOPCML, the number of suspicious transaction reports received by the Office is increasing since 2009 (Figure 1), after the period 2006 to 2008 there was a downward trend (3196 papers in 2006, 2574 in 2007 and 2367 respectively in 2008).

Figure 1. Evolution of the number of suspicious transaction reports received at the Office during 2009 – 2011



Source: Report N.O.P.C.M.L. the years 2011

To note, for the entire projection period, the increase in the number of cases solved and thus the decrease in the stock of papers under review at the end.

A major contribution in this regard was a 2008 application from a system of prioritization of works entering the analysis system, in fact, is the preliminary analysis of suspicious transaction reports.

The beneficial effects [9] resulting from the use of this system include the reduced stock of papers in the portfolio of financial analysts in the Department, leading to better management of work in analysis, thus addressing the Moneyval Committee recommendation.

The situation of the papers located in stock in analysis at the end of the period 2006 - 2011 is shown in Table 1.

Table 1. Stock papers in analysis in the period 2006 – 2011

An	2006	2007	2008	2009	2010	2011
Lucr.	3153	2625	1590	1995	680	710

Source: Data from the Report N.O.P.C.M.L. the years 2006 - 2011

From financial analyzes performed over the past years that, of all complaints submitted to the criminal investigation bodies, the main dirty money generating offense was tax evasion; this phenomenon is followed by acts of fraud; offenses under Law 31/1990 on companies; offense under the Customs Code; other offenses (drug trafficking, corruption, terrorism, etc.) (Table 2).

Table 2. Weight of the main "dirty money" generating offenses (%)

	2007	2008	2009	2010	2011
Tax evasion	66.41	74	64	65	79
Fraud	5.47	9.5	12	15	14
Offenses under Law 31/1990	7.81	5.3	7	10	3
Offense under the Customs Code	11.3	3.7	7	4	2
Other offenses	9.01	7.5	10	6	2

Source: Data from the Report N.O.P.C.M.L. the years 2007 - 2011

According to the Activity Report of N.O.P.C.M.L. for the period 2007 - 2011, the Office has received numerous requests by the EGMONT secure network of information on suspicious transactions.

If in 2006, the pre-accession year to the EU, 80 requests for information were submitted to the National Office, since 2007 their number increased significantly. In 2007 there were 128 requests for information; in 2008 to 100 applications, in 2009-185 applications, in 2010 to 188 requests for information, and in 2011-200 requests for information.

The share of geographical areas where the requests for information submitted to National Office originate is found in Table 3.

Taking into account that Romania is an EU member country, in order to have a clearer picture of the extent of money laundering, for Europe the situation is presented in detail, by region, both for highlighting the origin of information requests received by the NOPCML on suspicious transactions to be investigated as

well as in the geographical destination relating to requests for information on suspicious transactions provided by NOPCML for investigation.

*Table 3. Origin requests for information on suspicious transactions received by the N.O.P.C.M.L. for investigation of FIUs in Europe, from 2007 to 2011 (%)*

	2007	2008	2009	2010	2011
	%	%	%	%	%
<b>Europe</b>	92	82	87	83	85
Central Europe			41	40	20.5
South Europe			-	-	4
South-East Europe			14	18	9.5
North Europe			14	-	2.5
Western Europe			10	-	45.5
South-West Europe			-	25	2.5
Eastern Europe			8	-	0.5
Asia	2	8	6	10	2
America	5	5	6	7	8
Africa	1	3	1	-	0.5
Oceania	-	2	-	-	-
Middle East	-	-	-	-	4.5

Source: Data from the Report N.O.P.C.M.L. the years 2007- 2011

The data in Table 3 shows that in 2009 and 2010 approximately 40% of applications originated from reporters in Central Europe, while in 2011, over 45% of inquiries came from Western Europe rapporteurs.

Regarding the request for information sent to the N.O.P.C.M.L. investigation the period 2007 - 2011 by speakers from Europe, America, Asia, Africa, Middle East and Oceania, is as follows (Table 4):

*Tabel 4. Geographical destination of requests for information on suspicious transactions sent to N.O.P.C.M.L. for investigation during 2007 to 2011 towards foreign reporters (%)*

	2007	2008	2009	2010	2011
	%	%	%	%	%
<b>Europe</b>	68	65	65	76	74
Central			26	26	25

Europe					
South Europe			-	-	1
South-East Europe			15	24	9
North Europe			6	-	2
Western Europe			11	-	28
South-West Europe			-	26	6
Eastern Europe			7	-	3
Asia	14	16	18	14	3
America	17	17	15	8	16
Africa	-	1	-	-	3
Oceania	1	1	2	2	1
Middle East	-	-	-	-	3
<b>Total number request sent by NOPCML</b>	<b>525</b>	<b>417</b>	<b>337</b>	<b>145</b>	<b>199</b>

Source: Data from the Report N.O.P.C.M.L. the years 2007 - 2011

Analyzing the data above we see that in terms of the destination of the requests for information sent by NOPCML in the period 2009 - 2011 about 25% of applications are addressed to rapporteurs from central Europe in 2010, a similar percentage also found in the reporting applications transmitted in South-Eastern and South-west respectively, and in 2011 the majority reporting that addresses fine Romania Office are in Western Europe (28%). Also, we found a higher ponder and reporters in Asia and America.

#### 4. Concerns on combating money laundering in Romania

Throughout the period analyzed, especially in the last three years, NOPCML has directed its efforts towards actions aimed at strengthening its main operational capacity and to strengthen cooperation with all law enforcement authorities and raising awareness of reporting entities, as well as their supervision by law.

In legislative terms, the year 2011 [9] is distinguished by the Romanian Parliament adopting the *Law on the approval of Government Emergency Ordinance amending and supplementing nr.53/2008 Law 656/2002* on preventing and sanctioning

money laundering, as well as on measures to prevent and combat terrorist financing, respectively *Law nr.238/2011*.

In drafting this legislation, which has made important additions to the national framework in the field, to take account of the recommendations included in the Report of Moneyval-Council of Europe on the third round detailed assessment of Romania in combating money laundering and terrorist financing.

During 2009 - 2011 there have been actions to improve the activity in terms of prevention and respectively combating money laundering [6, 9], of which include:

- Supervision and control authorities have adopted measures related to secondary legislation to cover all aspects included in primary legislation in the field.
- In June 2010 the National Strategy for Preventing and Combating Money Laundering and Terrorist Financing and an Action Plan was adopted to strengthen, to optimize and reinforce the national capacity to prevent and combat money laundering / financing of terrorism.
- New legislative measures were adopted regarding the Office's competence to suspend certain transactions suspected of money laundering / terrorist financing at the request of a foreign FIU (harmonize Romanian legislation with the Warsaw Convention of 2005).
- Amendments to the legislation in the field have sought to achieve a high degree of harmonization of Romanian legislation with the provisions of Directive 2005/60/EC of the European Commission and the FATF Recommendations.

In 2012, NOPCML [9] has continued and will continue measures to strengthen cooperation with institutions component at national level in preventing and combating money laundering, by holding regular working meetings for the exchange of expertise, to identify the best methods to investigate of suspected cases of money laundering and / or terrorist financing.

It also envisages further development of information exchange between NOPCML and financial intelligence units (FIUs) from abroad, using secure networks (Egmont Secure Web and FIU.NET), and the conclusion by the Office of the new Memorandum of Understanding with

Financial Intelligence Units.

## 5. Conclusions

"The money laundering is the terminus on corruption and organized crime, which basically crowns the ingenious techniques in economic and financial crimes and is the glue connecting the cross-border economic crime." [7]

According to the Activity Report of the N.O.P.C.M.L. for the period 2007 - 2011, the Office has received numerous requests of information through the EGDMONT secure network on suspicious transactions, most of them coming from European FIUs, particularly in Central and South Eastern Europe.

Analyzing the sources of origin of amounts subject to recycling, established in 2007 - 2011 Activity Report of the National Office for Preventing and Combating Money Laundering [6, 9], results that the most vulnerable areas of activity are: domestic trade, foreign trade, real estate and service and investments.

From financial analyzes performed over the past years that, of all complaints submitted to the criminal investigation bodies, the main dirty money generating offense was tax evasion, this phenomenon is followed by acts of fraud, offenses under Law 31/1990 on companies, offense under the Customs Code, other offenses (drug trafficking, corruption, terrorism, etc.).

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# Historical Perspective on International Financial Centers

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## Abstract

*International financial services in their most basic conceivable forms have been provided, in one form or another, for at least two millennia. The growth of international finance as we know it (financial services, institutions and markets) has been shaped by history in response to requirements for capital specific to different times and different places. In early times, when there was no infrastructure, no central banking, and no financial regulation, merchants and bankers worked alone and had great difficulty in raising funds for their investments. They eventually diversified their sources of funds (to royalty, church, landed aristocracy and wealthy professionals) and began collaborating with partners in other locations. These early impulses resulted in incipient clusters of financial expertise that were later to evolve into what we call international financial centers (IFCs) nowadays.*

**Key words:** IFC, trade, entrepôt, stock exchange, regulation.

**J.E.L.:** G15, N20

## 1. Introduction

There are several key elements to being a top global financial center these days: ready access to capital, a solid regulatory regime, and a large pool of professional talent.

It appears that most great international financial centers originated in cities with superior location and benefited from a deep financial transformation of economies that were leaders in the world economy. This transformation resulted from institutional changes that were driven by expanding markets and opportunities. From a historical perspective, a natural antecedent of a financial center is what has become known as a financial revolution, similar to those that occurred in Florence in the 14th century, Genoa and Venice in the 15th century,

Antwerp in the 16th century, Amsterdam in the 17th century, England in the 18th century, and the United States in the 19th century supported by three basic pillars: innovations in financial institutions, instruments and markets; an institutional mechanism through which the debtor commits not to renege on debt, and the presence of a public bank.

History also demonstrates that the hierarchy of financial centers appears stable, but in fact it is evolving all the time and that established IFCs are not immune to decline due to competition from new challengers. Examples include Sydney surpassing Melbourne, Toronto surpassing Montreal, Johannesburg surpassing Cape Town, and Sao Paulo surpassing Rio de Janeiro during the post war period. Such a shift of comparative advantage between competing cities should not come as a surprise considering that financial production is increasingly footloose thanks to the advancement of information and telecommunication technology, even though location still matters.

## 2. IFCs before the 19th Century

From the 12<sup>th</sup> through the 16<sup>th</sup> century Europe was economically dominated by **Florence, Venice and Genoa**. Though not a port city, Florence had very extensive trading and banking activities with the countries of Northern Europe. Genoa and Venice were maritime powers fighting for dominance of the maritime routes to West and East, respectively.

At the end of the sixteenth century, world trade shifted from the Mediterranean to the Atlantic. During that period the Netherlands gained commercial supremacy based on the fact that the port of **Amsterdam** became an entrepôt for merchandise coming from all the corners of the world and most of it being then re-exported. This, together with the high level of urbanization and the productivity of its agricultural and industrial sectors, placed the Netherlands in leading position ahead of its competitors. The growth of the international trade led to the growth of the

financial sector – loans and insurance prospered in the early 1700s.

The Dutch financial revolution was sparked by Emperor Charles V in his attempt to find new ways to borrow money. In 1609, the *Wisselbank* of Amsterdam received the monopoly on money changing, on bills of exchange valued in excess of 600 guilders, and on bullion transactions and soon became the center of the Dutch payment mechanism. Two centuries later, the center of gravity of international trade shifted from Amsterdam towards **London**, but Amsterdam still kept its position as the world’s dominant financial center. Interesting to notice that the two cities are both port cities and were commercial hubs of large empires.

The Glorious Revolution of 1688, the fact that the Parliament made property rights more secure, the creation of a public bank, the Bank of England in 1694, which, along with the East India Company began to issue shares that were well received by the public, all these elements opened the ascendancy of London as a financial center.

The cradle of the Industrial Revolution, colonial England turned into a genuine trading power. From that emerged an insurance market and a banking sector (bills of exchange, private banks).

The Napoleonic Wars left their marks on the history of financial capital. After the war, military spending dropped and thus liquidities increased.

In 1817 a loan denominated in francs to finance French war reparations was arranged. One year later, the first foreign loan in sterling was arranged by Rothschild for Prussia. Foreign loans were allowed to be listed on the London Stock Exchange in 1823.

As a financial center, **Paris** was appealing to British and Americans who bought here bills of exchange to pay for their purchases and to clear their debts with the Anglo-Saxon countries.

In the mid 19th century the banking world expanded through the creation of joint-stock banks, with limited liability, with far larger capital than private banks, and with the possibility of taking larger risks, of deposit banks, investment banks, and overseas banks. The railway revolution of those times triggered a substantial development of the capital market.

**Berlin** rose to the top ranks among international financial centers following the

unification of Germany in 1871, as a response to Germany’s fast pace of industrialization and growth which needed to have a financial center of such dimensions.

### 3. Historical Perspective on Modern Day IFCs in Europe

Both the Xinhua-Dow Jones International Financial Centers Development Index and the Global Financial Centres Index place **London** in first position in the top ten financial centers of the world. It appears that when companies seek to list their stocks, they would rather go to London before New York. London's location between Asia and the U.S. meant that it was particularly suitable when taking into account time zones.

London as a financial center took shape as an addition to (not a substitute for) its role as a commercial center. London's port, its insurers, its activities in the distribution of minerals and metals were complementary to its central position in international finance.

The London Stock Exchange is usually seen as the model example of an open competitive market, and many have argued that this model explains, at least in part, the success of London as a financial center.

**Paris**, considered until 1914 as the second international financial centre after London, declined more than the other ones after WW1.

The Bourse was established in 1801. From the early 19th c. onwards, the structure of the Parisian stock market was bipolar, including two very different markets, the Parquet and the Coullisse.

The Parquet was the regulated market organized by the *Compagnie des agents de change* (CAC), the semi-private body of 60 official brokers (agents de change) with a legal monopoly on transactions who were recruited on strict social and wealth conditions which provided high guarantees to the investors.

By contrast, the Coullisse was a loosely organized market (with no juridical structure until 1884), illegal *de jure* but *de facto* tolerated and even protected by the government. Its members (the coullissiers) acted both as brokers and jobbers. They were usually less wealthy than the official brokers. Their number was not fixed, and the admission procedure was loose.

The differences between the two markets led to a specialization, competition developing only at the margin.

This bipolar architecture remained quite steady over the century, than in 1893, the creation of a new tax gave to the *Coulisse* a legal status. The 1893 reform was reversed as soon as 1898.

The Paris Bourse escaped the 1907 crisis and remained more important at the international level than the French economy, emphasizing the capacity of dual market organizations in providing efficient services to the users of stock exchanges.

After 2000, the stock exchange has officially been dubbed the Euronext Paris and is the second-largest European exchange following the London Stock Exchange.

It is quite surprising to learn that the city of **Zurich** has a short history as a financial centre. It has gradually developed as a banking, industrial and financial center only since the 18th century.

The foundation stone for Zurich's banking center was laid in 1755 when Bank Leu & Co. was established. Then, in 1856, a second major bank was founded: Schweizerische Kreditanstalt (now Credit Suisse). Eidgenössische Bank (EIBA) was set up in Berne in 1863 and later transferred its headquarters to Zurich in 1892. Bank in Winterthur (established in 1862) became Schweizerische Bankgesellschaft (SBG) in 1912 and also moved its headquarters to Zurich.

As industrialization gathered pace, Zurich developed into the leading center of industry in Switzerland. After the Swiss Federal State was set up in 1848, Zurich began to take on the leading role in the country's economy.

In 1880, the construction of the stock literally laid the foundations for a prestigious financial center. However, it was not until after the Second World War that Zurich developed into one of the leading IFCs.

#### **4. Historical Perspective on Modern Day IFCs in America**

**New York's** Wall Street was leader of the financial world for most of the 20th century, but over the past decades numerous financial centers have challenged its position.

New York was founded in the early 17th century, by Dutch fishers and fur traders. Unlike most New World colonies, it was not an escape from religious persecution or a

state sanctioned colonial expedition but rather a purely commercial venture.

It is important to remember that the wealth created from New York's position as a trade center was not accompanied by financial activity. There were systems of rents and various forms of insurance offered as financial products, but nothing compared to the central banking system modeled by the Bank of England or the myriad of private and joint-stock commercial banks such as Barclays or Lloyd's. It was wealth born of agricultural entrepreneurship, the manufacturing of staples, and trade with Europe. In the period leading up until the Revolutionary war, financial institutions were almost nonexistent in America.

It was not until after the Revolutionary War that modern financial institutions began to form in the colonies where they first engaged in large scale government finance. In fighting the war against Britain, the American colonies had incurred huge war debts. It was from these primitive roots that American finance was born.

**Chicago** owes its existence to its strategic position: The patch of land where it stands straddles a key point along an inland water route linking Canada to the Gulf of Mexico.

Given the fact that the Chicago Mercantile Exchange (founded in 1898 as a non-profit organization and gone public in 2002) is the United States' oldest futures exchange and that the Chicago Board of Trade (established in 1848 for the business of trading futures and commodities options) acts as the largest trader of derivative products, it is easy to understand the position of the city of Chicago (founded in the 1830s) as one of the nation's financial centers.

It was not until 1826 in England, and 1867 in the United States, that the traditional futures market was established. In the US, Chicago was the natural locale as it represented the great railroad center for products grown in the West to be moved to the population centers in the East. It proved to be a huge commercial success for the city. Throughout its formal history, traditional futures were based on agricultural products.

#### **Toronto**

Toronto is both the financial services capital of Canada and the fastest growing financial centre in North America. The Toronto Stock Exchange is the third largest in North America, after New York and Chicago.

Toronto's central geographic location shares a time zone and borders the world's largest concentration of economic activity - New York, Boston and Washington- which makes Toronto an ideal market to head-quarter North American operations.

## 5. Historical Perspective on Modern Day IFCs in Asia

Asia's financial centers – **Tokyo, Hong Kong, Singapore, and Shanghai** - rank in the mid-part of the top ten IFCs.

Both **Hong Kong** and **Singapore** entered the modern era as colonies of Great Britain, Singapore in 1819 and Hong Kong in 1842.

A primary entry and exit point for mainland trade and investment financing, **Hong Kong** has particular strengths in banking, equity markets, funds management, and, increasingly, insurance. The main legacies of relevance to both of their financial markets today are the British common law tradition and the English language.

The East India Company made the first sea venture to China in 1699, and the region's trade with British merchants developed rapidly soon after. The bustling city of Hong Kong was just a collection of fishing villages when claimed by Britain in 1842 following the First Opium War with China. After being ceded by China to the British, the colony of Hong Kong quickly became a regional center for financial and commercial services. In 1841 there were only 7500 Chinese inhabitants of Hong Kong and a handful of foreigners, but by 1859 the Chinese community was over 85,000 supplemented by about 1600 foreigners. The economy was closely linked to commercial activity, dominated by shipping, banking and merchant companies. Gradually there was increasing diversification to services and retail outlets to meet the needs of the local population, and also shipbuilding and maintenance linked to the presence of the British naval and merchant shipping. From a relatively unpopulated territory at the beginning of the nineteenth century, Hong Kong grew to become one of the most important international financial centers in the world.

A boom occurred after 1945 and pushed forward the city's capacity to make the most of favorable economic trends outside the Chinese Mainland. Hong Kong's banking markets soon recovered from the war.

Having successfully ridden waves generated by instability in China and by global monetary turmoil associated with the end of the Bretton Woods exchange rate system and the oil price shocks of the early 1970s, Hong Kong emerged as a centre for offshore credit operations for the region's governments and expanding industrial corporations.

Hong Kong was severely tested during the so-called Asian crises of the late 1990s and affirmed by its outstanding performance during the worst global crisis since the 1930s, which began in the United States in 2007.

The government of Hong Kong created important tax advantages by dropping its previous 15% withholding tax on interest paid on foreign deposits.

In Hong Kong, government played the role of facilitator; it restrained its tax policies and kept individual and corporate taxes low across the board, it intervened directly in its economy on an *ad hoc* basis, mainly in response to emergencies, and it adjusted its regulatory framework as required by periodic scandals.

In Hong Kong, a government with widely distributed powers accommodated often opaque linkages between public and private sectors that, relatively speaking, permitted deep interaction between domestic and international markets.

Perhaps because of the turbulent financial history of Hong Kong, dating back to the 1866 crisis that saw six of eleven then-existing banks fail (including two note-issuing banks), the biggest licensed banks are now well-known for conservative management.

Modern **Singapore** was founded as a trading post of the East India Company in 1819. The British obtained full sovereignty over the island in 1824 and Singapore became one of the British Straits Settlements in 1826. Before its independence, Singapore was also the main British naval base in East Asia and hosted the largest dry dock in the world at that time, being described in the press as the 'Gibraltar of the East'.

Singapore was occupied by the Japanese in World War II and reverted to British rule after the war. It became internally self-governing in 1959. It united with other former British territories form Malaysia in 1963 and became a fully independent state two years later after separation from Malaysia. Since then it has had a massive

increase in wealth, and is one of the Four Asian Tigers and a strong Asian competitor, especially in foreign exchange and derivatives trading, international banking, and bonds.

In Singapore, government played the role of leader; it believed in industrial policy and it implemented such a policy through targeted tax concessions, strict regulation, and sectoral planning.

In Singapore a centralized government promoted new industries and encouraged the development of locally based ‘off-shore’ markets.

With 24 state banks, over 200 private lenders, trust companies and other financial institutions, **Shanghai** was the leading financial centre in Asia in 1949. The economic reform and opening to the world policies launched in 1979 gave a new lease of life to Shanghai. Now, after the launch of the Chinese open door policy, Shanghai is once again seeking to transform itself into an IFC. The stated objective of the Chinese government was to develop Shanghai into a leading international industrial, financial, and commercial centre by the year 2010.

Shanghai has already established itself as the domestic financial hub of mainland China. Its stock market has developed rapidly since 1991 to become the third largest in Asia, following only Tokyo and Hong Kong. Steps have been taken to transform Shanghai into the centre for many of the country’s other financial activities (interbank lending, bond trading, foreign exchange trading and fledgling futures and commodity trading).

## 6. Conclusions

International financial centers do not appear at random. They emerge and develop in places offering a cluster of attractive conditions to the financial actors that have established their activities there. And, it is but a small step from trade in commodities and manufactured goods to trade in services.

At world scale, before 1870, a large number of cities (including Amsterdam, Berlin, Florence, Frankfurt, Genoa, Hamburg, London, Milan, New York, Paris, Philadelphia, Rome, Turin, Venice, and Zurich) provided regional and global financial services, but none greatly dominated the others. Around 1870, London and Paris began to emerge as the strongest centers and competed against each other

vigorously. After 1870 (after the Franco-Prussian War and France’s defeat by Germany), London won out as the dominant IFC in the world and remained so until the outbreak of the First World War in 1914. After the war, New York City challenged London for the top spot and after the Great Depression of the 1930s it surpassed London. New York remained the leading IFC through and after the Second World War.

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## A New Social Class-The Knowledge Workers

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### Abstract

*In the new economy classical occupations (lawyers, engineers, economists, farmers, vendors, etc..) coexist with the new occupations (marketing specialists, computer scientists, analysts, teachers, doctors, managers, etc..), specific to the knowledge-based economy*

*In the new economy a certain category of specialists, called knowledge-based specialists is emerging. The usual employee works with his hands and produce goods or services. Instead a knowledge worker works with its head instead its hands and produces ideas, knowledge and information.*

**Key words:** knowledge economy, knowledge workers, education unemployment.

**J.E.L. Classification:** D 8

### 1. Introduction

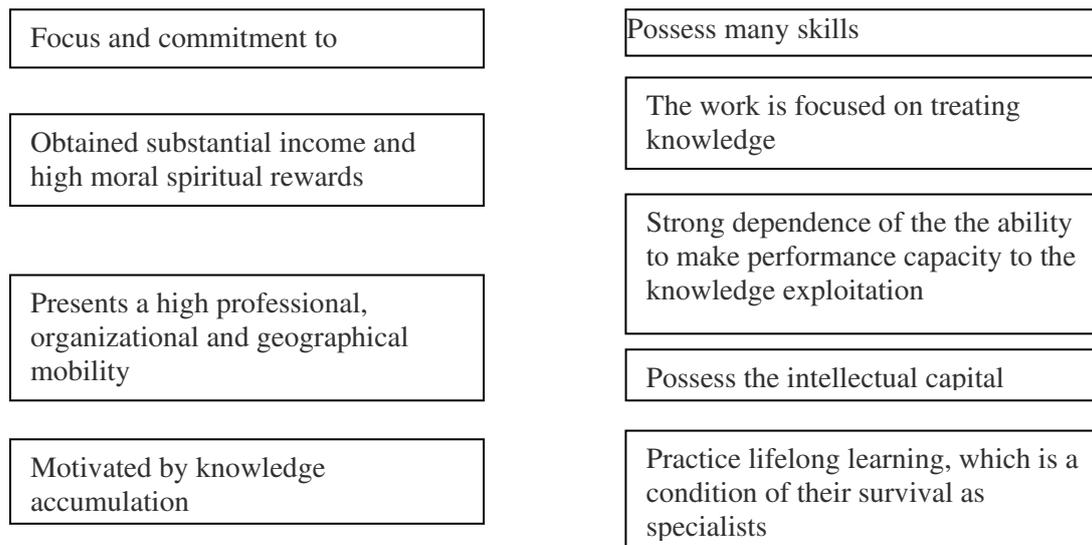
The characteristics listed in the figure conclude that knowledge-based specialists are both owners of the intellectual capital and active human resources participating in economic activities.

The knowledge workers possess knowledge and they constantly renew them through continuous learning in order to maintain their title of knowledge workers.

The essence, productivity and work performance of the knowledge workers lies in the collection, assimilation, creation, combination, use and exploitation of knowledge.

The knowledge workers present high mobility, meaning that they can change their job to another post or function within the same organization or in a different organization, they can change their profession, being available to change their home for their job.

Fig. no. 1- Characteristics of the knowledge-based workers



Source: Ovidiu Nicolescu, Luminita Nicolescu, *The knowledge economy, business and management, Economic Publishing, 2005, p.65*

Knowledge-based specialists are dedicated people to their job, get high incomes in the form of salaries, bonuses, shares in companies in which they work, concomitantly with a special moral treatment, all these rewards reflecting the knowledge and the intellectual capital they hold.

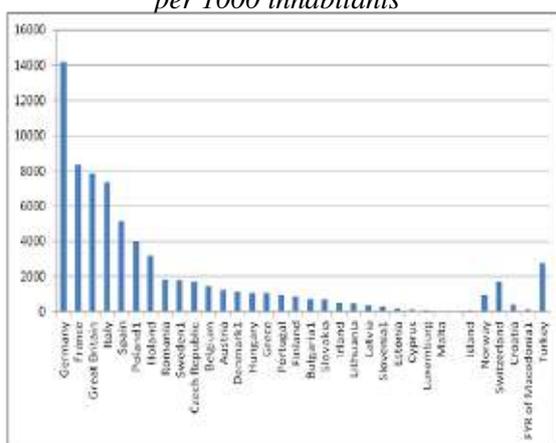
In the knowledge based economy, the specialized workforce is well trained in handling data, information, knowledge, which will lead to demand for careers such as scientists, engineers, chemists, biologists, mathematicians, scientific inventors etc..

Also, entities that use knowledge workers such as clusters, will be vital for the global economy.

## 2. Human resources in science and technological domains

In 2007, within the EU-27, 65.1 million people held positions in science and technological domains, representing approximately 29.8% of the total employed population within the EU-27. From the figure showed below you can see that the countries with a large number of human resources in science and technological domains is Germany, followed by France and Great Britain. Romania ranks the eighth place among the EU-27 countries.

Fig. no.2 -Human resources in science and technological domains in the EU-27 in 2008 per 1000 inhabitants



Source: Eurostat statistical books, Eurostat yearbook 2011, “Science and Tehnlogy” section, p. 587

\* For the following countries: Bulgaria, Denmark, Poland, Slovenia, and Sweden the values refer to 2007

## 3. The unemployment rate in Romania

In the current economic crisis, the main problem facing the economy is unemployment (as can be seen from the table and chart below, the Romania's unemployment rate in Q3/2011 stood at 7.2%). Because old occupations can not be reborn, the solution is looking for new jobs according to the skills that people have.

Table no.1-The evolution of the ILO unemployment rate in Romania in the period 2009-2011 (%)

Q	T	M	F	U	R
Q3/2011 <sup>1</sup>	7,2	7,8	6,6	8,9	5,1
Q2/2011 <sup>2</sup>	7,2	7,5	6,8	8,5	5,5
Q1/2011 <sup>3</sup>	7,6	8,2	6,8	8,8	5,9
Q4/2010 <sup>4</sup>	7,3	7,9	6,5	9,0	5,0
Q3/2010 <sup>5</sup>	6,9	7,4	6,3	9,0	4,4
Q2/2010 <sup>6</sup>	6,8	7,3	6,2	8,6	4,7
Q1/2010 <sup>7</sup>	8,1	8,8	7,1	9,9	5,8
Q4/2009 <sup>8</sup>	7,5	8,1	6,7	8,9	5,8
Q3/2009 <sup>9</sup>	6,8	7,6	5,9	8,2	5,2
Q2/2009 <sup>10</sup>	6,3	7,1	5,2	7,7	4,5
Q1/2009 <sup>11</sup>	6,9	7,9	5,5	7,5	6,0

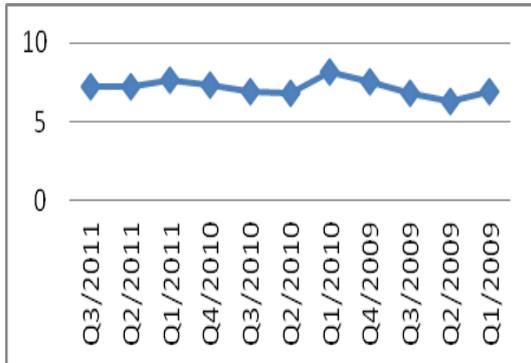
Legend: Q=quarter, T=total, M=masculin, F=feminin, U=urban, R=rural

Source: National Institute of Statistics

\*According to the International Labour Office criteria

- (1) press release no. 275/2011
- (2) press release no.. 202/2011
- (3) press release no. 131/2011
- (4) press release no. 61/2011
- (5) press release no. 2/2011
- (6) press release no. 209/2010
- (7) press release no. 138/2010
- (8) press release no. 66/2010
- (9) press release no. 3/2010
- (10)press release no. 198/2009
- (11)press release no. 130.2009

Fig. no. 3-Evolution of the ILO unemployment rate in Romania during 2009-2011



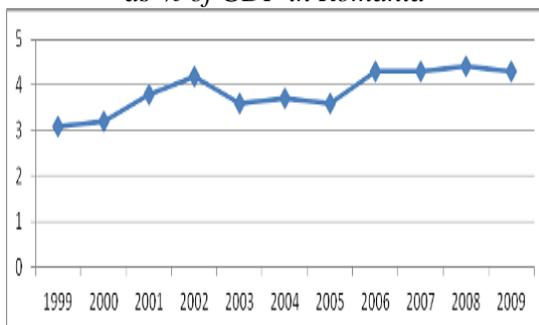
\* According to the International Labour Office criteria

Education in general and especially the economic education are considered essential variables in the context of the development and progress of the knowledge based society and economy.

In most developed countries of the world investments in human capital in general, and investments education in particular are considered keys of the economic and social life-long development.

The analysis of the education raised the attention of economists since the beginning of the modern economic science, revealing the beneficial effects generated both on the individuals and on the society.

Fig. no. 4 - Public expenditure on education as % of GDP in Romania



Source: National Institute of Statistics

\*The data for 2008 and 2009 are partially completed

The share of the public expenditures for education in GDP highlights the proportion of the annual national financial achieved allocated from the Government to the development of the education.

The share of the public expenditures for education in GDP is determined by dividing the total amount of public expenditure for education to the gross domestic product from a particular financial year and multiplied by 100.

From the above chart, we see that in Romania, public spending on education as a percentage of GDP recorded during the analyzed period, values between 3 and 4.5%.

#### 4. Conclusion

In the new economy a certain category of specialists, called knowledge workers is emerging. A knowledge worker works with its head instead its hands and produces ideas, knowledge and information. They constantly renew their knowledge through continuous learning

In the new economy classical occupations coexist with the new occupations, specific to the knowledge-based economy

In 2007, within the EU-27, 65.1 million people held positions in science and technological domains, representing approximately 29.8% of the total employed population within the EU-27

In the current economic crisis, the main problem facing the economy is unemployment. Because old occupations can not be reborn, the solution is looking for new jobs according to the skills that people have and their education in this direction.

In the context of the knowledge-based economy, continuous access to education is considered extremely important. The role that education plays is ensuring what today is one of the most important elements for obtaining the performance in a economy –the competitiveness of an economy.

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## Information and Communication Technologies- Vector of Development of the Knowledge Based Economy

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### Abstract

The new economy is often assigned as the information economy due to the importance of the information as a resource in creating wealth. Thus, when speaking of the new economy, we refer to a world where people work with their brains instead of hands. Information and communication technologies bring together all the tools necessary for managing the information

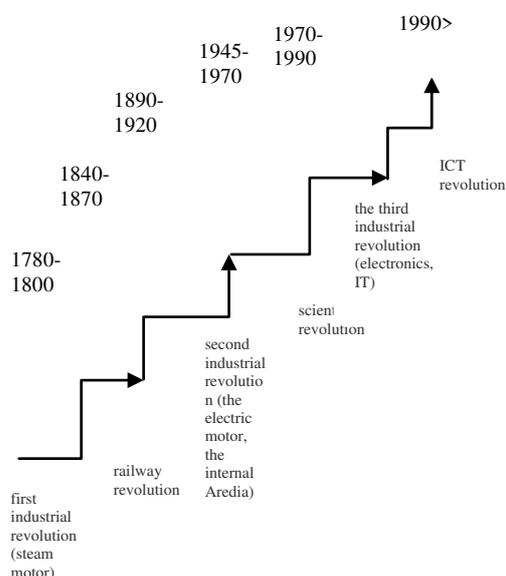
**Key words:** knowledge based economy, ICT revolution, ICT sector.

**J.E.L. classification:** D 83

### 1. Introduction

Today's ICT revolution shows both commonalities and differences with previous technological revolutions.

Fig. no.1- The succession of industrial revolutions



Source: Minodora Ursacescu, Information and Knowledge Economy, University Publishing House, Bucharest, 2009, p 160

The today's ICT revolution and the previous revolutions are characterized by the fact that no matter when it comes to electricity, transport or technologies, the first beneficiaries of the advantages of these revolution were the industrialized countries.

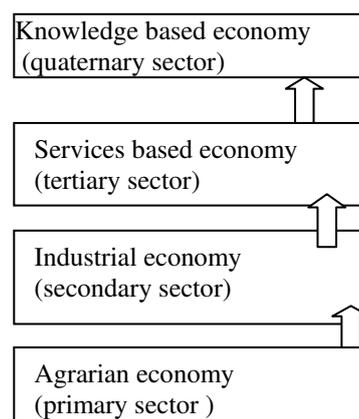
If we think at the differences between the previous industrial revolution and the current revolution, the first aspect to consider is the necessary time to generalize technological innovations.

If for the connection to the electricity it took 46 years (from 1873), the spread of television has lasted 26 years (since 1926), in exchange the development and dissemination of the modern technologies was done in short time: for example for the widespread use of personal computers were needed 16 years, 13 years for the expanding of the cellular phone, the extensively access to the Internet took seven years.

Secondly, while previous industrial revolutions covered a certain sector, ICT revolution presents the property of being transverse, and is quite extensive in all economic sectors.

The society as a whole is moving towards to a network society characterized by the significant weight of the quaternary sector (the knowledge sector).

Fig. no. 2-The transition from agrarian economy to knowledge economy



## 2. ICT impact on the new economy

ICT impact analysis on the new economy will be structured on three levels: economic, social and political. The ICT sector is the engine of **economic development** whose impact can be highlighted by the following elements:

- ICT sector generates due to the development of the Internet, new ways of production and forms of exchange;

- ICT sector presents a strong character of transversality. Unlike the previous industrial revolutions, the current technological revolution is quite extensive in all economic sectors.

Regarding the **social dimension**, ICT industries and services, bring new valences to the communication processes, within organizations and also between individuals due to the appearance of certain products (cultural products, media) with impact on the social aspects of life (eg. Education).

Because organizations, governments, and consumers are dependent of the use of TIC services and products, worldwide raise a number of security issues and reliability of the transactions made through them. In this context, the **political component** plays a crucial role to reform the legal framework regarding the use of TIC services and products.

Beyond the positive impact of ICT sector on the current economy cannot be ignorant that, its development is not equally worldwide disseminated. Even if the beginning of this century revealed a significant number of countries that have made progresses in all ICT areas, there are numerous disproportion between different geographical areas of the world.

In the context of the economic deterioration that began in 2008, essential in ensuring the balance of this sector are the investments in research, innovation and training of the human resources.

## 3. Analysis of ICT sector

Information and communication technologies (ICT) have developed and spread rapidly, especially in the last 20 years. Assumptions of this evolution have been the progresses in electronics, information and communications.

The development of the knowledge and information based society is the result of the considerable progress in the last three decades registered in information and communication technologies.

The ICT industries and services were accelerated after 1995 when a new wave of technologies based on the World Wide Web applications have expanded to the entire economy.

Expanding computer networks, the Internet boom after the 90, the miniaturization of electronic components, are just some of the most significant stages of the rapid advances in the technological transformation.

Opportunities offered by new information and communication technologies influence the new economy infrastructure, organizational processes, the competitive market behavior, revealing the potential of the ICT sector to accelerate global growth and performance of the organizations.

According to a general approach, ICT groups a set of activities aimed to produce goods and services through which is ensured the collection, processing, transmitting, receiving information through electronic means.

Continuing I will present statistics on computer, Internet, e-commerce by population in the EU and Romania.

*Table no. 1- Level of competence in using the computer in Romania (% , 16-74 years)*

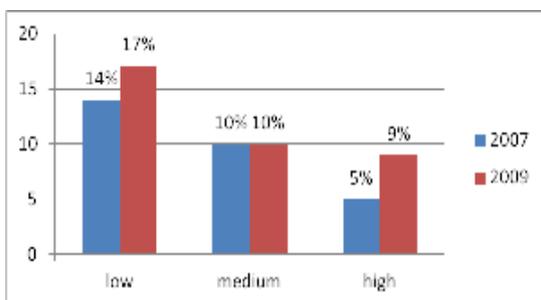
	Level of competence in computing <sup>1)</sup>					
	2007			2009		
	low	medium	high	low	medium	high
<b>Total</b>	<b>14</b>	<b>10</b>	<b>5</b>	<b>17</b>	<b>10</b>	<b>9</b>
<b>Sex</b>						
M	15	11	6	18	10	11
F	14	10	4	16	11	8
Age groups						
16-24	25	23	12	25	22	21
25-34	19	13	7	23	13	14
35-44	15	11	4	19	10	8
45-54	11	7	3	14	7	6
55-64	6	2	1	8	4	2
65-74	1	–	* <sup>2)</sup>	2	1	–

Source: National Institute of Statistics

\*1) the difference to 100% is the share of persons of 16-74 years who are engaged in activities other than the activities analyzed

\*2) insignificant estimates

Fig. no. 3- Share of persons with computing skills in Romania (% , 16-74 years segment)



Source: <http://data.worldbank.org/>

The percentage of persons of 16-74 years, with computer skills (low, medium or high), as a total of 16-74 years persons using computer, assesses skills in using computer.

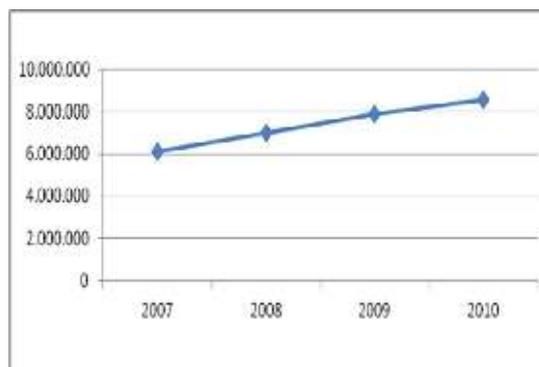
The level of competence in computing is obtained by reporting the number of people between 16-73 years with low / medium / high skills in computing to the total number of persons of 16-74 years using computers.

Low computer skills have people who have held one or two computer-related activities. Medium computer skills have persons who have held three or four computer-related activities. High computer skills have persons who have held five or six computer-related activities. The activities considered are:

- 1) Copying or moving files or directories;
- 2) Copying / moving text or objects in a file;
- 3) Using basic arithmetic operation formulas in a spreadsheet;
- 4) Compression / archiving files;
- 5) Connection and installation of new equipment;
- 6) Writing computer programs using special programming languages

The fig. no. 3 shows that in Romania, in 2009, 17% of the population aged 16-74 years has low skills in computing, 10% of the analyzed segment has medium skills in computer handling, and 9% of the same segment has high competence in computing. High level skills in computer handling were recorded within the population aged 16-24 years.

Fig. no. 4-No. Internet users in Romania between 2007-2010



Source: <http://data.worldbank.org/>

From the above table we can see that in the recent years (2007-2010), more and more Romanians started to use the internet, so that in 2010, we can say that about 40% of the population is using the Internet.

Table no.3 - Level of competence in using the internet in Romania (% , 16-74 years)

	Level of competence in using Internetului1)					
	2007			2010		
	low	medium	high	low	medium	high
<b>Total</b>	<b>16</b>	<b>10</b>	<b>2</b>	<b>25</b>	<b>16</b>	<b>1</b>
<b>Sex</b>						
M	17	11	3	27	18	1
F	16	9	2	25	16	1
<b>Age groups</b>						
16-24	27	25	7	36	33	2
25-34	23	13	3	33	26	1
35-44	19	9	2	31	14	-
45-54	15	4	1	24	10	-
55-64	6	2	-	13	4	1
65-74	1	-	*2)	4	1	*

\*1) the difference to 100% is the share of persons of 16-74 years who conducted activities other than analyzed activities

\*2) insignificant estimates

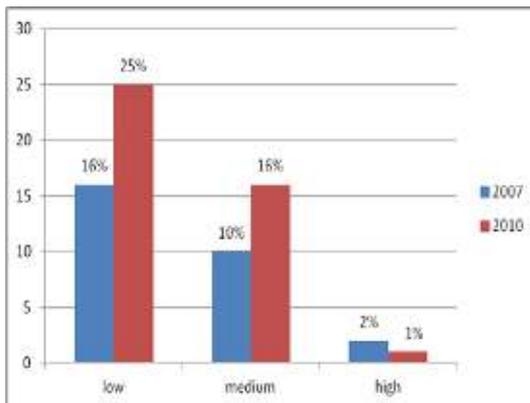
The percentage of persons of 16-74 years, with skill levels (low, medium or high) in Internet usage, in total people of 16-74 years is an indicator that assesses skills in Internet use. The indicator is calculated by reporting the number of people of 16-74 years with low

/ medium / high skills in the use of the Internet, to all persons of 16-74 years.

Low skills have persons who have held one or two Internet-related activities. Medium skills have persons who have held three or four Internet-related activities. High level skills have persons who have held five or six Internet related activities. The activities considered are:

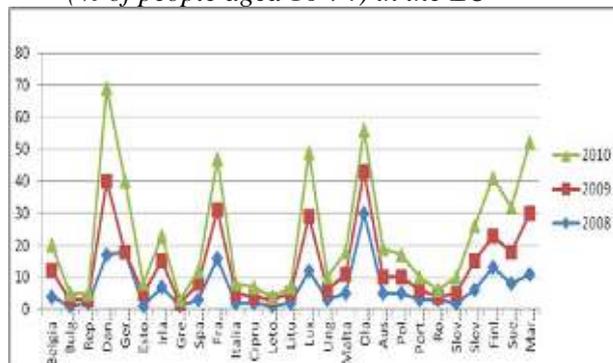
- 1) the use of a search method to find information;
- 2) sending e-mails with the attachment of files;
- 3) posting messages on chat, group discussions;
- 4) the use of the Internet for phone calls;
- 5) the use of the share files in order to share movies, music etc.
- 6) creation of web pages.

Fig. no.5 - Level of competence in internet activities, Romania (% , 16-74 years segment)



From the above figure we can observe that most Internet users have low and medium skills in using the Internet.

Fig. no. 6-Individuals who use the Internet to buy or order products with online content (% of people aged 16-74) in the EU



Source: Eurostat

The chart above shows that e-commerce has recorded an ascendent evolution during the analyzed period (2008-2010). Leading countries in the year 2010 in which individuals purchase or buy products with on-line content are Denmark, Netherlands, United Kingdom, Luxembourg, France. Romania belongs to the category of countries where e-commerce recorded low percentages (2% in the year 2010).

#### 4. Conclusion

The development of the knowledge and information based society is the result of the considerable progress in the last three decades registered in information and communication technologies. The society as a whole is moving towards to a network society . According to a general approach, ICT groups a set of activities aimed to produce goods and services through which is ensured the collection, processing, transmitting, receiving information through electronic means. In the context of the economic deterioration that began in 2008, essential in ensuring the balance of this sector are the investments in research, innovation and training of the human resources. Information and communication technologies (ICT) have developed and spread rapidly, especially in the last 20 years

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## Theoretical Framework for Corporate Governance

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### Abstract

*History has revealed that there is a never-ending evolution of theories or models of corporate governance. Companies are trying to instill the sense of governance into their corporate structure. This article is a review of literature on the range of theories in corporate governance. The fundamental theories in corporate governance began with the agency theory, expanded into stewardship theory and stakeholder theory and evolved to transaction cost theory. However, these theories address the cause and effect of variables, such as the configuration of board members, audit committee, independent directors and the role of top management and their social relationships rather than its regulatory frameworks. Hence, it is suggested that a combination of various theories is best to describe an effective and good governance practice rather than theorizing corporate governance based on a single theory.*

**Keywords:** Agency theory, stewardship theory, stakeholder theory, transaction cost theory.

**JEL Classification:** D21, G34

### 1. Introduction

Corporations have become a powerful and dominant institution. They have reached to every corner of the globe in various sizes, capabilities and influences. Their governance has influenced economies and various aspects of social landscape.

In order to understand corporate governance, it is important to highlight its definition. Even though, there is no single accepted definition of corporate governance but it can be defined as a set of processes and structures for controlling and directing an

organization. It constitutes a set of rules, which governs the relationships between management, shareholders and stakeholders.

This article reviews various fundamental theories underlining corporate governance. These theories range from the agency theory and expanded into stewardship theory, stakeholder theory and transaction cost theory.

### 2. Definitions of Corporate Governance

The term “corporate governance” has a clear origin from a Greek word, “kyberman” meaning to steer, guide or govern. From a Greek word, it moved over to Latin, where it was known as “gubernare” and the French version of “governer”. It could also mean the process of decision-making and the process by which decisions may be implemented.

It is difficult to define the concept of corporate governance in a universally acceptable way because definitions vary from country to country. Moreover, countries differ from each other in terms of culture, legal systems and historical developments. This explains why there is a wide range of definitions of the concept of corporate governance.

Shleifer and Vishny (1997) define corporate governance in terms of the ways in which suppliers of finance to a firm assure themselves of a good return to their investment. This definition is shallow in that it emphasises the suppliers of finance and it does not recognize the relationships between a firm’s stakeholders and managers. Each firm has numerous stakeholders whose different interests must be taken care of. This is why corporate governance has also been referred to as a collective group of people united as one body with the power and authority to direct, control and rule an organization.

Corporate governance is, according to the Organization for Economic Cooperation and Development tenets:

- A set of relations between the company management, the managing board, its shareholders and other interest groups within the company;
- The structure by which company objectives are set as well as the means for achieving these objectives and monitoring performances;
- The stimuli system granted to the management board and administration in order to increase the objectives that are in the company's and shareholders' best interest and to facilitate monitoring, thus encouraging companies to use their resources more efficiently.

This definition is the most consistent definition, because it specifically integrates a company's relations to its internal environment, i.e. the shareholders and employees, as well as the outer environment, such as suppliers, creditors and, last but not least, the interaction between the two environments and management frames: management board, company management.

### **3. The Main Theories Underlying the Concept of Corporate Governance**

#### **3.1. Agency Theory**

The agency theory having its roots in economic theory was expounded by Alchian and Demsetz (1972) and further developed by Jensen and Meckling (1976). Agency theory is defined as “*the relationship between the principals, such as shareholders and agents such as the company executives and managers*”. In this theory, shareholders who are the owners or principals of the company, hires the agents to perform work. Principals delegate the running of business to the directors or managers, who are the shareholder's agents (Clarke, 2004).

According to Eisenhardt (1989), the agency theory is concerned with analyzing and resolving problems that occur in the relationship between principals (owners or shareholders) and their agents or top management. The theory rests on the assumption that the role of organizations is to maximize the wealth of their owners or shareholders (Blair, 1995).

The agency theory holds that most businesses operate under conditions of incomplete information and uncertainty. Such conditions expose businesses to two agency problems namely adverse selection and moral hazard. Adverse selection occurs when a principal cannot ascertain whether an agent accurately represents his or her ability to do the work for which he or she is paid to do. On the other hand, moral hazard is a condition under which a principal cannot be sure if an agent has put forth maximal effort (Eisenhardt, 1989).

These agency problems arise because of the impossibility of perfectly contracting for every possible action of an agent whose decisions affect both his own welfare and the welfare of the principal, Brennan (1995b). Arising from this problem is how to induce the agent to act in the best interests of the principal.

Managers bear the entire cost of failing to pursue their own goals, but capture only a fraction of the benefits. Jensen and Meckling (1976) argue that this inefficiency is reduced as managerial incentives to take value maximising decisions are increased. As with any other costs, agency problems will be captured by financial markets and reflected in a company's share price.

Within the agency framework *agency conflicts* arise from divergences of interest between any two parties to a contract within an organisation. As a result, they are almost limitless in nature. Differing researchers have argued over the severity of each of the different types of conflicts described above. Research by Jensen (1986) and Himmelberg, Canella, and Paetzold (1999) amongst others stress the importance of a firm's contracting environment, as vitally important in determining the importance of such problems. For example, while perquisite consumption may be a major problem in larger companies, this may not be the case in smaller firms, where assets can be more easily monitored.

Daily, Dalton and Canella (2003) argued that two factors can influence the prominence of agency theory:

- *the theory is conceptually and simple theory that reduces the corporation to two participants of managers and shareholders.* Shareholders expect the agents to act and make decisions in the principal's interest. On

the contrary, the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2000). Such a problem was first highlighted by Adam Smith in the 18th century and subsequently explored by Ross (1973) and the first detailed description of agency theory was presented by Jensen and Meckling (1976).

- *agency theory suggests that employees or managers in organizations can be self-interested.* The agent may be succumbed to self-interest, opportunistic behavior and falling short of congruence between the aspirations of the principal and the agent's pursuits. Even the understanding of risk defers in its approach.

Therefore, agency theory was introduced basically as a separation of ownership and control. Holmstrom and Milgrom (1994) argued that instead of providing fluctuating incentive payments, the agents will only focus on projects that have a high return and have a fixed wage without any incentive component. Although this will provide a fair assessment, but it does not eradicate or even minimize corporate misconduct. Here, the positivist approach is used where the agents are controlled by principal-made rules, with the aim of maximizing shareholders value. Hence, a more individualistic view is applied in this theory (Clarke, 2004). Indeed, agency theory can be employed to explore the relationship between the ownership and management structure. However, where there is a separation, the agency model can be applied to align the goals of the management with that of the owners.

In summary, the idea of agency theory can be attributed to Coase (1937) but the ideals of the theory have only been applied to directors and boards since the 1980's. According to this theory, people are self-interested rather than altruistic and cannot be trusted to act in the best interests of others. On the contrary, people seek to maximize their own utility. The agency theory presents the relationship between directors and shareholders as a contract. This implies that the actions of directors, acting as agents of shareholders, must be checked to ensure that they are in the best interests of the shareholders.

### **3.2. Stewardship Theory**

The stewardship theory has its roots from psychology and sociology and is defined by

Davis, Schoorman and Donaldson (1997) as *“a steward protects and maximises shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximised”*. In this perspective, stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders.

The stewardship theory, adopts a different approach from the agency theory. Stewardship theory stresses not on the perspective of individualism (Donaldson & Davis, 1991), but rather on the role of top management being as stewards, integrating their goals as part of the organization. The theory starts from the premise that organizations serve a broader social purpose than just maximizing the wealth of shareholders.

Agyris (1973) argues agency theory looks at an employee or people as an economic being, which suppresses an individual's own aspirations. However, stewardship theory recognizes the importance of structures that empower the steward and offers maximum autonomy built on trust (Donaldson and Davis, 1991). It stresses on the position of employees or executives to act more autonomously so that the shareholders' returns are maximized. Indeed, this can minimize the costs aimed at monitoring and controlling behaviours (Davis et al., 1997).

On the other end, Daily, Dalton and Canella (2003) argued that in order to protect their reputations as decision makers in organizations, executives and directors are inclined to operate the firm to maximize financial performance as well as shareholders' profits. In this sense, it is believed that the firm's performance can directly impact perceptions of their individual performance. Indeed, Fama (1980) contend that executives and directors are also managing their careers in order to be seen as effective stewards of their organization, whilst, Shleifer and Vishny (1997) insists that managers return finance to investors to establish a good reputation so that that can re-enter the market for future finance.

In summary, stewardship theory suggests unifying the role of the CEO and the chairman so as to reduce agency costs and to have greater role as stewards in the organization. It was evident that there would

be better safeguarding of the interest of the shareholders. It was empirically found that the returns have improved by having both these theories combined rather than separated (Donaldson & Davis, 1991).

### 3.3. Stakeholder Theory

Stakeholder theory was embedded in the management discipline in 1970 and gradually developed by Freeman (1984) incorporating corporate accountability to a broad range of stakeholders. Wheeler, Colbert and Freeman (2002) argued that stakeholder theory derived from a combination of the sociological and organizational disciplines. Indeed, stakeholder theory is less of a formal unified theory and more of a broad research tradition, incorporating philosophy, ethics, political theory, economics, law and organizational science. This theory holds that corporations are social entities that affect the welfare of many stakeholders.

Stakeholder theory can be defined as “*any group or individual who can affect or is affected by the achievement of the organization’s objectives*”. Unlike agency theory in which the managers are working and serving for the stakeholders, stakeholder theorists suggest that managers in organizations have a network of relationships to serve – this include the suppliers, employees and business partners. And it was argued that this group of network is important other than owner-manager-employee relationship as in agency theory (Freeman, 1999). On the other end, Sundaram and Inkpen (2004) contend that stakeholder theory attempts to address the group of stakeholder deserving and requiring management’s attention. Whilst, Donaldson and Preston (1995) claimed that all groups participate in a business to obtain benefits. Nevertheless, Clarkson (1995) suggested that the firm is a system, where there are stakeholders and the purpose of the organization is to create wealth for its stakeholders.

Freeman (1984) contends that the network of relationships with many groups can affect decision making processes as stakeholder theory is concerned with the nature of these relationships in terms of both processes and outcomes for the firm and its stakeholders. Freeman's theory as presented can be criticized in four ways: inadequate

explanation of process, incomplete linkage of internal and external variables, insufficient attention to the system within which business operates and the levels of analysis within the system, and inadequate environmental assessment.

Therefore, more work has begun to try to attach theory to the stakeholder framework (Donaldson & Preston, 1995; Mitchell et al., 1995). Donaldson and Preston (1995) suggest that stakeholder theory is normative. Also, they argued that this theory focuses on managerial decision making and interests of all stakeholders have intrinsic value, and no sets of interests is assumed to dominate the others.

Thus, stakeholder theory has provided scholars with a clearer tool for knowing, and thus fulfilled one requirement of theory. It has brought greater credibility and acceptance to the tenet of corporate social performance that business is embedded in a system of social relationships that it affects and it is affected by.

In summary, the stakeholder theory suggests that a firm’s board of directors and its CEO, acting as stewards, are more motivated to act in the best interests of the firm rather than for their own selfish interests. This is because, over time, senior executives tend to view a firm as an extension of themselves (Clarke, 2004). Therefore, the stakeholder theory argues that, compared to shareholders, a firm’s top management cares more about the firm’s long term success (Mallin, 2004). Successful organizations are judged by their ability to add value for all their stakeholders. Some scholars consider the natural environment to be a key stakeholder (Dunphy et al., 2003).

### 3.4. Transaction Cost Theory

Transaction cost theory was an interdisciplinary alliance of law, economics and organizations. This theory attempts to view the firm as an organization comprising people with different views and objectives.

Transaction cost theory is part of the New Institutional Economics research tradition. This theory has become an increasingly important anchor for the analysis of a wide range of strategic and organizational issues of considerable importance to firms (Williamson, 1996). In particular, the transaction cost theory has been employed in

studying firms' boundaries, vertical integration decisions, the rationale for conducting an acquisition, the networks and other hybrid governance forms.

The unit of analysis in transaction cost theory is the transaction. Therefore, the combination of people with transaction suggests that transaction cost theory managers are opportunists and arrange firms' transactions to their interests (Williamson, 1996).

The main focus of transaction cost theory is the definition of the determinants of coordination of the transactions through markets or hierarchies. In this sense, the boundaries of the firm should be a function of the governance structure (Williamson, 2005), especially when we consider that this governance structure would assure the optimal adaptability of the firm to changes in the conditions of supply and demand. One important aspect of transaction cost theory is that it focus not only on the two extremes of transaction governance (hierarchy vs. market), but also on other hybrid forms and long term contracts.

Transaction cost theory argues that there are costs to conduct transactions through the market; these transaction costs can be reduced through mechanisms other than markets (Coase, 1937; Williamson, 1975). Specifically there are costs to "drafting, negotiating, and safeguarding any exchange or transaction" that are "friction" impeding smooth transactions (Williamson, 1985). Transaction cost theory claims that these transaction costs driving economic organization are as important as production costs, or perhaps even more important.

Transaction costs are an important part of the total costs of a firm, because production costs are easier to assess than transaction costs, Transactions costs comprise the ex-ante costs of searching and information, drafting and negotiating na agreement, and costs of safeguarding the agreement. The ex-post costs entail the costs of evaluating the input, measuring the output, and monitoring and enforcement (Williamson, 1985).

#### 4. Conclusion

This review has seen corporate governance from various theoretical perspectives. The emergence of agency

theory, stewardship theory, stakeholder theory and transaction cost theory addresses the cause and effect of variables, such as the configuration of board members, audit committee, independent directors and the role of top management. In addition, ethics in business have been closely associated with corporate governance. Hence, it can be argued that corporate governance is more of a social relationships rather than process orientated structure.

These theories focused on the view that the shareholders' aimed to get a return on their investments. In todays business environment, business process should also focus on other critical factors such as legislation, culture and institutional contexts.

Corporate governance is constantly changing and evolving and changes are driven by both internal and external environmental dynamics. The internal environment has a fixed mindset of shareholders' relationship with stakeholders and maximizing profits. Whilst, issues in the external environment such as the breakup of large conglomerates, mergers and acquisitions of corporation, business collaborations, easier financial funding, human resource diversity, new business start-ups, globalization and business internationalization, and the advance of communication and information technology have directly and indirectly caused the changes in corporate governance.

An effective and good corporate governance cannot be explained by one theory but it is best to combine a variation of theories, addressing not only the social relationships but also emphasize on the rules and legislation and stricter enforcement surrounding good governance practice and going beyond the norms of a mechanical approach towards corporate governance.

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# Institutionalization of Consumer Protection by Government Involvement and Responsabilization of Business Organizations

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## Abstract

*The existence of “sovereign consumer”, appealed by the adherents of free market cult, is jeopardized, within the context of economic reality, by the manifestation of some market failures. Consequently, the purpose of this paper is the argumentation of the importance of direct consumer protection as an instrument for assuring his sovereignty within market economy.*

**Key words:** consumer protection, institutions, legislation, government, business organizations

**J.E.L. classification:** D18, K29, M14

## 1. Introduction

The internal logic of functioning of market economy, approached from the perspective of the interests and motivations of the consumers in economic activity – producers and consumers, points out the fact that they are in an out of balance proportion, objectively, at the expense of the latter, even if the consumers, with their needs and necessities, should represent the origin and at the same the final point of the production activity. The existence of the “sovereign consumer”, invoked by the supporters of free market, is jeopardized within the context of economic reality, by the failure of the action of spontaneous self-adjustment of the market, which, despite the fact that in many situations it is possible and desirable, in many others it demands the deliberate intervention of public power towards the diminution of this relation which is unfavorable to the consumers up to an acceptable sustainability level.

All the aspects point out the imperative of organizing consumer protection nationally under the form of a complex process, in which both public power – namely the

government, and the market forces, by means of business organizations, and also of the consumers themselves should be involved.

## 2. Government involvement in consumer protection process

Although often criticized from the point of view of its inefficiency, *government involvement in consumer protection process* represents an irrefutable reality of contemporary economic life and it is done in two ways.

Firstly, one of the assignments presently recognized to public power of each country characterized by a market economy is represented by *the enactment of a legislation that corresponds to the necessities generated by the assurance of an adequate consumer protection*. This assignment is exercised by elaborating and enacting laws which point the regulation of the various aspects and types of relations that may arise within the sale-purchase transactions.

Secondly, the involvement of public power in the consumer protection process is concretized in *the creation of institutions and organizations in charge either with the supervision of the compliance with the legislative framework in the field, or with the granting of specialty assistance to consumer organizations or even directly to the consumer*.

Among the main types of institutions and organizations created and organized by the government on purpose to protect the consumers are the following: consumer protection authorities or services (for example, National Authority for Consumer Protection in Romania or Service for Protection of Consumer Rights in Belgium); councils and offices which supervise trader correctitude within the market (for example, Competition Council in Romania or Federal Office for Competition in the United States

of America); central or regional analysis laboratories (for example, Laboratory for the Analysis of Wine and Spirits Quality in Romania) etc.

A series of ministries, departments, agencies or other governmental bodies are also integrated in consumer protection process with special assignments, acting in the branches or fields in which, in addition to the basic objectives specific to the branch in which they operate, they also encompass tasks connected to consumer protection (for example, General Direction for Competition, Consumption and Frauds punishments within the French Ministry of Economy, Finance and Industry).

Moreover, during the last decades a new type of institutions appeared, institutions that are organized under the form of national centers or institutes of scientific research and created on purpose to grant large specialty assistance (juridical, technical etc.) to all the categories of consumers (for example, National Center for Commodity Testing and Expertise – LAREX in Romania).

The main mission of the mentioned structures points the improvement of consumer life quality by developing informative, protective or even coercive actions. Their customers consist of traders or even other public agencies that require professional training and counseling, in addition to the consumers who require information and assistance.

Same as any other intervention from the public power within the market, the one meant to protect the consumer knows a specific optimal level, beyond which the net marginal benefit of governmental intervention becomes negative. Theoretically, the level considered to be optimum from the social point of view of such an intervention is registered only when the marginal social benefit of the last provided protection unit equals the marginal social cost involved.

The determination in practice of the optimal level is, however, extremely difficult to carry out, and the extent to which it would actually assure an efficient consumer protection is questionable. Under these conditions, the involvement of public power in economy by specific means is entailed to be completed, on one hand, by taking on responsibility toward the observance of consumer rights within the market by

business organizations, and on the other hand, by the active participation of the consumers, starting from their awareness with regard to the rights which come to them within the market and until their exercise in practice on a continuous base.

### **3. Responsabilization of business organizations toward the consumers**

Starting from the specific necessities shown in contemporary economic, social, political and not lastly cultural environment, the need for *the responsabilization of business organizations toward the consumers* is shown more and more intense.

From the ideological point of view, the debates on corporative “responsibility” or “morality” theme are remarkably fervent. Thus, with regard to moral responsibility of business organizations there are two opposed ideas which affirm: on one hand, that any business organization is responsible from the moral point of view for the undertaken actions, and, on the other hand, that generally they cannot be evaluated from the moral point of view, because they do not act on their own, but the individuals within them carry on different activities susceptible of being catalogued as moral or immoral. [1]

Without being able to be totally rejected, we consider that moral responsibility of business organizations is situated, in fact, at the border of the two ideas, because they are not moral entities of the same nature as individuals, but also cannot be disengaged from duties under moral aspect, within free market, as: the obligation not to do harm; the obligation to avoid doing harm; the obligation not to restrict the freedom of the economic activities that lie at the basis of the system; the obligation of correctness in transactions and the observance of the undertaken commitments.

From the practical point of view it is very important for any business organization – no matter whether it is a producer, a service provider or a distributor - to contribute constructively to the good development of market economy, implicitly by consolidating the relations with their clients, appreciating the profit as a reward for the activity provided to their use.

Consequently, in regard to the consumers, a series of responsibilities of different nature

come to business organizations [2,3], respectively: *economic responsibilities* – which assume to offer only the goods and services the consumers need; *legal responsibilities* – they point the supply of goods and services compliant with active legal norms; *ethical responsibilities* – they aim the adoption of a proper attitude toward the consumers, without disappointing their moral or ethical expectations; *discretionary or charitable responsibilities* – they involve voluntary participation in actions meant to promote the awareness by the consumers of the rights they have within the market.

In fact, the acceptance by business organizations of responsibilities meant to protect the consumers has in view the multiple benefits they involve.

Firstly, it is about the fact that social responsibility activities offer to business organizations the opportunity to differentiate from the competition and to obtain consumers loyalty to their brand-type, consolidating their long term profit. Thus, it is estimated that there are two factors which make social responsibility of business organizations a powerful weapon in the construction of a brand name, namely: on one hand, consumers became more and more informed, more capable to express their opinions and more preoccupied with the subjects concerning health, environment or different social problems, and on the other hand, the affirmation of a global market in which an increasingly fierce competition is shown among traders and which assures multiple possibilities of choice to the consumers, forces business organizations to find new and relevant methods to construct emotional bonds with their clients.

Secondly, the success of business organizations depends directly on the confidence and respect granted by the community in which they operate, by the authorities, mass-media or business partners with whom they come in contact and without whom they would be exposed to several risks, as: increased vulnerability in front of protest actions on the part of some consumer groups or organizations; endangerment of the relations with authorities or business partners, who will not want to jeopardize their public image by associating with a company whose practices are socially controversial.

In general, it is estimated that there are several categories of *enterprises by which business organizations can state their social responsibility* [4] and to which they can appeal separately or, the most common variant, they can approach them in a joint manner, depending on the final purpose intended by their promotion, namely: the consolidation of the position held by the company on the market, the acquirement of a better visibility among consumers or the increase of the preference for its offer.

Among these social enterprises, the most important for the consumers refers to the adoption by business organizations of some *socially responsible corporate practices*, by which they voluntarily improve their operation mode, so that to contribute to consumer welfare by: retiring the products that may be considered harmful to them, even if they are not illegal; modifying production technology in order to meet at halfway some specific needs of the consumers; providing the consumers with objective information about their offer; using auditing and external reporting activities, on purpose to release correct information to the consumers with regard to the registered performances etc.

In order insure a favorable environment for the development of the performances associated to corporate social responsibility, there is a large variety of *instruments* [5] in practice, among which those addressed with predilection to consumers are circumscribed in the promotion activities of a *socially responsible management and consumption*.

On one hand, *the activities of socially responsible management* assume the use of instruments by which performance standards and management aspects used by business organizations are established on purpose to incorporate the characteristic values of corporate social responsibility within the developed strategies and activities and to obtain an improvement of their corporate performances.

A prime example is represented by the codes of conduct [5], essentially perceived as an alternative to governmental regulations in the field of consumer protection, which they only complete, without replacing them. To these voluntary instruments of socially responsible management business organizations appeal from various reasons especially connected to a better satisfaction

of the consumers, respectively: in order to make known the ethical values and standards according to which they run their business; in order to inform the consumers with regard to the principles they observe in producing goods and services; in order to respond to public pressure or to prevent the critics that can be brought to them, especially if their sales depend fundamentally on the company identity or on public opinion. The fields of interests for the consumers in which most of the codes of conduct were adopted regard: distance and direct selling, product labeling, advertising and standardization.

The voluntary management standards represent another example, understanding by these internal instruments which business organizations use in order to integrate own values in current activities by means of a series of procedures, stages and specifications to which they appeal to put into operation a process or an activity. Among these, quality management standards and other general procedures associated to social corporate responsibility present a particular importance for consumer protection, because they place in the limelight a high level for satisfying them.

On the other hand, the activities designed to promote a *socially responsible consumption* involves the use of some market instruments addressed directly to consumers, which serve for certifying the fact that the production and trading of the pointed products comply with specific ethical, social or ecological criteria.

An example to this effect is represented by *social and ecologic labels*, which influence consumers' purchasing decisions, still without offering them information with regard to the internal characteristics of the product, as the case of organic or safety labels. These are applied especially on imported products, pointing the producers from the developing countries and resorting to the consumers from the developed countries, in order to offer them the guarantee of using some products which comply with specific internationally recognized standards.

All these instruments specific to corporate social implication have the role of consolidating the strategic approach of business organizations with reference to their economic performances, so that to transform

the implication in an active competitive advantage on purpose to gain consumers' loyalty and confidence in the offered products and services.

Although in international debate forums and in professional literature, social corporate responsibility is tightly connected to the globalization of business environment and considered as the appanage of multinational companies [6,7], the necessity involving in such initiatives small and medium companies was more and more asserted. Unlike large companies in the world, the small and medium ones confront with the problem of supplementary costs involved in such activities and their recovery, whose surmounting is very important, due to the practical and, also, theoretical confirmation enjoyed by corporate social responsibility in the profitable business practice, which supports the financial interests of the companies that promote it by assuring a high level of satisfaction of the consumers.

#### 4. Conclusions

The institutionalization of consumer protection - both nationally, and internationally - as an instrument for assuring his sovereignty within the market economy, presents an extremely complex character, its efficiency in practice being determined by the quality of the partnership established between:

- *the market* – whose signals must be interpreted accordingly in order not to abridge the capacity of their forces to remunerate the producers who are receptive to consumers' needs and to penalize those guilty of adopting incorrect practices;

- *public power* – whose mechanisms especially put in the service of protecting the consumer must be carefully handled and developed so as to complement the specific market mechanisms, potentiating their practical efficiency;

- *the producer* – whose responsibility towards the compliance with consumer rights must be taken over on a continuous base, as a profitable business practice, which supports his financial interests by assuring a high level of satisfaction of the transaction partner;

- *the consumer* – whose capacity of individual self-protection (the consumer becoming aware of his rights within the

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## Consumer Self-Protection

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### Abstract

*Whether it is about an imbalance of economic, informational, judicial nature or at the level of the representation of interests, the cleavages which intervene within the market in the relations between producer/trader and consumer unequivocally call for the intervention in favor of the latter. Consequently, the purpose of this paper is the argumentation of the importance of indirect consumer protection as an instrument for assuring his sovereignty within market economy.*

**Key words:** consumer protection, complaint, collective action, consumer organization

**J.E.L. classification:** D18, D72

### 1. Introduction

The internal logic of functioning of market economy, approached from the perspective of the interests and motivations of the consumers in economic activity – producers and consumers, points out the fact that they are in an out of balance proportion, objectively, at the expense of the latter, even if the consumers, with their needs and necessities, should represent the origin and at the same the final point of the production activity. The existence of the “sovereign consumer”, invoked by the supporters of free market, is jeopardized within the context of economic reality, by the failure of the action of spontaneous self-adjustment of the market, which, despite the fact that in many situations it is possible and desirable, in many others it demands the deliberate intervention of public power towards the diminution of this relation which is unfavorable to the consumers up to an acceptable sustainability level.

All the aspects point out the imperative of organizing consumer protection nationally under the form of a complex process, in

which both public power – namely the government, and the market forces, by means of business organizations, and also of the consumers themselves should be involved.

### 2. How consumer can protect himself

We appreciate that the most important role in consumer protection process comes to the consumer himself. Thus, when he is dissatisfied with regard to a provided service or product, the consumer has to make the decision of undertaking something to this effect or not. The simplest choice of the consumer consists in the decision of giving up purchasing the product or service which caused him the state of dissatisfaction or turning his attention to a different producer of goods or service provider, at the risk of being disappointed again.

This hypothesis of the *passive consumer* leads, on one hand, to the accumulation of dissatisfactions in time, through the repetition of such situations, fact which generates the distrust in the virtues of market economy and especially in its role of satisfying his own needs, and, on the other hand, it involves the proliferation of unfair commercial practices from the sellers and which affect other consumers if they are not punished, with negative implications on the overall efficiency of economy.

The consumer still has a different alternative at his disposal, respectively that of *being heard* [1]. In the new hypostasis of *active consumer*, he can make “his voice” heard either *horizontally* – addressing directly to potential consumers, respectively by disclosing to his relatives, friends, acquaintances the dissatisfaction he feels and the cause that generated it, warning them not to purchase that product or service or not to appeal to the supplier who disappointed them, or *vertically* – sense in which he can express individually or collectively, his “voice” taking different forms, as: complaint

formulation; participation in boycotting actions of some suppliers; participation as a member in various involved non-governmental organizations, institutions or organizations, locally or centrally, in the process of adopting the decisions that may affect their interests.

*Taken individually, a large part of the consumers either do not have time to make their “voice” heard with regard to a specific problem that may appear and pertains to them, or are discouraged to become active by formulating complaints, for various reasons,* as: the product or service being purchased at a low cost, in his mind there is a probability of some inconveniences in using it; the consumer estimates that the problem which arises is minor and, consequently, it is not worth the effort of a complaint; the calculations the consumer makes with reference to the cost of the complaint show that it is too high as compared with the perspective of the benefit that can be obtained, in order to, in some situations, the latter not even exist; many times the consumer is even discouraged by the traders to formulate complaints; the consumer anticipates that after the complaint he would obtain a dissatisfactory answer; not lastly, on the consumer’s part there may exist a profound feeling of lack of force, of power afore traders, generated by low incomes, elderly age or reduced level of training and education.

*The consumers who manage to surpass these reasons, manifest actively on the market and formulate complaints individually, being animated by several reasons* [2], respectively: the price of the product or service which generated them the state of dissatisfaction is higher or the retrieve of the fault would cost too much so that they opt for its retrieve from their own resources; the social and economic state allows them this step, because they have high incomes, of a superior level of training, knowledge in the field and even time to unfold such an action; the fact they can hereby show their information and knowledge degree of the rights which come to them, proving, at the same time, the power they have within the market.

In extreme cases, there is also the possibility of a more vehement manifestation on the consumer’s part, by taking an attitude

against specific trading practices he disapproves (such as, for example, the excessive bulge of the prices practiced to specific products or their reduced quality), by participating, together with other consumers, in the organization of boycotts, under the form of refraining from doing certain shopping within the market. Such initiatives can point only a specific category of products or exclusively a specific company, their purpose being to alert and determine the abandonment of that trading practice or its modification in favor of the consumers. As a matter of fact, until the appearance of the first consumerist group coherently organized, boycotts represented the most extreme form of manifestation of consumers’ dissatisfaction within the market.

However, the problem that comes up in this case is generated by the fact that boycotts imply the collective action of the consumers for defending specific common interests, situation in which they confront with the “free rider” dilemma, an aspect which was analyzed previously in the context of the discussion connected to public goods. In this situation, consumers can be very numerous, and the result of their collective action represents, in substance, a public instrument, which any consumer can enjoy, without being necessary for him to spend his resources and participate actively in this action. Being that these aspects menace the organizational capacity of consumer groups, boycott actions must exploit only certain weaknesses with which most of the consumers can identify themselves, appealing more and more nowadays to the power of mass communication means (prints, television) in order to exercise a high influence on the general public. [3]

A different form for defending consumers’ interests points their representation by the agency of a negotiator who acts on behalf of the group he represents. To this effect, the concerns of public authorities in the field of consumer protection were also accompanied by the establishment of a legal framework intended to facilitate the development of own organization systems of the consumers which regard *the collective action in favor of the protection of their rights*, as: besides specific social institutions, the organization of consultative councils or the national or international establishment of consumer

organization or association. [4] The efforts of these entities are directed toward the improvement of consumer position within the market, the removal of the opportunities for the promotion of unfair practices on traders' part and the retrieve of the prejudices caused by the proliferation of such practices, goals towards which their action may result in:

- *The constant effectuation and publishing of comparative tests* – whose result materializes in the compilation of a list of parameters and comparative characteristics of different products that currently exist on the market, by groups and areas of use, prices and facilities. Their goal is to offer the consumers objective information, which allows them a rational image and analysis on the products which exist within the market;

- *The organization of selective social investigations among the consumers, on specific fields or subjects, and the periodic publishing of the results obtained in this way* – it purposes to inform the consumers with reference to the way in which market relations between economic agents develop, drawing their attention on certain aspects related to different products and services, in order to improve the position they occupy in the negotiation process with regard to the quality of the necessary products and services and the advantages they are going to profit by;

- *The development of a mass-media campaign for the consumers* – it supposes either the creation and use of instruments specific to mass communication (for example specialized publications), or the recurrence to independent ones (prints, radio and television stations), on purpose to assure the best and the most useful information of the consumers, the refutation of unrighteous practices from the traders and the intimation of supervision courts within the market with regard to these;

- *The contribution to the improvement of legal framework in the field* – it aims to draw producers/traders' attention, and also of public power bodies in order to promulgate specific laws designed to consumer protection;

- *Direct involvement in the settlement of the conflicts that may arise in the relations between consumers and producers/traders* – it can be done either by mediating the negotiations and conciliating the involved

parties, or by arranging the conflicts and reaching an agreement for a specific problem, or by filing a proceeding.

Consumer organization in partnership on purpose to protect the specific interests may hence take several forms. Among these, the simplest one from the point of view of the organizational structure and the form of action is represented by the establishment of some *consultative councils*, which function in conjunction with social institutions, public organizations etc. Their activity is summarized only to counseling actions on different problems that intervene in the decisional process and concern the consumers, and also to polling consumers' opinion with regard to the measures and actions that have already been undertaken or are going to be undertaken by the society or business organizations on purpose to protect them.

Furthermore, the legal framework developed at the national level by each state in the field of consumer protection favored the appearance of a great diversity of *national independent organizations and associations* which intend to inform and defend his rights.

In order to contribute to consumer's information, the organizations and associations constituted in this way have documentation centers, analysis laboratories and own publications, being able to execute and broadcast information to the consumer with regard to studies, researches, analyses, tests and even audits effectuated on their own in relation to different products, the way in which the trading process develops, and also with reference to the observation of the legislation in the field. In the matter of consumer protection, these organizations and associations make a series of representations with the organizations of central power on purpose to improve the quality of production and trading activity of the products for the convenience of consumers. Furthermore, they take legal actions in favor of the consumers prejudiced by the producers or traders who contravene the legislation in the field.

Given the importance of the practices for consumer protection, which exceed the national borders in frequent cases, a series of *international or regional organizations for consumer protection* appeared at the international level. These act either

independently – as, for example, the *International Organization of Consumers’ Union* or *Consumers International (CI)*, which presently counts over 220 members from 115 different countries, or with certain regional communities - for example, the case of *Bureau Europeen des Unions des Consommateurs (BEUC)*, which functions within the European Union and reunites 43 independent national organizations of the consumers from 31 European countries.

The purposes of such organizations regard mainly the cooperation among their members for the development of the best practices designed to the consumer protection beyond the national borders and their uniformization at the international level. Examples concerning the way of materializing such objectives developed by international organizations with regard to consumer protection are: the adoption, as early as 1973, by the Council of Europe of the “Consumer Protection Charter”, in 1985, by the United Nations Organization of the Resolution no. 39/248 concerning “Guidelines for consumer protection” or, in 2003, of „Guidelines for consumer protection from fraudulent and deceptive commercial practices across borders” adopted by the Organization for Economic Cooperation and Development.

### 3. Conclusions

The institutionalization of consumer protection - both nationally, and internationally - as an instrument for assuring his sovereignty within the market economy, presents an extremely complex character, its efficiency in practice being determined by the quality of the partnership established between:

- *the market* – whose signals must be interpreted accordingly in order not to abridge the capacity of their forces to remunerate the producers who are receptive to consumers’ needs and to penalize those guilty of adopting incorrect practices;

- *public power* – whose mechanisms especially put in the service of protecting the consumer must be carefully handled and developed so as to complement the specific market mechanisms, potentiating their practical efficiency;

- *the producer* – whose responsibility towards the compliance with consumer rights must be taken over on a continuous base, as a profitable business practice, which supports his financial interests by assuring a high level of satisfaction of the transaction partner;

- *the consumer* – whose capacity of individual self-protection (the consumer becoming aware of his rights within the market) and associative (the consumer involving actively in the exercise of his rights) must be permanently improved.

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## Explaining the Regional Economic Growth in Romania. Does Foreign Capital Play a Role?

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### Abstract

*The foreign investment acts as a supplement to domestic savings and provides access to newer and improved technology, thus increasing the growth prospects of the receiving economy. This study addresses the understudied issue of regional effects of FDI location in Romania. From the econometric perspective the novelty to earlier research consists in the use of a panel data model instead of the usual cross-sectional or time-series approaches. This technique allowed us to control for region-specific differences in the factors of influence included in the economic growth model.*

**Key words:** foreign direct investment, panel data model, region, Romania.

**JEL Classification:** J21, J64

### 1. Introduction

The foreign direct investment (FDI) represents an important factor of growth, especially for the developing economies. In theory, the likely impact of FDI on economic growth occurs in two ways. Firstly, the capital accumulation through new FDI inflows increases the production capacity. Secondly, as a tool for international technology transfer, FDI conveys new technology and management expertise, thus contributing to higher productivity and competitiveness in the receiving region. The empirical evidence on the real FDI impact on output growth and technological progress is however mixed. For instance, de Mello (1999) found that FDI's ability to induce

output growth critically depends on its complementarity and substitution with domestic investment, at least in the short run. In addition, FDI appears to have highly beneficial effects on domestic investment. For instance Alguacil et al (2008) found, based on dynamic panel data models, the existence of a positive contribution of FDI to greater domestic investment and economic growth in the new member states.

The beneficial impact of FDI was especially important for the transition economies in Central and Eastern Europe, in need for additional capital investment, as well as access to foreign technology and management techniques in order to modernise and improve their economies and narrow the development gaps [4]. Foreign capital played a decisive role in the reshaping of the transition economies in Central and Eastern Europe [21]. Among the benefits from FDI there were also some indirect effects on local firms, such as increased local competition that force other firms to improve their economic performance. The countries in Central and Eastern Europe have been recipients of large foreign capital inflows, driven by the lower factor prices and skilled labour force that compensated for transportation costs and loss of accessibility [6].

After 1990, the barriers to foreign capital accession were lifted in Romania as well, creating the potential for rapid reforms to market structures and for the development of the economy. The physical capital stock of Romania was largely obsolete at the end of the communist regime and modernization was urgent. Since Romania opened up for foreign capital, the much needed foreign

influx of investment gradually increased, FDI showing substantial growth rates especially after the accession to EU, with a high of 9.3 bn euro in 2008. Unfortunately, the economic crisis reversed this trend, inducing a sharp decrease in the FDI inflows: 3.49 bn in 2009, 2.22 bn in 2010 and only 1.9 bn euro in 2011.

At regional level the FDI picture is marked by high interregional disparities, showing a major imbalance between Bucharest-Ilfov and the other regions, as well as an important gap between the East and West of Romania. Ranking the regions based on their ability to attract foreign investors, Danciu et al (2011) confirmed the strong domination of the Bucharest-Ilfov region, placed on the first position, followed at a long distance by the West and North East regions.

Considering the potential impact of foreign investments on the economic development of the regions and on narrowing the territorial disparities, it is important to assess the economic effects of the regional inflows of FDI, both in periods of economic growth and during recessions. In this context, our paper seeks to explore the impact of the FDI in Romania, focusing on the development regions. We use a panel data analysis in an attempt to harvest the advantages of both cross-sectional and time series data by bringing together the 8 development regions of Romania over 2001-2008. The time span under consideration is a period of constant and relatively rapid economic growth, allowing us to capture the characteristics of the economic boom.

## 2. The variables

Our main variable of interest is FDI, as a potentially significant factor of influence on the regional development. Many empirical studies gave preference to the FDI stock, rather than the FDI inflows, as a factor of influence in the economic growth model, as it seems to have a more stable relationship with the economic development [20].

The dependent variable GDP per capita captures the regional development level and can be used as a proxy for economic performance of the regions. We selected the candidate variables for explaining the economic performance of the regions based

on significant factors which had been identified in the literature ([3], [5], [7], [8], [11], [13], [14], [18], [22], [23]) and on available data. The independent variables in our growth model are the production factors strongly influencing the economic development of the regions, hence able to explain the regional and temporal variation of GDP/capita (see Table 1 for the detailed description of all variables).

A potentially major factor in the development of any region is the knowledge economy, captured in our model by two variables: government spending for research and development and business expenditures for research and development. We also included in the model the three variables expressing the technological specialization of a region via employed population structure, namely employment in industrial activities with high to medium-high technological intensity, low to medium low-tech intensity and employment in the knowledge-intensive services. Gross fixed capital formation by regions reflects domestic investment [16] that complements the foreign capital.

Table 1. The variables\*

Variable	Description
<b>FDI</b>	Foreign direct investment stock in the region (Euro)
<b>GDP</b>	GDP per capita (Euro/ inhabitant) is gross domestic product ( the sum of gross value added by all resident producers in the region plus any product taxes and minus any subsidies not included in the value of the products) divided by midyear population of the region
<b>BERD</b>	Total intramural R&D expenditure of Business enterprise sector by region, as percentage of GDP
<b>GOVERD</b>	Total intramural R&D expenditure of Government sector by region, as percentage of GDP
<b>POHT</b>	Employment in <i>high-technology</i> manufacturing industries: Manufacture of pharmaceuticals, medicinal chemicals and botanical products; Manufacture of office machinery and computers; Manufacture of radio, television and communication

<p>equipment; Manufacture of medical, precision and optical instruments; Manufacture of aircraft and spacecraft and employment in <b>medium-high-technology</b> manufacturing industries: Manufacture of chemicals and chemical product; Manufacture of machinery and equipment; Manufacture of electrical machinery and apparatus; Manufacture of motor vehicles, trailers and semi-trailers; Manufacture of other transport equipment, Building and repairing of ships and boats; Manufacture of aircraft and spacecraft.</p>
<p><b>POLT</b> Employment in <b>low-technology</b> manufacturing industries: Manufacture of food products, beverages and tobacco; textiles and textile products; leather and leather products; wood and wood products; pulp, paper and paper products, publishing and printing and employment in <b>medium low-technology</b> manufacturing industries: Manufacture of coke, refined petroleum products and nuclear fuel; Manufacture of rubber and plastic products; basic metals and fabricated metal products; other non-metallic mineral products; Building and repairing of ships and boats.</p>
<p><b>POSI</b> Employment in <b>knowledge-intensive services</b> at the regional level: Air and Water transport; Post and telecommunications; Financial intermediation; Real estate, renting and business activities; Education; Health and social work; Recreational, cultural and sporting activities.</p>
<p><b>CAPITAL</b> Annual gross fixed capital formation (additions to the fixed assets of the region plus net changes in the level of inventories) in million euro</p>
<p><b>EMPL</b> The employment rate at the regional level represents the employed persons as a percentage of the population of the region</p>

\*The data source for the variables is Eurostat, except for FDI stocks that were provided by Romanian National Trade Register Office

### 3. Model specification

The literature on the FDI location uses either cross-sectional or time series data,

each option entailing both advantages and drawbacks ([3], [4], [10]). Time series data allow for changes in the long-run factors of influence to be taken into account, for instance the variations in government economic intervention and specific economic policies that affect GDP, while cross-sectional data capture the influence that individual characteristics of the regions may have on the output.

In this paper we are aiming at empirically analysing how significant is the economic impact that FDI is likely to have on the development of Romanian regions, while controlling both for regions' characteristics and for underlying time changes. Therefore we need to include both cross-sectional and time series data in the framework of a panel data model.

Based on the previous selection of variables (Table 1) the general model specification is:

$$\begin{aligned}
 GDP_{it} = & \beta_1 + \beta_2 FDI_{it} + \beta_3 Capital_{it} + \\
 & + \beta_4 POHT_{it} + \beta_5 POLT_{it} + \beta_6 POSI_{it} + \\
 & + \beta_7 GOVERD_{it} + \beta_8 BERD_{it} + \\
 & + \beta_9 EMPL_{it} + e_{it}, \quad (1)
 \end{aligned}$$

where:  $i = 1, \dots, 8$  (regions) and  
 $t = 2001, \dots, 2008$ .

### 4. The results

The preliminary statistical analysis of model variables showed that in Romania the FDI inflows and stocks are highly correlated to GDP/capita, the R&D indicators (BERD, GOVERD), the employment in knowledge-intensive services, and the capital. Employment rate and the population engaged in industrial high-tech and medium-high activities and the number of employees in industrial activities of low and medium-low technology correlate weakly with the FDI variables. The data also point to the lack of complementarity between advanced and low technologies: the population engaged in industrial high-tech and medium-high activities does not correlate with the number of employees in industrial activities of low and medium-low technology, neither with the employment in knowledge-intensive services. So in Romania seems to prevail regional technological specialization rather than an equal coexistence of sectors with different

technological intensity.

The general model specified in (1) was estimated using EViews 7. The results are illustrated in Appendix 1, where only the significant coefficients were displayed.

Model 1 (pooled data) confirms that the FDI stocks is a significant factor of influence for the economic development of the Romanian regions, but its influence is lower compared to domestic capital, indicating that Romanian regions do not fully exploit the potential benefits from the foreign capital inflows.

The technological level of production also influences the economic performance of the regions: GDP/capita is higher in the regions where a larger part of the population is employed in high-technology and medium high-technology manufacturing industries, as well as in knowledge-intensive services, while. Moreover, the level of public R&D spending seems to have a positive influence on the GDP/capita created in the region. The employment rate, although significant, has an unexpected negative sign, suggesting low labour productivity.

The panel data model allows for a further in-depths exploration of the regional growth factors by using two additional specifications: the fixed-effects model and the random-effects model.

The *fixed-effects model* may reveal the causes of changes within an entity (e.g. region). Each region has its own individual characteristics that potentially affect the dependent variable: for instance the specific business environment and the economic policy of a particular region may influence the economic performance of that region. The fixed-effects model assumes that time-invariant characteristics are unique to each region. Since every region is different, the error term and the constant of a certain region (capturing its specific characteristics) should not be correlated with the others [2]. If the opposite holds true then the fixed-effects model is inappropriate [15] and the random-effects model should be used instead, allowing for properly reflecting that relationship.

The *random-effects model* assumes a random variation across regions; this variation is not correlated with the predictor or independent variables in the model [12, p. 183], therefore this model is appropriate

whenever differences among regions may affect the dependent variable. The random effects model allows for the use of time invariant variables.

The results from the fixed-effects model and the random-effects model are presented in Appendix 1. Although their results are generally in accordance to the initial model, with FDI as a significant but rather weak factor of influence compared to domestic capital, there are also some differences. Employment rate is insignificant both for the fixed and random effects models, while, as expected, employment in low-technology and medium low-technology manufacturing industries exerts a negative impact on the GDP/capita magnitude. The results for the R&D variables are mixed: public expenditures on R&D are significant (but negative) only for the random effects model, while private expenditures on R&D have a negative sign in the fixed effects model, but is positive in the random effects model.

The adjusted coefficient of determination ( $R^2$ ) shows a very good fit for all three models, with 91-92 percent of GDP/capita explained by the variables in the models.

Finally we ran the Hausman test of significance to decide whether the fixed or random effects model is better. The results from Hausman test indicated that we should accept the fixed effects model as more appropriate. This is in support of regional heterogeneity, indicating that the specific characteristics of the Romanian regions determine their GDP/capita growth.

## 5. Conclusions

This paper explored the underlying factors that had driven the economic growth of the Romanian regions over 2001-2008, with a focus on the foreign capital, as a vehicle for modernisation, competitiveness and economic development. Our results on the regional determinants of GDP/capita are largely in accordance to the existing empirical literature. The FDI stocks were found to be positively related to GDP/capita, although their rather low influence on the economic performance of the regions suggest that their potential benefits are not entirely harvested. Other important factors of influence on regional growth are the domestic capital and the technological level of production.

Since the fixed effects model has proved to be the best specification for our data, we support the conclusion that the specific characteristics of the Romanian regions determine the GDP growth.

The time span under consideration allowed us to capture the characteristics of a relatively long period of constant economic growth, but the current global crisis brought about specific challenges that have to be addressed as well. Further in depths research is therefore needed to shed more light upon different channels through which FDI impacts the regional economies during and after an economic crisis.

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Appendix 1. The results

Applied on →	Dependent variable (Y): GDP per capita					
	Model 1		Model 2		Model 3	
	Pooled data		Panel model Fixed effects on cross-sections		Panel model Random effects on cross-sections	
Determinants (X)	Coefficient	Std. Error	Coefficient	Std. Error	Coefficient	Std. Error
<b>FDI</b>	0.000499*	0.000152	0.000468*	0.000166	0.000498*	0.000149
<b>CAPITAL</b>	0.425796*	0.067967	0.506075*	0.083841	0.424920*	0.066624
<b>EMPL</b>	-61.77194**	31.95675				
<b>POHT</b>	19.47833*	5.131130	20.19940*	7.724612	18.68614*	5.013839
<b>POLT</b>					-75.75964*	28.51585
<b>POSI</b>	68.53647**	29.32873	87.38824*	32.48616	6052.344*	1922.584
<b>GOVERD</b>	5927.710*	1962.333			-4064.551*	1472.866
<b>BERD</b>	-4272.769*	1506.362	-5392.922**	3176.752	2223.694*	410.5527
<b>C</b>	5708.359*	1850.747	3013.882*	741.8750	0.424920*	0.066624
<b>Adjusted R-squared</b>	0.919		0.9219		0.9153	
<b>Durbin-Watson statistic</b>	0.906		0.987		0.779	
<b>F-statistic</b>	103.387*		63.038*		114.499*	

\* probability less than 1%; \*\* less than 5%

## Recent Trends in Romanian Innovation Capacity. Evidence from Composite Innovation Indices

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### Abstract

*In the R&D policy making framework, synthetic innovation indicators were proved to be useful tools in identifying performance issues and general trends. This paper aims at providing empirical evidence on the recent trends in Romanian innovation capacity in an international context, based on the currently available composite innovation indices used in international statistics.*

**Key words:** Knowledge Economy Index, Global Innovation Index, Romania.

**JEL Classification:** O31, O38

### 1. Introduction

Innovation is an intangible phenomenon that it is not directly observable and can only be measured by using a selection of proxy variables, such as R&D public and private expenditures, R&D personnel, patents, scientific publications, Internet access, university graduates, etc. [7].

As an effective method for meaningfully combining many individual innovation indicators, both quantitative and qualitative, into a synthetic number, composite indicators are often employed. Composite innovation indicators respond to the needed to summarise large amounts of underlying information and allow for comparing and ranking countries/regions. They are especially useful in the analysis of R&D variables, to measure the performance relative to other countries and to point to innovation areas of poor national performance.

This paper aims at providing empirical evidence on the recent trends in Romanian innovation capacity based on the currently available composite innovation indices used in international statistics.

### 2. The build-up of composite innovation indices

The construction of composite indicators follows several steps [9]: establishing a theoretical framework; selecting the appropriate variables; standardising the selected variables; weighting the variables/groups of variables; checking the robustness of the results.

The theoretical framework underpins the selection of the most relevant variables in order to correctly reflect the innovation behaviour. As the selected variables usually have different measurement units and variation ranges, in order to put them on a common ground, they need to be standardised or normalised before being aggregated into the composite index. This process avoids domination of extreme values and may correct for poor underlying data.

The normalisation procedure means positioning each original value in relation to the maximum and minimum levels of the corresponding variable. There are several variants of the standardization procedure, such as: ranks, standardization to maximum, the 0-1 range standardization method, the inter-deciles range standardization method, Z-score standardizing.

The weighting procedure is reflecting the relative importance of the variables / groups of variables for the innovation process. The literature indicates different weighting

methods [6]: the equal weighting, “benefit of the doubt” weighting, and principal component analysis weighting, each procedure having both advantages and disadvantages and leading to different results.

The resulting composite indicators inform about the position of a country/region and are also useful for setting benchmarks and designing the R&D and innovation policies.

### **3. The World Bank methodology for innovation international comparisons**

The World Bank Institute has developed a Knowledge Assessment Methodology which benchmarks the knowledge economy performance of an economy or region relative to its neighbours, competitors, or countries. This tool helps to highlight countries progresses and to guide the development of explicit strategies to harness knowledge to improve growth, welfare and increase competitiveness. It wishes to emulate on important aspects related to the knowledge economy.

The World Bank methodology is based on the four pillars of the knowledge economy [2]: 1. Economic Incentive Regime is referring to the economic and institutional conditions that provide incentives for the efficient use of existing and new knowledge and the flourishing of entrepreneurship; 2. Education: an educated and skilled population can create, share, and use knowledge well; 3. Innovation: an efficient innovation system of firms, research units, universities, consultants and other organizations can tap into the growing stock of global knowledge, assimilate and adapt it to local needs, and create new technology; 4. Information Communications & Technology is important because a dynamic information infrastructure can facilitate the effective communication, dissemination, and processing of information.

The Knowledge Economy Index (KEI) represents a composite index which is a measurement of knowledge preparedness of a country and allows for benchmarking and comparison of regions and/or countries, based on the average of the performance scores of a country or region in 76 relevant variables. The set of variables serve as proxies for the conditions that are critical to the development of a knowledge economy

and is structured in 7 groups that compose the KEI: performance indicators, economic regime, governance, education and human resources, innovation system, information infrastructure, gender equality.

The Innovation Index is a part of KEI that consists of the following variables: FDI Outflows and Inflows as % of GDP, Royalty and License Fees Payments and Receipts Science and Engineering Enrolment Ratio, Researchers in R&D total and per Mil. People, Total Expenditure for R&D as % of GDP, Total Expenditure for R&D as % of GDP, University-Company Research Collaboration, S&E Journal Articles total and per mil. People, Availability of Venture Capital, Patents Granted by USPTO total and per Mil. People, High-Tech Exports as % of Manuf. Exports, Private Sector Spending on R&D, Private Sector Spending on R&D, Value Chain Presence, Capital goods gross imports and imports (% of GDP), S&E articles with foreign co-authorship (%), average number of citations per S&E article, Intellectual Property Protection.

The data are collected from World Bank datasets and international literature. Ranks are allocated to countries based on the absolute values (raw data) that describe each one of the variables. The rank equals 1 for a country that performs the best (it has the highest score) among the 121 countries in the sample for a particular variable. The rank equals to 2 for a country that performs second best, and so on. Countries with the same performance are allocated the same rank. The results are presented in the next section.

### **4. Romania’s innovation performance in an international context**

Applying the methodology previously described the normalized scores for the Knowledge Economy Index (KEI) and for the Innovation Index were selected for a number of 20 countries, Romania included. The results are displayed in Tables 1 and 2. One can easily notice that Romania holds a backward position for KEI not only in comparison with all the EU old member countries but, to a great extent, compared to the new member countries as well.

Table 1. The Knowledge Economy Index in selected countries

Country	2010	2000	1995
Finland	9.33	9.22	9.33
Denmark	9.16	9.32	9.48
Norway	9.11	9.25	9.46
Germany	8.90	8.84	8.91
Australia	8.88	9.27	9.27
United States	8.77	9.28	9.53
Belgium	8.71	8.86	8.94
Iceland	8.62	8.68	8.18
Austria	8.61	8.88	8.86
Estonia	8.40	8.15	7.94
France	8.21	8.53	8.67
Czech Republic	8.14	7.46	7.77
Hungary	8.02	7.81	7.50
Italy	7.89	7.98	8.04
Slovak Republic	7.64	7.03	7.22
Greece	7.51	7.60	7.85
Poland	7.41	7.23	6.85
<b>Romania</b>	<b>6.82</b>	<b>5.66</b>	<b>5.91</b>
Bulgaria	6.80	5.89	6.81
Russian Federation	5.78	5.28	5.67
World	5.12	5.95	n/a

Source: World Bank.

Despite improving its Innovation Index over 1995-2010, Romania is still situated slightly above a score of 6, which is the worst performance among the EU new member states. All other new member states are situated in the 7 – 8 interval, where countries like Spain and Greece are also placed, while most of the old member states have a score over 9. The results also confirm the leading position of Finland, Denmark, United States and Germany which are, according to various international statistics, among world’s leaders in terms of economic innovation and competitiveness.

Table 2. The Innovation Index in selected countries

Country	2010	2000	1995
Finland	9.66	9.68	9.33
Denmark	9.49	9.52	9.55
United States	9.46	9.55	9.55
Germany	9.11	9.09	9.20
Belgium	9.06	9.10	9.16

Norway	9.01	9.00	9.09
Austria	8.87	8.83	8.93
France	8.66	8.75	8.95
Hungary	8.15	8.03	7.71
Italy	8.01	8.24	8.34
Iceland	8.00	7.38	7.92
Czech Republic	7.90	7.50	7.15
Greece	7.83	7.63	7.40
Estonia	7.75	7.17	6.65
World	7.72	7.75	7.91
Slovak Republic	7.30	7.08	7.09
Poland	7.16	6.86	6.22
Bulgaria	6.94	5.76	7.17
Russian Federation	6.93	6.18	5.64
<b>Romania</b>	<b>6.14</b>	<b>5.24</b>	<b>4.89</b>

Source: World Bank.

## 5. The Eurostat methodology for innovation international comparisons

R&D and innovation are at the heart of the strategy launched by the European Council in Lisbon in 2000, with the objective of the EU becoming the most competitive and dynamic, knowledge-based economy in the world. EU’s competitiveness is strongly linked to its position in innovation, entrepreneurship and the diffusion of ICT.

A series of scoreboard indicators have been launched to provide policy makers with relevant information to measure the performance of each country as regards innovation, entrepreneurship, the use of technology and competitiveness.

The Global Innovation Index (GII) relies on two sub-indices, the Innovation Input Sub-Index and the Innovation Output Sub-Index, each built around pillars.

The GII has five enabler pillars: Institutions, Human capital and research, Infrastructure, Market sophistication, and Business sophistication. Enabler pillars define aspects of the environment conducive to innovation within an economy.

Two output pillars capture actual evidence of innovation outputs: Scientific outputs and Creative outputs. Each pillar is divided into sub-pillars and each sub-pillar is composed of individual indicators.

Sub-pillar scores are calculated as the weighted average of individual indicators;

pillar scores are calculated as the simple average of the sub-pillar scores. Four measures are then calculated: The Innovation Input Sub-Index is the simple average of the first five pillar scores; The Innovation Output Sub- Index is the simple average of the last two pillar scores; The overall GII is the simple average of the Input and Output Sub-Indices; The Innovation Efficiency Index is the ratio of the Output Sub-Index over the Input Sub-Index.

The data are collected from Eurostat datasets and international literature. The *Community Innovation Survey* provides information on innovation activity in the EU. A sample of 125 economies is retained in the final computation of the global GII and the sub-indices.

*Table 3. The Global Innovation Index in selected countries, 2011*

Rank	Country	Score
1	Switzerland	63.82
2	Sweden	62.12
3	Singapore	59.64
4	China	58.8
5	Finland	57.5
6	Denmark	56.96
7	United States of America	56.57
8	Canada	56.33
9	Netherlands	56.31
10	United Kingdom	55.96
11	Iceland	55.1
12	Germany	54.89
13	Ireland	54.1
20	Japan	50.32
21	Australia	49.85
22	France	49.25
23	Estonia	49.18
24	Belgium	49.05
25	Hungary	48.12
27	Czech Rep.	47.3
28	Cyprus	46.45
29	China	46.43
30	Slovenia	45.07
32	Spain	43.81
33	Portugal	42.4
35	Italy	40.69
36	Latvia	39.8
37	Slovakia	39.05
39	Moldova	38.66
40	Lithuania	38.49
42	Bulgaria	38.42
43	Poland	38.02
<b>50</b>	<b>Romania</b>	<b>36.83</b>

Source: Eurostat.

Romania scores low in the GII hierarchy, with a value of 36.83 in the Global Innovation Index, lagging behind all new members of the EU, and Moldova as well. The hierarchy for the year 2011 is dominated by Switzerland and Sweden, both having almost double scores compared to Romania. This position confirms the previously discussed poor performance of Romania in the Innovation Index calculated by the World Bank and suggest the need of a particular emphasis on the R&D and innovation policy in Romania.

## 6. Final remarks

Innovation is defined by a mixture of complex and mainly qualitative processes, difficult to capture by statistical measures.

Innovation can only be measured by using a selection of proxy variables that have to be combined into synthetic indicators in order to be useful to the decision makers. The resulting composite indicators inform about the position of a country/region and are useful for setting benchmarks and designing the R&D and innovation policies.

This paper presented and discussed Romanian position and progresses in innovation performance in a larger international context, based on two well-known innovation measures: the Knowledge Economy Index calculated by the World Bank and the Global Innovation Index calculated by Eurostat.

The results point out a pretty weak position of Romania, despite the progress recorded over the 1995-2010 period. The results also suggest the need of increased support for the R&D and innovation policy in Romania, in order to narrow the gaps.

Although the composite indicators are able to convey synthetic information about the position of a country/region, they should be accompanied by more in-depths analysis of individual indicators, as a basis for appropriate R&D and innovation policy decisions.

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## Health Expenditure, Socio-Economic Context and Health Outcomes

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### Abstract

*Most of the times health expenditure is considered the main cause for health care systems' lack of performance. On the other side, the existing literature identifies numerous factors (others than expenditure) associated with health outcomes. Life expectancy at birth is one commonly used indicator to measure the population health status and the level of development.*

*This paper aims at exploring the relationship between health expenditure, socio-economic context and health outcomes, measured with life expectancy at birth and to identify the factors associated with it at the level of EU countries. We also aim at highlighting the similarities and the differences between the countries, with a special focus on Romania, from the point of view of the identified variables. The findings of the research confirm the existence of a strong relationship between the variables and also point out significant differences among EU countries.*

**Key words:** quality of life, life expectancy, health expenditure, socioeconomic context.

**JEL Classification:** H51, I11, I14, I18

### 1. Introduction

Health is an essential element of human wellbeing. At society level, good health status is a component of a country's human capital, contributing to its competitiveness [1]. A society is considered superior to another one from the perspective of quality of life if its people live longer, healthier and have more fulfilled lives [2].

The present study approaches health as a dimension of quality of life [3]. In this approach health is the result of a complex combination of factors relevant at individual and macro level ([4] quoted in [3]). At individual level health status is influenced by numerous factors such as, genetic inheritance, social status, life style, behavior, attitudes and values related to health status [3]. At society level the factors influencing health status are those related to the socioeconomic context, governance, macroeconomic, social and health policies, but also the societal norms and cultural values [3].

This paper aims at exploring the relationship between health expenditure, socio-economic context and health outcomes, measured with Life expectancy at birth (years) and to identify the factors associated with it at the level of EU countries. We also aim at highlighting the similarities and the differences between the countries, with a special focus on Romania, from the point of view of the identified variables.

The study uses quantitative secondary data from international databases, registered for 2010 and for all 27 EU members. The statistical methods used are correlation analysis and principal components analysis (PCA).

The findings of the research confirm the existence of a strong relationship between Life expectancy at birth and several identified factors respectively, GDP per capita, Health expenditure per capita, Life long learning, Control of Corruption, and People at-risk-of-poverty or social exclusion. The results also point out significant differences among EU countries.

## 2. Literature review

Numerous theoretical and empirical studies take into consideration either individual factors or macro social one, or both in order to identify the determinants of health status in different context and different times.

Considering education as a determinant of health status, researches reach the conclusion that the more educated the individuals are, the better their health status [5].

Income and income inequalities are strong explanatory variables for health status. Wilkinson reaches the conclusion that the population health status is determined not only by economic welfare but also by income inequalities and social cohesion [6]. Other studies identify a strong correlation between income inequality and life expectancy [7] and infant mortality [8].

Considering the relationship between public health expenditure and the health outcomes Filmer and Pritchett conclude that an increase in GDP from 3% to 6% leads to a decrease in infant mortality with only 9-13% [9].

Also, a large body of empirical literature is focused on the influence of governance and institutional factors on health outcomes. For example, Kaufman et al. demonstrate that governance indicators (voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, control of corruption) have a strong positive impact on infant mortality [10]. Rajkumar and Swaroop [11] conclude that the effectiveness of health public spending is strongly influenced by the quality of institutions and, much more, an increase in public spending leads to an improvement in health status only in countries with good governance; in countries with weak governance an increase in public health expenditure has no effect on population health status.

Life expectancy at birth is one commonly used indicator to measure the population health status and the level of development [12] because it has the advantage has the advantage of over passing the difficulties of defining health status among different individuals, communities, cultures and between different moments in time [13]. Over the time life expectancy has registered

an ascending trend but the evolution of this indicator also shows large discrepancies between countries ([14], [15]).

Statistics show a 9 years difference among EU countries in 2010, between Romania and Lithuania, the countries with the lowest life expectancy (73 years) and Italy and Spain, the countries with the highest life expectancy (82 years).

The variations in life expectancy are explained by variations of numerous factors, from political regime to socioeconomic status [16]. Lin et al. identify economic factors, literacy rate, undernourishment and political regime as main determinants of life expectancy [17]. Yavari and Mehrnoosh show that there is a positive strong correlation between life expectancy and per capita income, health expenditures, literacy rate and daily calorie intake and a negative strong correlation between life expectancy and number of people per doctor [18]. Crepaz and Crepaz (2004) demonstrate that the low levels of income inequality are connected with shorter life expectancy and, additionally, that the life expectancy is driven by factors like perceived political control, the generosity of the welfare state, life-styles, GDP per capita and the poverty rate [19].

## 3. Data and methodology

### *Variables*

Using desk research we identified the factors associated in literature with Life expectancy at birth.

We use Life expectancy at birth as dependent variable (health outcome) and five independent variables describing the level of health expenditure (Health expenditure per capita) and the socioeconomic environment (GDP per capita, People at-risk-of-poverty or social exclusion as a share of total population, Control of Corruption and Life long learning, i.e. Percentage of the adult population aged 25 to 64 participating in education and training). Data were obtained from World Bank and Eurostat databases.

Data are recorded at country level for all 27 EU members, for 2010.

Table 1 presents the descriptive statistics for included variables.

Table 1. Descriptive statistics for included variables

	Mean	Min	Max	Std. dev.	Reference year	Source
Life expectancy at birth (years)	78	73	82	3	2010	1
GDP per capita	31320	6333	105195	20826	2010	1
Health expenditure per capita (current US\$)	2975	428	8181	2048	2010	1
People at-risk-of-poverty or social exclusion (% of total population)	23,9	14,4	41,6	7,7	2010	2
Control of Corruption	1,02	-0,18	2,37	0,81	2010	3
Life long learning	9,9	1,2	32,8	7,8	2010	2

Source:

- 1 World Bank, World Development Indicators
- 2 Eurostat
- 3 World Bank, World Governance Indicators

### Statistical analysis

#### Correlation analysis

We use correlation analysis in order to study the intensity of the relationships existing between variables and to identify those factors which have a strong influence on Life expectancy at birth. For the sample of 27 countries, we study the bivariate correlation between Life expectancy at birth, the dependent variable and each independent variable using the Pearson correlation coefficient.

The statistical significance of the Pearson correlation coefficient is tested using Student t - test. The statistical hypotheses are: the null hypothesis, the absence of correlation between the two analyzed variables ( $H_0 : \rho = 0$ ), and the alternative hypothesis, the presence of significant correlation ( $H_1 : \rho \neq 0$ ). If Sig probability associated to the calculated value of t statistic is higher than the conventional probability  $\alpha$ ,  $Sig > \alpha$ , the null hypothesis is validated. On the contrary, if  $Sig < \alpha$ , we reject the null hypothesis, with assumed  $\alpha$  risk.

#### Principal components analysis

In order to identify and describe the relationships between variables and also similarities and differences between statistical units, from the perspective of the

analyzed variables, we use a multivariate statistical method, Principal Components Analysis (PCA) [20].

Before applying PCA, a preliminary analysis is performed, aiming at verifying the adequacy of data for a factorial analysis. The  $\chi^2$  test is used to test the null hypothesis that the variables in the correlation matrix of the population are uncorrelated, and the indicator MSA of KMO to evaluate in which degree each variable may be predicted by all the other variables.

If Sig value is smaller than 0.05, (conventional value associated to  $\chi^2$  test), the null hypothesis is rejected and it can be guaranteed with a risk of 5% that there are significant statistical relationships between the variables. The identification of the relationships is made with KMO statistics. If KMO is higher than 0.5, the PCA can be applied.

After processing the data in SPSS we obtain the Initial Eigen values corresponding to the 6 factorial axes (there are 6 variables included in the analysis), the variance explained by each factorial axis, and the graphical representations which allow us to identify and describe the relationships between variables and statistical units.

## 4. Results

### Results of the correlation analysis

Table 2 presents, for each analyzed correlation the estimated value of Pearson correlation coefficient ( $r$ ) and Sig probability associated to the computed value of Student statistic.

Table 2. The correlation coefficient between Life expectancy at birth (years) and other factors

Variable	r	Sig
GDP per capita	.631(**)	.000
Health expenditure per capita (current US\$)	.705(**)	.000
People at-risk-of-poverty or social exclusion (% of total population)	-.666(**)	.000
Control of Corruption	.605(**)	.001
Life long learning	.441(*)	.021

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

\* Correlation is significant at the 0.05 level (2-tailed).

For a risk of 5%, we accept the existence of a significant relationship between Life

expectancy at birth and the following determinant factors: GDP per capita, Health expenditure per capita, Control of Corruption, Life long learning and People at-risk-of-poverty or social exclusion. The first four factors are positively correlated with Life expectancy at birth, while People at-risk-of-poverty or social exclusion is negatively correlated with Life expectancy at birth.

*Results of principal components analysis*

The results obtained with SPSS (Table 3) show a significant value associated to Barlett’s test of sphericity, with  $\chi^2$  statistic, Sig = 0.000 that is smaller than 0.05 (conventional value), which means the null hypothesis of variables’ uncorrelation is rejected, and the considered variables are adequate for a PCA. Thus, with a probability of 95%, we can say that there is a significant relationship between the statistical variables. The value of the indicator MSA of KMO (KMO=0.813), higher than 0.5, shows that the solution obtained with PCA can be accepted.

*Table 3. Values of KMO test and  $\chi^2$  statistic*

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.813
Bartlett's Test of Sphericity	Approx. Chi-Square	42.252
	df	15
	Sig.	.000

Source: Output obtained in SPSS with PCA

Factorial solution indicates variables’ grouping in two principal components which have an explicative power of 83.227% of the total variance (Table 3).

*Table 3. Total Variance Explained*

Component	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	4.370	72.828	72.828
2	.624	10.400	83.227
3	.552	9.194	92.421
4	.270	4.494	96.915
5	.147	2.455	99.370
6	.038	.630	100.000

Variables coordinates on the first two factorial axes are presented in Table 3. They show variables positioning on the factorial axes. The variables GDP per capita, Health expenditure per capita (current US\$) and Life expectancy at birth (years) are located in the positive quadrants of both factorial axes. The variable People at-risk-of-poverty or social exclusion (% of total population) is located in the negative quadrant of the first factorial axis and the positive quadrant of the second while the variables Life long learning and Control of Corruption are located in the positive quadrant of the first factorial axis and the negative quadrant of the second.

*Table 4. Variables’ coordinates on the first two factorial axes*

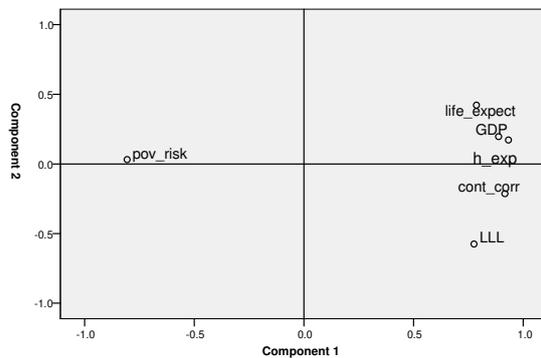
	Component	
	1	2
GDP per capita	.888	.196
Health expenditure per capita (current US\$)	.933	.173
Life expectancy at birth (years)	.787	.422
People at-risk-of-poverty or social exclusion (% of total population)	-.806	.032
Life long learning	.776	-.575
Control of Corruption	.917	-.214

Source: Output obtained in SPSS with PCA

Displaying high values of the coordinates, all variables are strongly correlated with the first factorial axis showing that there are significant differences among the statistical units. Between the variables GDP per capita, Health expenditure per capita (current US\$), Life expectancy at birth (years), Life long learning and Control of Corruption there is a strong positive relationship while between them and the variable People at-risk-of-poverty or social exclusion (% of total population) there is a strong negative relationship.

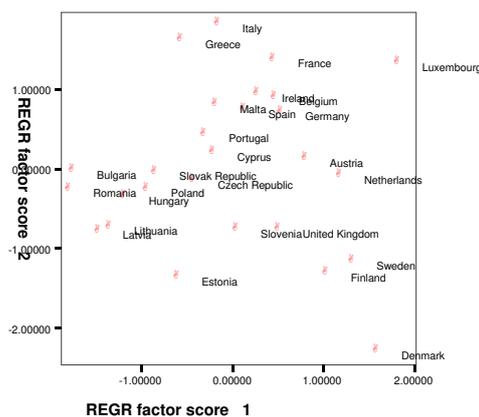
Variables’ positioning in the plane of the first two factorial axes is presented in Figure 1.

Figure 1. Variables' positioning in the plane of the first two factorial axes



The graphical representation of the statistical units on the factorial map is presented in Figure 2.

Figure 2. Countries' position in the plane of the first two factorial axes



The first factorial axis in Figure 2 above points out the “opposition” between countries like Luxembourg, Netherlands, Denmark, Sweden, Finland on one side and Romania, Bulgaria, Hungary, Latvia and Lithuania, on the other. The most significant differences among the statistical units from the point of view of the analyzed variables are explained by this axis.

Overlapping of graphical representation of countries on the factorial map (Figure 2) and variables map obtained with PCA (Figure 1) allows us to identify several characteristics of life expectancy at birth and socio-economic factors for the EU members. Thus, countries such as Luxembourg, Netherlands, Denmark, Sweden, Finland display high values for Life

expectancy (years), GDP per capita, Health expenditure per capita (current US\$), Life long learning and Control of Corruption and low values for People at-risk-of-poverty or social exclusion (% of total population). On the contrary, countries like Bulgaria, Hungary, Latvia and Lithuania are characterized by low values for Life expectancy and all the variables positively related with it and high values for People at-risk-of-poverty or social exclusion, which is negatively correlated with Life expectancy.

## 5. Discussions and conclusions

The main aim of this paper was to explore the relationship between health expenditure, socio-economic context and health outcomes, measured with life expectancy at birth.

The results of the correlation analysis are consistent with the ones of previous research in this area namely that, there is a positive correlation between GDP per capita, Health expenditure per capita, Control of Corruption, Life long learning and Life expectancy at birth while poverty negatively impacts upon the latter variable.

The results of the performed PCA confirm the results of the correlation analysis.

Also, the performed PCA shows differences between the EU members from the perspective of life expectancy and its associated factors.

The most significant differences are between Luxembourg, Netherlands, Denmark, Sweden and Finland, on one side and Bulgaria, Hungary, Latvia and Lithuania, on the other. These countries register low values for the indicators positively correlated with life expectancy at birth and high values for poverty which is negatively correlated with quality.

We can state that Life expectancy at birth is higher in those countries characterized by high values for GDP per capita, Health expenditure per capita, Control of Corruption, Life long learning and low levels of poverty.

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## From Traditional to Behavioral Economics. A Doctrinaire Perspective

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### Abstract

*The paper aims to contribute to the building of a more realistic understanding of the new born field of behavioral economics, based on a (fragmented) historical perspective of the psychological influences that can be traced in representative works from important economists.*

*Exploring the theory of moral sentiments of Adam Smith, the animal spirits of J.M.Keynes and other representative concepts from Thorstein Veblen, Tibor Scitovsky and Herbert Simon, we emphasize the existence of a solid background for current research on similar topics and a sense of coherence that makes a significant link between different periods of economic thought and the actual trends.*

**Key words:** behavioral economics, economic thought, homo economicus, bounded rationality

**J.E.L codes:** B31, D03

### 1. Introduction

Labeling economic science as „behavioral” has attracted many critics starting from pure semantics. One of the arguments claimed redundancy on the reason that all economics is, or it should be, about behavior. The paradox appears when we look at the simple definition of the word „behavior” - the aggregate of responses to internal and external stimuli – and compare it with the standard picture of the economic agent. What is essentially missing is the concern for internal stimuli, thus for a normal psychological dimension. In exchange, he benefits from unbounded rationality, unbounded willpower and unbounded selfishness. All of these positivist traits, proven unrealistic in different experimental

and field settings, are generating a „non-behavioral” aura around economics, making a clear proof on why we need a behavioral approach.

However, our intent is not to abandon the traditional structure of economics, but to build upon it. In this sense, the main objective of the paper is to bring into light some behavioral ideas that are highly discussed nowadays but that actually have older roots that were ignored or overshadowed at the time of their appearance. Having this purpose in mind, each section will analyze a particular concept or a certain work pertaining to five economists: Adam Smith, J.M.Keynes, Thorstein Veblen, Tibor Scitovsky and Herbert Simon. Their choice was based on their relevance either as founders of schools of economic thought, either as pioneers in their specific research, due to their unconventionality and interdisciplinary orientation.

### 2. Adam Smith in the light of moral sentiments

After more than two centuries, Smith’s view on moral sentiments and the wealth of nations seems to be still quite contradictory. The German economists named it `the problem of Adam Smith`, expressing the dilemma concerning the drivers of human motivation: on the one hand self-interest [1] and on the other hand feelings, affects, passions and the impartial spectator who sets the standard for our moral judgment [2]. Nowadays, this dilemma was classified as a false one, generated by an insufficient understanding of the two works, usually focusing more on the Wealth of Nations (generally considered as a seminal work, „the Bible” of economics). Unfortunately, these distinctions were made clear only at a theoretical level and the general public

continues to associate Smith with the father of *Homo Economicus*, thus a fervent promoter of selfishness in order to achieve economic prosperity: *‘It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest’* [1].

Professor Ion Pohoată [3] underlines the injustice made to Smith when it is placed next to a very rigid rationalism. The idea of acting in its own interest follows a stoic spirit, as it is revealed in the Theory of Moral Sentiments, and recommends loving itself as a condition for self preservation. However, the economist completes this perspective by adding the fact that arrogant forms must be always reduced to humility, in accordance with the judgment of the impartial spectator [2]. In consequence, by accepting that people can pursue their interests and, in the same time, be capable of showing the main virtue of benevolence, the apparent contradiction is solved. This point of view is further applied to commerce and transactions in general, by setting a moral scheme under which they are carried on. In an ideal scenario, the spectrum of economic virtues, including justice, prudence, self-control, selfishness and fidelity, would be enhanced by noble virtues: kindness, generosity, compassion, gratitude, friendship and love.

Taking a very informed look at these matters, Ashraf et al. [4] design an interesting case of Adam Smith as a behavioral economist. They depart from the keen observation that Smith’s psychological approach is extremely similar to the perspective of dual processes revealed on the basis of human brain research. The limits faced by the impartial spectator confronted with emotions and passions stands as a good analogy for this recent theory that provides an account of how a phenomenon can occur in two different ways, or as a result of two different processes: unconscious/implicit/automatic versus conscious/explicit/controlled [5].

The authors argue in a systematic manner that the theory of moral sentiments offers a comprehensive view on human nature, anticipating basic elements of nowadays behavioral economics: loss aversion, fairness, overconfidence, consumption, wellbeing and happiness.

### 3. The animal spirits of J.M.Keynes

The Keynesian thought has produced huge mutations to the body of economic science but we will focus only on a few central elements for our behavioral analysis, starting with the concept of animal spirits. This well known metaphor stands for the irrational factors that influence many of our decisions: an urge to act which is far from being a simple calculus between benefits and objective probabilities [6]. Keynes used the idea of animal spirits not only to indicate impulsiveness, due to vital energies and vital forces, but also to designate an environment characterized by ambiguity and uncertainty. Thereby, going from investigating macroeconomic fluctuations since the time of the great depression between the years 1929-1933, to decoding the financial crisis started in 2007, the role played by animal spirits seems to be surprisingly similar. Akerlof and Shiller (2010) have delved into this concept presenting it into a behavioral light and underlying its important consequences for economic behavior. Moreover, they have enhanced its theoretical valences by incorporating elements such as trust, equity, corruption, antisocial behavioral, monetary illusion and stories [7]. Expressed slightly different, these are also the inflexion points in which Keynes made strong psychological assumptions, departing its discourse from the neoclassical tradition.

Taking even a more audacious position, Weasley and Marcelo (2009) explain in a methodical address the parallels between some famous cognitive heuristics developed by Kahneman and Tversky [8] in the ‘70 and some useful mental shortcuts described by Keynes. Just to give some specific examples, Keynes discusses on the impact had by the most recent results in decision-making and he also notices the way entrepreneurs use information they consider to be representative in a context or just information which is easy to access or to imagine. Translating this in the ‘jargon’ of behavioral economics, we instantly connect to the availability and representativeness heuristics.

On top, we can add its point of view on overconfidence as an essential condition in expectancies formation and an inherent one for human nature. In practice this can lead to situations where individuals perceived as

experts (based on their knowledge and their previous decisions with a high degree of unpredictability) express a high level of trust in very complex matters positioned in uncertain conditions.

The list can continue with great ease but the same authors mentioned above, among others, give a pertinent explanation for the reason why it is an underexplored research segment: the existence of a certain degree of confusion and divergent interpretations over Keynes view on psychology, sometimes considered absolutely needed and other times appreciated as contrary to rationality or conventional behaviors [9].

#### **4. The institutionalist school of economic thought**

The basic concepts of institutionalism are oriented towards the dynamic examination of institutions, habits and rules, from an evolutionary angle. This approach brought to its affiliates the quality of bringing economics on the ground and making it more human [3]. We could not neglect the realism of such a characterization and thus we have chosen to investigate a leading member of this community and its unconventional ideas - Thorstein Veblen.

A first remarkable note is his hedonic (and simultaneously ironic) definition of the rational economic man: *“a lightning calculator of pleasures and pains, who oscillates like a homogenous globule of desire of happiness under the impulse of stimuli”* [10]. This explicit disapproval of the hedonic principles does not represent a rejection of psychology but, at contrary, it expresses the need of finding a more sound psychological basis. Furthermore, this idea was strengthened by the view of other institutionalists, like Mitchell [11], who had understood institutions as psychological entities with thinking and acting habits. In time, it was previewed even the possibility that economists will not also borrow elements from psychology but they will also contribute to its development.

Veblen questioned the static assumptions of economics, its normative models and limited preoccupations for natural rights, utilitarianism and administrative efficiency. He has systematically contested the deterministic spirit of the period, pointing out for example

the relevance of emotions in understanding human action.

Not last, one of his main works, „The Theory of Leisure Class”, offers a comprehensive picture on how the concept of conspicuous pleasure (waste of time), has evolved over time and finally has metamorphozed itself in conspicuous consumption (waste of money). The term was initially coined by the author in order to depict the behavioral characteristics of the wealthy class but nowadays it has a substance of its own, being broadly defined as "the act of buying a lot of things, especially expensive things that are not necessary, in a way that people notice" [12].

Veblen distinguishes two main reasons for this type of consumption: invidious comparison and pecuniary emulation. The first element illustrates the case of an individual from a higher class which consumes to set itself apart from the members of lower social classes. In the second scenario, the positions are switched and an individual from an inferior class consumes in order to be noticed or registered in a superior class. These two signaling mechanism of wealth are clear proofs of the malfunctioning of the law of decreasing marginal utility, a topic extensively researched by behavioral economists. In other words, consumption behavior is determined and influenced by many other neglected variables, apart from the main and rational objective of maximizing utility. Within microeconomic theory, this particular behavior where a consumer is willing to buy a more expensive good when it has an accesible alternative, similar regarding functionality, was named the Veblen effect [13]. The same `lexical` family includes the snob effect and the bandwagon effect. Standard discourse treats them as anomalies but their generalized significance is more and more examined with the tools of experimental economics.

#### **5. T.Scitovsky and his joyless economy**

Under the premises of neoclassical economics, mall shoppers, loyal TV watchers and other categories of individuals in search for similar entertainment, are nothing else than rational consumers that act in order to maximize their utility, expressing their

preferences through market behavior.

Tibor Scitovsky was not convinced at all by this explanation, having great doubts on the true origins of consumer behavior. His initiative was materialized in „The Joyless Economy: The Psychology of Human Satisfaction” [14], where he convincingly argues that the lack of joy around economics is caused by the maximizing philosophy.

The tipping point of his work consists of an essential distinction over the way we understand utility: on the one hand there is an approach oriented to search comfort and on the other hand the purpose is to find pleasure. To have a complete perspective we need to mention the link between human motivation and arousal- the state of being awake or reactive to stimuli. In this case, particularly relevant is the correlation arousal – curiosity in the sense that a lower level of arousal than the optimal one can determine a more intense exploring behavior [15].

Within this context, the economist suggests that while reaching a state of comfort implies a reduction of pain or discomfort, pleasure is intrinsically connected with arousal and stimulation. So, if the desire for comfort can be saturated, not the same happens with the desire for pleasure. The search takes the shape of a spiral that grows continuously as we are getting closer to a perfect state of comfort, characterized by a lack of stimulation. At this point, we will compensate this lack by consumption acts that can bring joy and excitement. Deriving from here, there can be identified two categories of goods and services: the ones that produce comfort and the ones that offer stimulation. Scitovsky analyzes more thoroughly this aspect making references to the differences between Americans and Europeans. Thus, he claims that Americans value more the first class of goods, in the sense of saving time, money and effort. The problem is that what they save it is meant to new consumption of the same type. At the other end, he perceives Europeans as a more discerning category of consumers that use their time to obtain more exciting experiences: they prefer long conversations in cafes, go on longer holidays, eat healthier food and so on.

To synthesize this argumentation line, we can say that the boredom generated by the consumption society it is also a driving force

for new consumption. Comfort states assume absolute levels of arousal and pleasure is obtained by fluctuating levels. This tense relationship is revealed by human’s natural tendency of over-searching comfort on the account of pleasure.

On a more technical note, Scitovsky was also disappointed of the non-scientific approach neoclassics had on preferences: people’s tastes and choices are issues that were just observed by economists and not deeply understood as structures [14]. This was an additional reason that gets him closer to work of psychologists and very impressed by their experimental research methodology. Needless to say that he supported the use of experiments in economics, anticipating today’s experimental economics.

## **6. Herbert Simon between bounded rationality and decision-making**

The vast contributions of Herbert Simon to economics, organizational behavior and artificial intelligence are disclosing a visionary spirit, preoccupied to build a human science which will treat in a comfortable manner the dual nature of the individual: social and rational animal.

Departing from the basic structures of the functionalist approach in sociology, Simon emphasize that the notion of rationality described by the theory of rational choice, promoted by economics, is conceptually different than its usual meaning. The critical distinction is made by the maximizing individual construct which, according to Gary Becker, would only read at night in his bed if the value of reading surpasses the value (perceived by him) of the lost sleep of his wife [16]. Extrapolating this sarcastic metaphor of marginal calculus, Simon points out that economic interest is manifested only in relations with the envisaged results of rational choices and it ignores for the most part the choice process. From this observation, he further identifies two types of rationality: substantive rationality and procedural rationality. The first category is the one validated by economics, while the second is utilized by psychologists, thus incorporates aspects of thought, judgment, affectivity and emotions.

With a cooperative intention in mind, Simon imposes the paradigm of bounded

rationality as a comprehensive model that takes in consideration that individuals do not have access to complete information, that they have cognitive limitations in terms of processing and computing, but also physical limitations of available time. In consequence, due to the fact that decision-makers do not have the abilities and resources to make the optimal decision, they apply their rationality only after they simplify as much as they can the decision alternatives. Moreover, they are not following the optimal/maximizing decision but a satisficing decision. This can be translated into a rational behavior in accordance with the simplified model defined by the individual, but far from the rational behavior defined from a mathematical point of view.

To reflect these departures from optimality, Simon considers as instrumental the following attributes of cognitive heuristics [17]:

- Optimizing is replaced by satisficing
- Decision are revealed in a sequential manner
- Individual are formulating and following rules that serves as choice alternatives in recurring situations
- Each rule can be applied to a restricted set of cases
- Each rule can be independently applied.

Finally, the scissor’s metaphor [18] offers some quintessential insights: one blade is represented by cognitive limitations and the other is constituted by the environment structure. Focusing on only one blade is ineffective because we need both of them to cut. So, the bounded rationality logic presents the steps taken to reach a certain judgment or decision (through heuristics or proximal mechanisms) and also the types of environments in which these heuristics will succeed or fail. At the end, this is the ultimate argument for the fact that bounded rationality is not optimization, neither irrationality nor an inferior form of rationality. But what it actually stands for is a self-standing theory that aims at rethinking certain norms and studying real individual and institutional behaviors.

## 7. Conclusions

Behavioral economics is an emerging sub-discipline which promotes important structural changes, epistemologically and philosophically, at the core of economic science.

Current research streams are abounding with new theoretical structures (prospect theory versus expected utility, mental accounting, social preferences) and new working methodologies (experimental economics, neuroeconomics) that are developing at an extremely fast pace.

However, as history has proven it so many times, the new is somewhat encrypted in the old. Our paper has followed this red line and has discovered unexpected anticipatory resources in the work of traditional economists.

We believe that the numerous behavioral clues that we have found in the writings of Adam Smith (emotions, feelings, affects), J.M.Keynes (animal spirits, overconfidence), Thorstein Veblen (the nature of conspicuous consumption and consumerism), Tibor Scitovsky (the underlying structure of utility and human satisfaction) and Herbert Simon (bounded rationality), have the potential to minimize the gap between neoclassical discourses and behavioral economics.

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## Cybercrime - Part of the Underground Economy in Romania

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### Abstract

*In recent years, organized crime has expanded considerably, the presence, complexity and importance, and now threatens many aspects of normal life of citizens in private life, work and business.*

*Organized crime promotes corruption, violence and other illegal activities threatening the security of borders and cause human injury.*

*It undermines the integrity of banking systems and financial markets and capital goods and virtual space.*

*International networks of organized crime are a national security problem that requires a concerted policy response of governments.*

**Keywords:** cybercrime, organized crime, underground economy, counterfeit cards

**Classification J.E.L.:** E26, K42, O17

### 1. Introduction

Romania, together with other Member States of the Council of Europe, signed in Budapest on November 21, 2001, the first international treaty aimed at illegal activities conducted on the Internet or other networks, especially those on electronic fraud, unauthorized access the systems and data interception.

This treaty, known as the "Convention on combating cybercrime", was implemented in Romania by the provisions of Title III on "Preventing and combating cybercrime" of the Law no.161/2003.

In addition to appropriate legislation, which allows including strengthening international cooperation in the field, MCIT (Ministry of Communications and Information Technology) has released [www.eFrauda.ro](http://www.eFrauda.ro) site

This portal allows you to receive

notifications regarding activities of an apparently illegal in information society services and carrying out direct interaction between providers and consumers of information society services and authorities with relevant expertise.

[www.eFrauda.ro](http://www.eFrauda.ro) site provides space to complete assisted electronic forms, which contain identification of the depositor and a brief description of the documents seized.

Depending on the type of computer crime at issue, registered complaints reach the Directorate for Combating Organized Crime Prosecutor's Office or the High Court of Cassation and Justice.

Once completed and submitted form content is confidential, it can not be accessed by the authorities than it is intended.

Counterfeit credit card fraud consistently shows an increase in criminal efforts to conserve, specialization and full use of their youth members with real talent in the criminal field, leading to financial gains fabulous, in a very short time and difficult to prove.

For 2011, are deemed to have been rigged about 4 euro in 100 euro traded via electronic payment systems.

In Romania, the figure is several times lower.

Moreover, Romania is known internationally as a small nursery professionals involved in this phenomenon, whose evolution is increasing steadily and very harmful to the financial systems used at the macro-economic in all states.

This has long been intuited and exploited by large organized crime groups, drawing their ranks almost all the major criminal offenders with talent in committing such fraud.

According to statistics recorded by the Directorate for Combating Organized Crime, in 2011, structures cybercrime confiscated and returned to the economic cycle, from

specific activities, the following:

- 219,057 euro;
- 92,173 U.S. \$;
- 117,800,000 lei cash;
- 3,992,000 lei value of other goods.

With reference to those goods in domestic and values, resulting a total of about 132,000,000 lei representing total damage recovered and reintroduced into the economic circuit.

In same context, not to ignore any statistics on human involvement in crime cybercrime represented.

Thus, in 2011, specialized structures within the Directorate for Combating Organized Crime reported issuing 174 indictments, in which 558 people were surveyed, of which 278 in custody.

However, following specific activities were destructured 42 organized criminal groups, composed of 478 persons, of which 220 in custody.

Preventing and combating this type of crime is very complex. Thus, in 2011, organized crime police have made no less than 33,068 computer searches and house searches in 1078.

## 2. Types of cybercrime

Contains material competence, in accordance with Law nr.39/2003:

Internet scams (most common);

- offenses relating to copyright and related rights achieved through computer systems;

- child pornography through computer systems;

- cloning credit cards and other electronic payment instruments;

- any offense done by computer systems, a phenomenon called generic cyber crime and the modus operandi: "hacking" (unauthorized intrusions into computer systems), "phishing" (Internet identity theft, fraudulently obtaining confidential data etc.), "phreaking" (use of mobile services through systems), "breaking" (unauthorized intrusions into computer systems followed by causing some damage), etc.

I will, in this paper, to deception and fraud on the Internet with counterfeit credit cards.

## 3. Deception via internet

In general, there is a decrease in addressing such offenses by members of organized crime groups.

If in previous years the phenomenon known a great extent, with time and the emergence of more and more IT specialists, organized crime such as fraud concerns had a computer recycling criminal inclinations, from simple computer fraud, with gains small to large counterfeit credit card fraud, which involves the use of "brain" local, consisting of young members recruited and trained in electronics and IT, leading to much greater financial gain.

Members of organized crime groups with interests in committing such crimes come from young talents in navigation on the Internet, and communication skills and application of persuasive techniques.

Easy access to computer technology work with the network moved the areas of criminal activity by old enclosures internet cafes, in various locations, from particularly motel rooms rented by the day, until they cover areas of parks mobile communication networks to the Internet.

Features:

- offender can not justify the money (their title, nature of transactions worth hundreds of thousands of dollars) shipped by various means banking or financial, on behalf of foreign citizens,

- the offender has no source of income, but has large sums of money,

- complaints are obtained for a small number of these,

- inconsistent sentences imposed, not taking precautionary measures on property owned by criminals - look who permit them, after their sentence to fully enjoy the product of crime,

- although not justify, in terms of lack of income, how to obtain them (luxury cars, expensive property, money, jewelry, etc.), do nothing to encourage the development of this scourge,

- commit old crimes through modern (identity theft, confidential data, cloning sites, etc.), At distances of thousands of kilometers,

- perpetrators were used to migrate to other locations than those of origin, buying electronics and renting property, where they

conduct their criminal activities, lately seen in the real migration in countries like Italy, France, Netherlands, USA, Spain, Germany, Norway, Sweden etc.

From field cybercrime offenses have escalated manifested by purchasing goods from various shops hosted on the Internet, using fictitious data on the identity of the buyer and payment method.

The authors of these types of offenses are not within the classical typology of offenders, it can be summarized as follows: male aged between 14 and 45, good social status, no prior criminal record, intelligent and motivated.

We have therefore to deal with common criminal who commits crimes classic, but with an intelligent person, well trained in informatics, which uses the computer as tool for committing crime.

Subjects who threaten the security of information may belong to different categories, committing crimes more or less serious way it can be broadly classified into insiders and outsiders of an organization that is also a major source of risk, the considerations that are more difficult to detect and investigate only those within organizations.

Ways of achieving diversity offenses through information systems, dynamic and continuous development of walking both require correlation legislation, legal procedures for investigation, the rules of the relevant institutions and the technology required to serve this area.

#### **4. Counterfeit credit card frauds**

The card payment instrument specific electronic payment system, it allows the owner to pay for goods and services purchased in various trade points and get cash from vending machines to distribute banknotes based on the existing account balance in the bank.

The development of technical means that have revolutionized every field and of course banking, credit card transactions on their accounts and records as us.

But this means not only reached the endowment of well-meaning people but also the hands of some who use these means for committing illegal acts.

Criminals have become more efficient

than ever. They operate in the world of online communications between computers, sometimes called cyberspace.

Increasingly, many offenders commit their deeds now that is entered electronically on the Internet using a computer.

One reason for choosing this method is often fast and simple operation that can commit such acts.

A track a criminal in the cyberspace is not in any way look like a classic track, where everything is action.

There are tens of thousands of places to visit in cyberspace and as many suitable places to commit crimes, like a city.

It was noted an increase in credit card fraud, recently receiving the signals serious offenders for purposes of reorientation ATMs in Romania, are expected in the near future and a process of specialization on bank cards issued in our country .

Far from being brought under control, this crime phenomenon is growing rapidly, attracting more people eager for quick gains, many of them were not even aware of their contribution to the achievement of crime.

Even now, in the era of computerization and information, the risks are handled responsibly incumbent, which will inevitably lead not only to financial losses, but also to perform more serious one being the unprecedented organized crime.

Offenses are directed at the media card, he was not present in the computer operations. Here are handled data entered on the card and account for these cards (card holder identification data and code specific to any credit card number and issue date thereof).

It should be noted that these cyber-criminals are divided into three categories:

The first category uses cards found, Runcie or expired no more money in the account or have very few, that is more than negligible amounts, and sometimes valid cards were stolen and used as such.

A second category of cyber-criminals use programs that generate numerical codes for credit cards. These programs are most often used by these computer criminals.

The most dangerous mode of operation but the operator is delinquent in various ways to be exposed later to take in numerical codes of valid cards directly from your bank unit.

Increased danger of this mode of operation results from the fact that once entered into

the files of a bank can cause criminal damage million in a very short time.

However the scope of these crimes knows no physical boundaries, a cyber-criminal could ever commit such offense in any state. Therefore it is necessary a very good cooperation in the field both between different Internet service providers and between police from different countries.

This cooperation resulted in the establishment of national training partnership in the field of cybercrime (National Cybercrime Training Partnership - NCTP) is a consortium composed of institutions of the federal police, state, local and international educational institutions and training designed to provide high technology.

Its main function and activity focuses on the design, development and implementation of quality programs and materials on computer crime for investigators and prosecutors working in this field.

Headquarters N.C.T.P. Fairmont State is in West Virginia in the U.S.

## **5. Suitable person to commit such crimes**

Committing offenses of this kind of means we use the latest technology, high performance, and its operation within the cyber-criminal. Such an individual must be familiar with operating languages and programming languages.

For this requirement to be met, this individual would be useful for long periods of study and practice.

For these reasons, we can say that the vast majority of cases, cyber-criminals are represented by young students or students who have a computer at home or the school to which they are legitimated, which are units with profile information or carrying out training courses in this area .

Other representatives are teachers of mathematics, computer science and physics that are connected to the Internet very long time and know very well every aspect of navigation and use of networks.

The fact that these people are connected in network long time, get to know and to procure even different programs that facilitate criminal acts.

Many times they are on the web, where you can find different methods and different ways of deceptive individuals and businesses.

Another coordinated this aspect is that these cyber-criminals acquire their very easily any security problem arising in the ninth to commit the crime, the future managing to avoid further problems in this regard.

Most of these people are in the former communist, because, as policy pursued at that time, being isolated from the Western policy, were not connected to the Internet and even computers were obsolete.

After the establishment of democratic regimes and take last minute technical information and the connection to the Internet, this phenomenon began and proliferation of cybercrimes.

Thus Eastern countries began to commit such offenses citizens Hungarian, Polish, Romanian, Bulgarian and Russian. Most such offenses were recorded in Romania and Russia, most offenders are high school students.

## **6. Recommendations**

Before you enter a credit card number online commerce site should be checked if the site is secure and requested first legitimate. Not used the assumption that if a site claims to be safe, so it is, but we convince ourselves about it.

Be checked each time the list of credit card transactions to prevent any additional revenue.

Perhaps the most important preventive measure is why not enter information about credit cards on any sites or in response to unsolicited emails, as banks issuing cards never use these tools to request information from customers.

## **7. Conclusions**

In the current economic crisis, which affected the macro-economic legacy mainframe systems throughout the world, there is the historical character of flowering repetitive crime in general and especially the organized type, by exploiting the poor population propensity to commit crimes.

In addition to traditional approaches of trafficking in human beings, drugs or weapons, current technology allows organized crime groups to deal with successful inclusion within the scope of

computer crime.

This, due to great financial gains in short time and with minimum investment of capital gains that can be easily included in the national economy underground and potential reintroduction into the economic, money laundering techniques.

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## Typology of Market Economies

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### Abstract

*The market economy is an economic system characterized by the following:*

*The objective pursued by the economic agents is the profit maximization. The goal of all the decisions and actions of the management staff is directly or indirectly aimed at having the company they work for obtaining the highest possible profit.*

*The national economy is made up in predominant proportion by economic (nor administrative) agents, mainly undertakings. By economic agent we understand an organization that aims at profit making, using predominantly economic means, and whose survival and development is conditioned by profit marking. The most frequent economic agent in the market economy conditions is the enterprise or company.*

**Key words:** market economy, economic agents, profit, enterprise.

**J.E.L. Classification:** A11.

### 1. Introduction

The management and operation of the economic agents are achieved using *economic levers*: price, salary, credit, interest, investment, profit, etc. These replace the directives, bureaucratic plans, guidelines and other elements specific for the super-centralized communist type economy, whose management is dominated by administrative red-tape and political elements.

The economic pillar of the market economy is the *private property*, which is required to be predominant. As demonstrated by the millenary history of mankind, the private property corresponds to the human nature, and entails multifarious and intense connections, attachments and involvement

between man and the object of man's activity. The private property is the *de facto* guaranteed property, the right of possession, use, disposal and usufruct, in the absence of which there are no genuine economic agents. That is why the predominance of the private property at the level of the economic agents is determinant for the emergence of the market economy.

Further on it will be presented the main types of market economies nowadays implemented in various parts of the world.

### 2. Anglo-Saxon type of market economy

These economies are the most liberal and less inclined to dirigisme (USA, Canada, United Kingdom, etc.).

The private sector prevails at the level of the economic organizational structures. Its main features are as follows:

a) Concentrates about 90% of the occupied population;

b) The large companies hold a dominant position, occupying the largest share of the industrial production, including the key and strategic industries, the scientific research, investment and foreign trade flows;

c) The State (government administration) initiates and implements an economic policy characterized by flexible and liberal interventionism, aimed at stimulating the private sector;

d) The public sector — productive and service enterprises — occupies a negligible position in the economy;

e) The State intervention is mainly achieved through the instruments of the fiscal budgetary, monetary and credit policies.

### 3. Western European type economy

This has the following features:

1. It is a market economy with a marked dirigist predisposition (Italy, France).

2. The active intervention of the State in the economy is achieved via the public sector, but also through planning as an instrument of the functioning of the economy, that confers these countries the feature of mixed economies.

3. These economies are competitive, nevertheless the flexibility of the market mechanisms is affected by the State intervention, which brings about a certain rigidity in respect of the functioning of the economy.

4. As regards the economic organizational structure, next to the private sector there is a powerful public sector, and a mixed sector that is not negligible.

5. The small and medium-sized enterprises coexist with the large companies, and enjoy special protection from State.

6. The State-owned enterprises and institutions, as well as those directly controlled by the State, hold a dominant or main position within key sectors or predominant sectors through their driving effect from exterior, and in sectors of general interest (for example, in France and Italy: energy, electronics, pharmaceutical industry, deposit banks, some commercial banks, etc.).

This model represents an approximate application of the Keynesian inspection theories, coexisting with, and combining, private and statist elements in respect of the economic structure and functioning of the economy.

#### **4. Social market economy**

This is characterized by the following:

- The reunion between the market freedom and social harmony (Germany, Austria, Netherlands).

- The goals of the social economy are as follows:

I. Attaining the most economic welfare via:

- a) regulation of competition;
- b) continuous and convenient growth, through instruments that restrain as little as possible the economic freedom;
- c) full occupation of the workforce;
- d) guaranteeing the freedom of the foreign trade, the free convertibility of the currency.

II. Safety of price level stability

- a) independent central bank;
- b) “stability” of the State budget;

c) offsetting the balance of payment and external economic balance.

III. Social safety, social justice and social progress, family safety, fair distribution of the income and wealth via:

a) maximization of social product;

b) correction by the State of the initial distribution of the income and wealth in the form of social aids, pensions and indemnities, of subsidies for the building of homes, measures favoring the building of wealth, affecting as little as possible the self-responsibility of the individual and social groups, the freedom and propensity toward performance of the individuals.

#### **5. Northern type of economy**

This has the following features:

It is a contractual market economy, in the sense of the cooperation between the private and State sectors, with mutual commitments aimed at satisfying certain economic and social needs (balanced repartition of revenue, social assistance in respect of all the social services, including the gratuity of some of them).

This type of market economy can be found in Sweden, Norway, Denmark, called the “socialized Northern block”, or “countries of the democratic socialism”.

State intervention at social level, the State becoming the “protective State”.

The State intervenes in the relationships between trade unions and employers unions, favoring a limitation of the concentration of wealth and, respectively, of the polarization of the society.

#### **6. Paternalist market economy**

This is characterized by the following:

Market economy with strong traditional and national elements (Japan).

Favors the development of the competition, spirit of free initiative and completeness of the economic agents.

The success of this model is mainly related to the following:

- a) promotion of free initiative;
- b) meritocratic management (“The path to the top goes through the highest competence and ability, the richest experience and the longest service”);

c) the government intervention watches over the development of the economy, and controls it by combining the local initiative and a competent central management;

d) high quality of general education and professional training;

e) supreme importance of the information.

The public sector in the form of public enterprises is least developed.

The State concentrates the scientific research, and makes it available to the companies.

Planning is used next to the banking, budgetary and financial levers.

The Japanese planning is unauthorized and indirect, flexible and of medium and long term perspective, gliding, inspirational and optimistic.

The cohesion and solidarity, as expression of paternalism, can be found at the level of the State as well as of the small and medium-sized and also large companies;

The Japanese companies compete each other locally, but not on the external market.

The Japanese companies show solidarity for the foreign capital, for the protection of the national currency, for the balance of payments surplus.

## **7. Market economy oriented toward and dependent on exterior**

This is characterized by the following:

Is specific for certain small independent States or former colonies, developed or underdeveloped. For example, the Ivory Coast, the most important producer and exporter of palm oil, a strategic raw material.

Fundamental principles: economic liberalism and opening towards the external world.

The export is the only solution to the development problems.

The State interventionism is flexible and selective; it is mainly active in the commercial activities, creates the economic and social infrastructure, has participants in private industrial companies, supports the establishment and development of the national private enterprises.

The State investments account for two thirds of the total investments of the Ivory Coast, and the public spending a third part from the gross domestic product.

The plan is the main instrument for directing the activity, and in certain cases it is imperative (economy of planned liberalism).

## **8. Conclusions**

The market plays the decisive role in respect of the guidance and operation of the national economy. As a matter of fact, it is the main regulator of the economic activity. The size of the prices, salaries, credits, interest, and also their progress, are established by the market, contingent upon the demand-supply relationships, obviously within the legal and economic regulations issued by the macro social decision-making factors. Particularly this last aspect is emphasized, since no civilized country worldwide any longer uses the system of spontaneous market, characteristic for the last century, which would make impossible a balanced operation of the economy.

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## Small Business Management Strategies

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### Abstract

*Small business management issues have long been ignored by management specialists. University studies related to the development stage of the strategic management have only emerged over the past decade as a new systematic approach of the small business management came into sight as regards this area of the economic agents.*

*The individual contribution of a small business to assigning the economic situation of a nation is insignificant but the small businesses as a whole play a major role. In countries with a developed market economy, over 95 % of the total number of companies is represented by small and medium-sized undertakings. These involve approximately half of the number of employees in the whole economy and generate 80 % of the new employment. The creativity associated to these companies is comparable to that of large organizations.*

**Key words:** small business, strategic management, market economy, small and medium-sized undertakings.

**J.E.L. Classification:** D04

### 1. Introduction

The undertaker is the person assigned to formulate the strategy. The undertaker is defined as the person who creates, organizes, manages and assumes the risks of a company. As a founder, owner and manager, the undertaker bears all the responsibilities which were horizontally or vertically distributed within the organisational structures of a large firm. The three strategic levels merge into one single level and the functional field is absent.

The small business and the entrepreneurial company are two different concepts even though they are sometimes used in order to

define the small-sized undertaking. Both are designated by certain authors by the label “small deal”.

The small business has the following characteristics: it is owned by only one person or small group of persons (individuals), it operates independently, it is not in a dominant position within its field of activity, it is not engaged in innovative practices.

The entrepreneurial company, unlike the small business, has the following characteristics: it applies innovative processes, the fundamental purpose consists in increasing and improving the profitability.

The difference between the two types of organizations is related to the manner in which these are tackling the innovation even though they fabricate the same products. The initial development stages enclose a superposition of the concepts as the entrepreneurial company begins its activity as a small business. Many undertakers prefer to remain in the initial stage without aiming to outrun a certain size of the company. This option is based on the intention to keep control over the growing business sacrificing future growth which might impact this challenge.

The national legislations define the small businesses by using some limitative standards associated to the following criteria: ownership (number of owners); the turnover associated to a well-defined field of activity; the number of employees related to the same field of activity.

If the company succeeds in being registered within these standards it is classified as small and medium-sized undertaking and benefits from a series of advantages (taxes, crediting conditions etc.) destined to encourage the respective field. The stimulation addresses both to the person who has already created such a company and to the person who would like to launch into business in the respective field.

## 2. Features of the small businesses strategic management

The manner in which small firms behave in terms of their economic activity indicates a visible lack of strategic guidance; this is less conspicuous for entrepreneurial companies as they aim the economic growth by adopting a plan within which innovation plays a very important role. According to the authors R. B. Robinsoni and J. A. Pearce (“Research Thrusts in Small Firm Strategic Planning”, Academy of Management Review, pagw 128-14 1, January 1984) the reasons for which strategic management is neglected by the small businesses are the following: lack of time – daily issues prevent the undertaker from dedicating himself to the drawing up of a long term plan; lack of expertise in the respective field– the managers of the small firms do not have the necessary theoretical knowledge concerning strategic management and lack the necessary resources for their acquiring or for hiring consultants; the unfamiliarity regarding the strategic management – as the managers disregard the related concepts, they are not aware of their utility or deem them as irrelevant for their respective situation; lack of confidence and opening the strategic orientation is impacted by the fact that owners keep for themselves, for the sake of certainty of the company, essential information for the efficiency of a support granted by consultants.

Recent studies shows that small firms engaged in a certain form of strategic planning obtain better performances than the average in the respective industry. This ascertainment could be explained by the fact that the plan denotes an analysis and an option based on a certain reasoning and not only on the people’s intuition.

As compared to large firms, the small business does not formally build up a plan. The manager owning the business could usually display a certain vision concerning the future of his company but he does not deem as necessary a formalized expression or its sharing to the other members of organization. If the specific terms and their definitions are excluded the pattern of the strategic management process proposed for the large organization might also be similarly

conceived by a certain undertaker, owner of a small business.

The business plan

If this plan is written, the undertaker shall make the first step towards what should become a strategic approach of the management. The formalization could be generated by the need to build credibility of the new organization in a certain background, most frequently encountered in the event of requiring a credit or a facility to which the undertaker is legally entitled as regards the small businesses.

The business plan shows how the business idea turns into reality. The summary of the business plan, its content is generally standardized by each bank or institution involved in supporting the small businesses.

The undertakers shall build up at least two plans: one plan for internal use which involves a set of ambitious objectives and a high risk margin while the business plan destined to external presentation shall be conservative and conceived as to avoid any failure. If the objectives aimed are easily tangible a waste of resources might arise and if the objectives are hazardous a high risk might be generated and finally a failure.

The use of experts for drawing up certain points of the business plan, especially the financial and accounting part is highly recommended.

## 3. Strategic context for small business

In Romanian language the term “context” could be define as “conjuncture, specific situation, circumstance, juncture”, in its figurative meaning. The Webster’s Dictionary explains the same term as “the correlated conditions where something exists or appears”, providing as a synonym the term “environment (circumstance, ambience)”.

The term of “context”, according to authors James Brian and Henry Mintzberg represents “a type of solution where particular structures, power relations, processes, competitive positioning could be found and so forth”. According to their vision, the strategic management approached on the basis of a dichotomy concepts – contexts is different from the classical dichotomy formulation-implementation.

The concepts explain the basic elements: strategy, processes, power, structure,

systems, etc., and the contexts explain the manner in which these elements combine.

The context of the small business is given by the operation on a single market, with a reduced number of products and with low turnovers. The experience accumulated in a certain business matters significantly and the environment is exerting tremendous pressures. The structure of the organization is simple and centered upon the person of the founder-owner who is also the active manager. Practically, there is no organizational structure with functional differences or clearly defined hierarchical levels. The main concern is represented by survival, followed by growing under the circumstances of a permanent need of capital stock.

According to Mintzberg and Quinn (1992) the entrepreneurial context is the result of development focused on innovation, of the strategy for a small business due to the managerial vision. The innovation is not limited only to the product but it may be connected to a new utility, a new organisational structure, a new type of relation initiated with the consumer.

The entrepreneurial context is specific both to developing industries and to fragmented industries but it has been recently associated with large organizations within mature industries under the label „intrapreneurship”, suggesting the development of innovation inside the organization and taking over the role of entrepreneur by some persons different from the top manager.

Therefore, one seek to obtain inside the large organizations some innovational tendencies similar to those growing within the small business. The leader guiding the organization constitutes the determinant element within this context.

According to certain authors of the strategic management courses the context of the firm is highly significant and especially the characteristics of the industry within which it operates. Thus, Porter (Porter, 1980) makes a typological differentiation of the various categories of industries, within which the categories of firms studied are developing – small and medium-sized enterprises, namely the small business and the entrepreneurial company.

The concept of “niche” has been introduced in relation with this context. “The strategic niche” represents a market segment which is too small and insignificant in order to be approached by large organizations specialized in the fabrication of large quantities of standardized products.

The small organization rapidly adapts to some special characteristics imposed by a market segment and obtains particular competitive advantages and economic results becoming a threat for the large organization but coexisting with it.

Also, the developing industries could be also approached as those industries newly created or reformed through technological innovations, subsequent to the emergence of consumption needs or through some other social and economic modifications which determines a new product to enjoy the status of a viable and potential opportunity for a business. In terms of strategical development, such an industry is characterized by the absence of rules governing the competition game. These will gradually appear and the companies will become adjusted and develop along with them.

Although the characteristics of the industries are different there are certain features which are common to developing industries as regards the following fields: structure, early barriers-to-entry, strategic options, the entry moment.

Structure- it refers to the number, the economic power, the typology of the constituent firms of the industry and to the characteristics of their environment. The companies operate under technological and strategic uncertainty: neither technologies, nor strategies with identifiable results are known. Most of them are recently created companies addressing to buyers who acquire for the first time a new type of product. The pressure of time and uncertainty will assess a short planning horizon. High initial costs are suddenly reduced subsequent to the improvement of the product, of the process and of the productivity. The start-ups to enter the industry are usually supported by the state by means of subsidies and other facilities in the event the product holds social significance.

Early barriers-to-entry – could be different from those characterizing the mature industry at a later period. These could be based on the

property over technology, on the access to resources or distribution channels and on costs associated to experience or borrowed capital under high-risk conditions.

Strategic options – shall depend on the risk and uncertainty associated to the industry. The companies should generate a convenient structure for the industry selected. This process also means the change of values held by suppliers or distributors and of the type of barriers-to-entry. Shortly there will be new interested companies classified as large companies which will increase the capital necessary for entry. Gradually, as the industry develops, the entrepreneurial companies might be interested in the standardization of the products.

The entry moment – represents a major option, as the early entry is associated with high risks but with low barriers. The early entry is recommended if advantages related to image, learning curve, consumer’s loyalty or provision of resources could be associated.

The small business will select a developing industry depending on the result of the contextual analysis similar to that above. The activity of this industry will depend on the final structure and not on the initial structure. If the level of strengths within the industry maturing stage shall permit making profit exceeding the economy average than the entry will be advantageous.

Fragmented industries are those industries where no single competitor own a significant market segment. The industry is populated by a large number of companies rated as small and medium-sized undertakings, with specialized products. The causes of the fragmentation range as follows: reduced barriers-to-entry, absence of the economics of scale or of the learning curve, high transport costs for products, high costs associated to stocks or strong sales fluctuations, lack of advantages related to the company’s size in relation with suppliers or consumers, disadvantages related to large-scale production, various needs of the market, the intense differentiation of the products, especially image-based, local rules, government legislation against concentration, novelty.

Under these circumstances, the strategy of the small companies should diminish the detrimental effects of fragmentation and aim at holding a strategic position which might

provide a significant market share during next stage.

#### **4. Innovation sources for the entrepreneurial company**

In order to better understand the condition of the entrepreneurial company, one should analyse the manner in which novelty appears, irrespective of whether the elements in question are products, processes, management or a combination of these in a new context. The novelty is traditionally associated with the mobility of the initiative of the undertaker which creates a small firm. The traditional approach is based on statistical data establishing a connection of the type “small business- equivalent to – potential novelty”.

Large companies responded with their own strategies to the credibility of this statistics. If innovation originates in a less formalized environment, self-sufficient in structural and cultural terms, than conditions will be generated for this environment but inside the organization.

The strategy of the organization is a diversification strategy and a differentiation strategy at the business level. The structures selected are based on autonomous teams or groups, with a wide decision-making and initiative. The network-type structure appears as a final structural innovation conferring a maximum mobility of relations. This approach is known in the managerial literature under the term of “entrepreneurship”.

Peter Drucker inventories a number of innovation sources and explains the manner in which they generate the novelty. Each specific case is justified with examples of companies well-known to the Romanian consumer and reader. This sources would be (Drucker, 1993):

The unforeseen

The new business opportunity may come under the form of an unexpected event: success, failure or something unanticipated inside or outside the milieu of the company. The management is rarely habituated to accept and seize the “step-element” which might radically modify the organization.

We can provide the example of the Matsushita company which became a giant because it exploited the desire of the poor to

have a television set in a period when this seemed unapproachable due to its high price or the example of the Ford company which was successful with a new model of motor cars in the '60 when it became aware that the segmentation of the motor car market in “lower” and “middle luxury” is replaced by segmentation according to the life style.

#### Incongruity

The opportunity might arise due to the difference between reality and the manner people perceive it, namely between “what is” and “what should be”. The discrepancies may appear between the realities of an industry and the assumptions regarding it, between efforts and expected values, between the rhythm and the logic of a process or between different industries. As an example we provide the revolutionary transformations in the field of naval transports, in the middle of the 60', due to the appearance of the container which shortened the operation time and reversed the increase tendency of handling costs and the tendency to supplement transport hours due to delays while performing the operations.

#### Process requirement

One source of innovation is represented by necessity. It appears in places where there is a weak connection (or lack) within a process. The typical example is provided by the enzyme dissolving the ligament of the cataract. By curiosity, the curing agent of the enzyme turned into a successful product.

#### Modifications within the industry and market structure

When the structures of the industry and market, which seemed fixed forever, begin to modify, each company seeks to continue the businesses by reason of old habits. Most of these companies will go bankrupt or irremediably lose the positions held before the companies which will use the opportunity for creating new approaches or rules for defining the characteristic elements: product, consumer, industry etc The examples provides are related to the motor vehicle industry, post services and cosmetics;

#### Demography

Demographical modifications have predictable consequences but sometimes these are ignored by companies which believe they “know better” what will happen in the future. Clients should be listened to all the time and major tendencies related to the

modification of populations' features should be seized. For instance, the ageing of the population irreversibly “displaced” the tastes or the urbanization tendency of the third world turned the large cities, such as Mexico City or Sao Paolo into profitable centers for certain businesses.

#### Changes of the perception, comprehension or disposition

As the society evolves, changes of peoples' mentality are generated and these changes provide opportunities to develop new businesses. People became more concerned about their own health and consequently issues on medical subjects flourished, private hospitals or companies manufacturing natural products made great strides. Parents spend less time with their children but spend more for accessories destined to their care, entertainment and education which led to the welfare of the companies “manufacturing” games, toys or even educational computers.

#### New knowledge

The progress of scientific and non-scientific knowledge generates new products or markets. Social innovations have a wider impact than the scientific innovations. For instance, the earl Saint-Simon developed the theory of a new bank which used the investment capital for the purpose of economic development after the napoleonic wars. Only in 1856 the first entrepreneurial bank was opened but the use of the financial capital was currently implemented afterwards. There are numerous examples of scientific innovations which were disregarded in the beginning and afterwards they revolutionized the industry: telephone, nylon, jet aircraft for passengers' transport, and so on.

According to Drucker, the first four sources are specific for the internal milieu of the company and could be seized by people habituated with the respective field. The other three involve changes within the external milieu of the company, especially at the industry level. Although there are specific elements for the above mentioned sources, these might overlap at a certain point as the borders between them are vanishing.

The enterpreneurial organization may be a large company, at a venerable age. More frequently, the innovating organization is a small business.

Drucker recommends five principles of the innovation which might lend a strategic advantage to the undertaker: one should start by studying the opportunities; opportunities are analysed in order to find out if people are interested in using the information; the innovation should be simple and clearly focused on a specific need; efficient innovations start slowly due to the fact that they address to a limited market; thereafter, as the market develops, fine adjustments should be carried out for remaining competitive; the innovation aims at supremacy, otherwise it will not impose upon the market and will create an opportunity for competitors.

## 5. Conclusions

The approach of a small business according to theories developed for large businesses is, in most cases, a mistake which may have serious consequences. The adoption of the strategic concepts should be carried out with great caution taking into account all elements involved and the particularities occurring in each situation analysed.

Statistics show that approximately half of the small companies are put out of business in the first 5 years of activity, without significant differences between the countries. The causes of these bankruptcies are various, but multiple analyses indicate the fact that in most situations the failure could be attributed to a poor management. In terms of the strategic management, each stage of the process comprises certain zones designated as vulnerable zones commencing with the identification of a consumer for whom a strategy should be advanced and ending with the assessing and checking of the performances obtained during a certain period of time with strategic implications.

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## Changes in the Components of the Human Development Index

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### Abstract

*Sustainable development, a benchmark for the current strategies, is quantified through the human development index. This paper aims at an overview of the global ranking according to this indicator and observing the changes that have influenced the human development index values recorded during 2007 – 2011. Along with the first countries in the world, Romania will be analyzed as well, in an effort to determine the human development index components that influence the most the indicator by the values recorded.*

**Keywords:** human development index, life expectancy, school enrolment, per capita GNI

**JEL Classification:** O 15

### 1. Introduction

The human development index enables a ranking of the world states. This paper aims at conducting an analysis of the evolution of the values recorded by this indicator, as well as presenting the states with the best results. The human development index will be analysed referring to three years: 2007, 2010 and 2011. Their choice targeted the comparison of the last years with 2007, the last year before the economic crisis that, in time, affected the whole world. Using this comparison we want to check if the changes that occurred as a result of the crisis led to changes in the human development index

values and if this was done, to establish which of the indicators that make up the human development index was strongly influenced.

The human development index is determined by calculating the following indicators:

- Life expectancy at birth which summarizes the combined influence of various factors on life, such as the individual's state of health, nutrition, housing conditions and providing healthcare, etc.
- The training rate which reflects the amount of knowledge available to the individual, the skills and his/her ability to communicate and participate in the economic and social activities.
- GDP/inhabitant which expresses the average amount of resources to which individuals have access to meet the needs of a decent living.

In literature these are the indicators that enable the calculation of the human development index. With this indicator we can determine the level specific to each state concerning sustainable development.

### 2. Content

In 2007, the human development index was calculated for 182 countries taking values between 0.971 and 0.340. The first place was held by Norway with an indicator value of 0.971, followed in ranking by Australia, Iceland, Canada and

Ireland. Romania ranked 63 recording a human development index value of 0.837. The ranking positions 6 to 10 were occupied by four European countries, namely: the Netherlands, Sweden, France and Switzerland, and the tenth position was held by Japan. Niger was placed on the last position in this ranking.

*Table 1. Ranking of the countries according to HDI in 2007*

HDI rank	Country	Value
1	Norway	0,971
2	Australia	0,970
3	Iceland	0,969
4	Canada	0,966
5	Ireland	0,965
6	Netherlands	0,964
7	Sweden	0,963
8	France	0,961
9	Switzerland	0,960
10	Japan	0,960
63	Romania	0,837

Source: Human Development Report 2009

In 2010 the indicator targeted a number of 169 countries and the values recorded were between the 0.938 and 0.140 interval. Norway was ranked first with an indicator value of 0.938. Next to Norway, on the first five places in the ranking there were Australia, New Zealand, the USA and Ireland. On the positions from 6 to 10 we notice four European countries, namely: Lichtenstein, the Netherlands, Sweden and Germany. Romania ranked 50, with a human development index value of 0.767. The last place was held by Zimbabwe.

*Table 2. Ranking of the countries according to HDI in 2010*

HDI rank	Country	Value
1	Norway	0,938
2	Australia	0,937
3	New Zealand	0,907
4	United States	0,902
5	Ireland	0,895
6	Liechtenstein	0,891
7	Netherlands	0,890
8	Canada	0,888
9	Sweden	0,885
10	Germany	0,885

50	Romania	0,767
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Source: Human Development Report 2010

In 2011, the ranking consisted of 187 countries and the human development index recorded values between 0.943 and 0.286. The first place is occupied by Norway with an indicator value of 0.943. The following countries in the ranking are Australia, the Netherlands, the USA and New Zealand. The positions from 6 to 10 are held by almost the same European countries, only Ireland ranked 7, being surpassed by the Netherlands. Romania kept its 50th place, with a human development index value of 0.781. The last position was held by the Democratic Republic of Congo.

*Table 3. Ranking of the countries according to HDI in 2011*

HDI rank	Country	Value
1	Norway	0,943
2	Australia	0,929
3	Netherlands	0,910
4	United States	0,910
5	New Zealand	0,908
6	Canada	0,908
7	Ireland	0,908
8	Liechtenstein	0,905
9	Germany	0,904
10	Sweden	0,903
50	Romania	0,781

Source: Human Development Report 2011

The human development index as discussed above is composed of three indicators, the values that they recorded in the years analysed are presented in the following tables to enable to draw the conclusions. In order to make a comparison between the values of these indicators we shall only present the top five ranked states and Romania, trying to compare the values obtained by those states that maintained their position in the top five.

In 2007 the human development index was measured using the following indicators: life expectancy at birth, expressed in years (1) combined gross enrolment ratio in education, expressed as a percentage (2) and GDP per capita expressed in PPP \$ (3).

The components of the human development index for 2007 for the first five

states present the following maximum values: life expectancy at birth – Iceland recorded 81.7 years, combined gross enrolment ratio in education - Australia obtained 114.2%; and for the GDP per capita - Norway stood out from the other states with a value of \$ 53.433.

Table 4. HDI components in 2007

HDI rank	1	2	3
1	80,5	98,6	53.433
2	81,4	114,2	34.923
3	81,7	96	35.742
4	80,6	99,3	35.812
5	79,7	97,6	44.613
63	72,5	79,2	12.369

Source: Human Development Report 2009

Our country recorded the highest difference as compared with the first ranked in the GDP per capita obtaining only \$ 12.369.

In the last two years the human development index was measured using the following indicators: life expectancy at birth expressed in years (1), the average of the years of schooling, expressed in years (2) and GNI per capita, expressed in PPP \$ (3).

Table 5. HDI components in 2010

HDI rank	1	2	3
1	81	12,6	58.810
2	81,9	12	38.629
3	80,6	12,5	25.438
4	79,6	12,4	47.094
5	80,3	11,6	33.078
50	73,2	10,6	12.844

Source: Human Development Report 2010

The human development index for 2010 for the first five states present the following maximum values: life expectancy at birth - Australia recorded 81.9 years, the average of the years of schooling - Norway had 12.6 years, and for the GDP per capita - Norway stood out from the other states with a value of \$ 58.810.

Our country recorded the highest difference as compared to the first ranked at GNI per capita obtaining only \$ 12.844.

For the last year for which we analysed the indicator by which sustainable development

is expressed the following maximum values occurred: life expectancy at birth - Australia recorded 81.9 years, the average of the years of schooling - Norway had 12.6 years, and for the GDP per capita - Norway recorded \$ 47.557.

Our country recorded the highest difference as compared with the first ranked ones at the same index as in the previous years, namely obtaining \$ 11.046 per capita GNI.

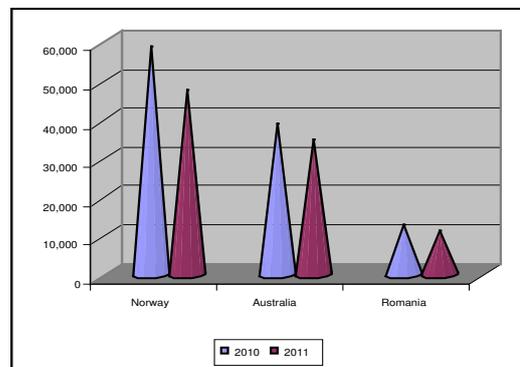
Table 6. HDI components in 2011

HDI rank	1	2	3
1	81,1	12,6	47.557
2	81,9	12	34.431
3	80,7	11,6	36.402
4	78,5	12,4	43.017
5	80,7	12,5	23.737
50	74	10,4	11.046

Source: Human Development Report 2011

In the three years analysed there are two states that have not left the top five positions in the rankings, furthermore, they have been dethroned from the top two places. These countries, in the order found in the ranking, are: Norway and Australia.

Graph 1. GNI per capita

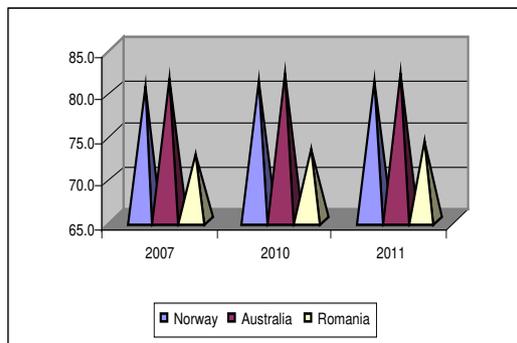


Source: Created by the authors using data from tables 1, 2 and 3

GNI per capita in 2010 and 2011 recorded declines for the first two states in the rankings. In the case of our country, we meet the same evolution, GNI per capita falling by \$ 1.798. The determination of GNI per capita is closely linked to the demographic evolution, thus in the case of Norway the population increased from 4,858,199 inhabitants in 2010 to 4,920,305 inhabitants in 2011. However, the difference between the

values recorded in the two years cannot be supported only by this increase of the population, being also influenced by the reduction of GNI. We meet the same issue in our country, where the population declined from 21,462,186 inhabitants in 2010 to 21,354,396 inhabitants in July 1, 2011, or according to the latest census, the population is of 20,254,866 inhabitants. If in Romania the GNI had maintained the same value as in 2010, the decrease of the population would have caused an increase in the GNI per capita, but this indicator has also decreased in absolute value in 2011 compared to 2010.

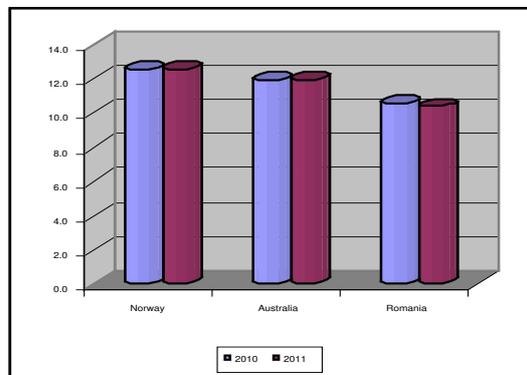
Graph 2. Life expectancy at birth



Source: Created by the authors using data from tables 1, 2 and 3

Life expectancy at birth increased between 2007 – 2011 for Norway, Australia and Romania, but there are no significant changes in the values. This indicator has undergone extremely small changes in the period under review and it has not decisively influenced the final value recorded by the human development index.

Graph 3. Average of the years of schooling



Source: Created by the authors using data from tables 1, 2 and 3

The average of the years of schooling for

the first two states in the ranking did not change in the last two years. Unfortunately for Romania, this indicator was slightly reduced, but without decisively influencing the final value of the human development index.

### 3. Conclusions

It is noted that the main indicator that determined the strongest final result of the human development index is the GNI per capita or GDP per capita (used before 2010).

The other two indicators have recorded relatively modest changes little influencing the human development index value.

The human development index has experienced a high level in 2007, followed by its reduction until 2010, as last year to show a new increase of the indicator. The crisis is one of the factors that triggered this change, leading to reducing the GNI per capita. Nevertheless, the results of 2011 have been seriously affected also because of the calculation method, because a significant drop in the GNI per capita and the maintenance of the values roughly at the same level for the other indicators resulted in a higher value of the human development index.

In 2011 the method of determining the human development index was performed using the geometric mean applied to the three indicators that compose it.

Even if the human development index provides important information to characterise sustainable development, the literature also states other indicators that can be used to complete it. These indicators are: the index of sustainable economic prosperity and the grain consumption per capita. The first indicator is the most comprehensive indicator of the living standards today, because it measures the average consumption and the distribution of environmental degradation, and the second one is generally used for the less developed states.

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## Romania’s Economic Growth

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### Abstract

*The correlation of the economic growth with the inflation rate in the Romanian economy allows observing the mistakes from the past and avoiding them in the present and future. The analysis of these two indicators demonstrates that the views according to which the economic growth was rapid and healthy are not supported by the changes at the macroeconomic level after 2009. Bridging the gap between the Romanian and the European economy has suffered a strong setback once with the crisis. The reduction of the gaps must be built on sustainable economic growth and on an investment-based economy.*

**Keywords:** GDP, inflation rate, inflationary growth, non-inflationary growth

**JEL Classification:** E 31, O 47

### 1. Introduction

In our country’s economy changes there have occurred changes in the past decade, and the period 2009 – 2011 was strongly influenced by the economic – financial crisis.

This paper aims to explore two of the most important macroeconomic indicators recorded in the Romanian economy, indicators that will allow us to see some of the changes in the economic life of Romania.

After 1989, the Romanian economy has experienced three recession episodes:

- the first recession, 1990 – 1992, is

considered a recession caused by the transition from the command economy to the beginning of the market economy;

- the second recession, 1997 – 1999, is considered to be a transformational recession and it occurred because of the lack of currency resources in a period of privatisation;
- the third recession is the one in 2009, being determined by the current account deficit financing.(1)

The crisis of 2009 affected the population by: reducing the net worth, the pressure of adjusting which disposable income has undergone and reducing the confidence in the Romanian economy.

### 2. Content

The economic growth expressed as GDP rate and inflation rate are the indicators analysed in order to determine the growth pattern specific to the Romanian economy, through the correlations between the monetary and the real economy. These correlations will allow us to explain if in Romania there was a non-inflationary growth or an inflationary growth.

For the period 2000 – 2004 the GDP had an upward trend, reaching the maximum value of 8.5% in 2004. Between 2005 – 2008 the values recorded alternate, without a uniform trend, approaching 8%, but fail to exceed this level. Clearly between 2008 – 2011 the effects of the crisis have very strongly influenced the values recorded by

the GDP, because after a value of 7.3% in 2008, there is a steep decline to -6.6% in the next year.

Table 1. GDP and inflation in Romania

Year	GDP	Inflation rate
2000	2.4	45.7
2001	5.7	34.5
2002	5.1	22.5
2003	5.2	15.3
2004	8.5	11.9
2005	4.2	9.1
2006	7.9	6.6
2007	6.3	4.9
2008	7.3	7.9
2009	-6.6	5.6
2010	-1.6	6.1
2011	2.5	5.8

Source: <http://epp.eurostat.ec.europa.eu>

In Romania, after 2001, the economic growth supported by the credit boom in 2003 and the easing of the fiscal and budgetary policy in 2005 was unable to resist at the end of 2008, when the crisis effects were felt in our country. The high growth rates recorded in the middle of the period analysed failed to be maintained so that they turned in 2009 – 2010 into the negative values.

The economic growth during 2003 – 2008 was supported by the household consumption which increased by 10 to 15% per year and by the gross formation of the fixed capital, which increased by 20 to 30% every year.

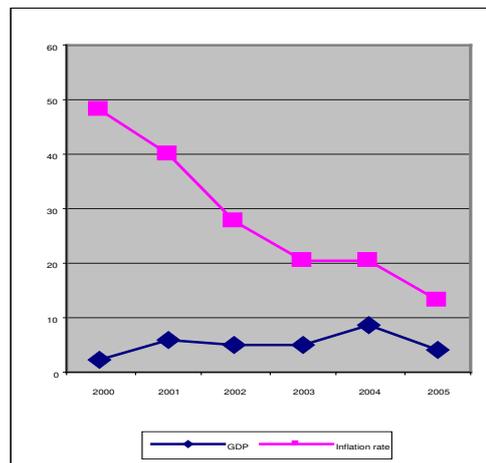
The inflation rate seen for the entire period is characterised by a downward trend, the significantly higher values of the first four years being the expression of the changes undergone by the Romanian economy after 1989. The values recorded by the inflation rate during 2000 – 2011 are relatively small compared to the period from 1990 to 1999. For the period analysed in this paper the first five years have produced double-digit inflation rates and in the period 2005 – 2011 the values have fallen below 10%.

The National Bank of Romania has set the inflation target to 3% this year and for 2013 to 2.5%, values relatively small and difficult to achieve given the figures recorded in the last three years.

We can see in Graph 1 that the inflation rate had much higher values as compared to

the real rate of the GDP during 2000 – 2005, especially in the first three years of the period analysed. In 2003, 2004 and 2005 the difference decreased between the two rates, but the inflation rate maintains the high values.

Graph 1. Evolution of GDP and inflation rate between 2000 – 2005



Source: Created by the authors using data from the Table 1

We can see in Graph 1 that the inflation rate had much higher values as compared to the real rate of the GDP during 2000 – 2005, especially in the first three years of the period analysed. In 2003, 2004 and 2005 the difference decreased between the two rates, but the inflation rate maintains the high values.

This evolution of the indicators allows us to conclude that in this period the Romanian economy was characterised by an inflationary growth.

The introduction of the unique quota in 2005 greatly influenced the demand, because the income of people and businesses increased and 82% of these additional revenues were directed towards consumption. The economic growth obtained based on increasing consumption, at Romanian macroeconomic level was also directed towards consumption, forming a real vicious circle.(1)

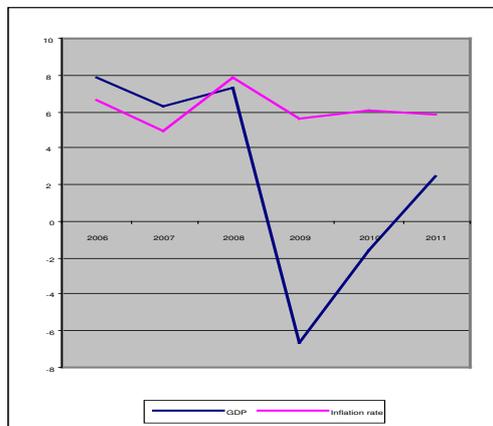
In 2006 and 2007, the relationship of the dimensions between the indicators changed as the inflation rate was below the GDP rate.

The evolution of the two indicators of the first period of the analysis also continued during 2008 – 2011 when the inflation rate was higher than the GDP rate.

In this situation, we can say that between

2006 – 2007 the Romanian economy was characterised by a non-inflationary growth. In the next period, 2008 – 2011, the inflationary growth comes back.

Graph 2. Evolution of GDP and inflation rate between 2006 – 2011



Source: Created by the authors using data from the Table 1

At EU level, the values of the two indicators did not record significant changes, the variation range being relatively small. The economic growth also recorded the largest decrease in 2009, but it managed to return the following year to positive values. The inflation rate has neither undergone significant changes, recording the highest value of 3.7% in 2008.

Table 2. GDP and inflation in EU

Year	GDP	Inflation rate
2000	3.9	1.9
2001	2.2	2.2
2002	1.3	2.1
2003	1.4	2
2004	2.5	2
2005	2	2.2
2006	3.3	2.2
2007	3.2	2.3
2008	0.3	3.7
2009	-4.3	1
2010	2	2.1
2011	1.5	3.1

Source: <http://epp.eurostat.ec.europa.eu>

Comparing our country-specific figures to the mean values obtained in the European Union we can notice the differences, which are negligible, between the growth rates of the GDP. The figures show that between 2001 – 2008 the GDP growth rate in

Romania was higher than the GDP growth rate in the European Union, allowing the reduction of the gap between our country’s economy and the European average. However, the fact that in Romania the economic growth was not a sustainable one was demonstrated by the economic – financial crisis through the difficulties occurred in all areas. Our country’s economic growth contracted stronger than the one at European level.

### 3. Conclusions

The decade 2000 – 2011 was characterised by an inflationary growth. The opinions according to which the economic growth was a healthy growth were shattered in 2009 when the weakness of the Romanian economy was noticed. The evolution of the economic growth did not also lead to an increase in the living standards even if the average net wage increased, but the inflation rates were higher than the growth rates.

The inflation recorded declining values in the period analysed, low values as compared to the first years after 1989, but it still does not equal the average of the lowest inflation rates in Europe. If you want to adopt the euro currency, it is necessary to fulfil the Maastricht criteria, concerning inflation in 2007 we got closer to 2% as compared to the European level, but the changes due to the crisis led to a rise in the inflation rate in Romania as compared to the reference level of the European Union.

The economic growth that allowed reducing the gaps as compared to Europe during 2001 – 2008 was affected by the crisis, showing that for the future a sustainable economic growth is needed, included in a realistic strategy designed on medium and long term. In this respect, the Europe 2020 Strategy states that it wants to achieve an intelligent, sustainable and favourable growth for social inclusion.

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## Purposes of Informational Systems– Electronic Payment Systems ReGIS, Sent

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### Abstract

*In Romania there are three payment systems, respectively one for large-value payments in lei (ReGIS), one for retail payment in lei (SENT), and one for large-value payments in Euro (TARGET2-Romania). There is also a system of depositing and settlement of government securities and certificates of deposit issued by the central bank (SaFIR) and two systems of clearing/settlement of mobile values RoClear and SIBEX that settle in ReGIS system. All the afore-mentioned systems ensure the settlement via accounts of the credit institutions opened in NBR.*

**Keywords:** payment system, CSD, SSD, ReGIS, SENT, TARGET2

**JEL Classification:** D80

### 1. Introduction

A **payment system** represents an assembly of instruments, banking procedures and rules that assure the funds transfer among the participants in the system (credit institutions and financial institutions). The system relies on the agreement between the participants in the system and the system operator, and the funds transfer is realized via an agreed technical infrastructure. [1]

A **central securities depository**, (CSD) represents a system (or institution) for holding securities that realize the transactions processing with securities on the basis of registration in accounts. The physical securities may be immobilized or dematerialized by the depository (so that they exist only as electronic records). In addition to holding in custody the securities, a central depository for securities may assure also

coupling functions of the transfer, clearing orders and their settlement.

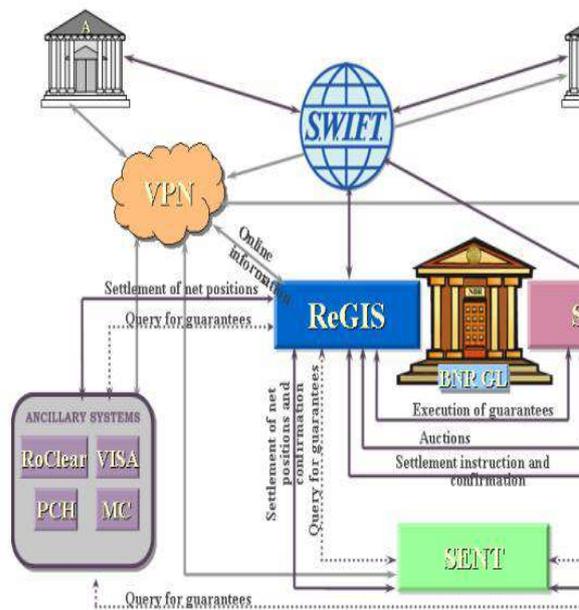
A **securities settlement system** (or SSS) represents a system that allows the transfer of securities *free of payment* (*free delivery* or FoP), as in case of pledge or against payment (*delivery versus payment* or DvP). The securities settlement occurs on securities deposit accounts held with the CSD (a private entity or a central national bank that acts as a CSD), or with the central bank (safe custody operational accounts). In the latter case, the central bank acts as intermediary custodian of the securities. Ordinarily the final custodian is a CSD. The settlement of the funds related to the transaction of securities occurs within an *interbank funds transfer system*" (or IFTS), through a settlement agent. [2]

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### The architecture of the Romanian electronic payment



Source: <http://www.bnr.ro/Mecanisme-de-decontare-3357.aspx>

The Partner of the Romanian National Bank in operation and implementation of Electronic Payment Systems is and TRANSFOND, the excellence centre for banking financial sector from Romania. TRANSFOND is an operator of Electronic Payment System: administrator and operator of SENT system (Automated Clearing House), technical administrator and operator of ReGIS system (gross settlement system in real time), according the commission assigned by NBR, technical operator of SaFIR system (system of depositing and settlement of government securities).

Electronic Payment System (SEP) was implemented by a project financed in common with the European Union through PHARE program and the banking community from Romania, through STFD – TRANSFOND S.A.

The project consisted in:

- Development of software and interfaces related to the systems ReGIS (RTGS), SENT (ACH) and SaFIR (GSRS);
- Purchase and organization of primary and secondary headquarters of the Electronic Payment System;
- Implementation of communication networks SWIFT and VPN;

- Equipments purchase, installation and configuration;
- Regulations and legislation elaboration related to Electronic Payment System performance;
- Training of Electronic Payment systems operators from SEP was implemented by a project financed in common with the European Union through PHARE program and the banking community from Romania, through STFD – TRANSFOND S.A.
- The system implementation was assured by a mixed team formed by 46 specialists of National Bank of Romania and STFD – TRANSFOND S.A.

## 2. ReGIS System

ReGIS is the national real-time gross settlement system of payments in domestic currency provided by the NBR. The system is used for the settlement of central bank's operations, interbank transfers, as well as of urgent or large-value payments in Romanian Leu (above 50,000 lei). ReGIS ensures the real-time processing (on a continuous basis) and the settlement in the central bank money, with immediate finality.

A real-time gross settlement system (RTGS) is a payment system in which payment instructions are processed and settled individually and continuously (in real time). Thus, transactions may be settled with immediate finality. Gross settlement implies that each transfer is settled on a gross basis, not on a net basis.

ReGIS system is managed by NBR. In this capacity, the NBR manages and controls system operation, authorizes the participation in the system, sets forth and changes the system rules, monitors their observance by the participants, imposing penalties in case of infringement.

## 3. Participating in ReGIS

The following categories of institutions are eligible for participating in ReGIS:

- credit institutions from the European Economic Area, including when they operate via a branch set up in the European Economic Area;

- credit institutions from outside the European Economic Area, provided that they operate via a branch set up in the European Economic Area;
- the National Bank of Romania;
- the State Treasury;
- organizations based in countries set up in the European Economic Area providing clearing or settlement services that are supervised by a competent authority.

#### 4. Types of transactions

ReGIS processes credit transfers in Romanian Leu, at national level. The types of payment transactions processed via ReGIS are as follows:

- payments related to central bank operations (monetary policy operations, currency market and lending operations, cash operations, etc.);
- settlement of net positions calculated within auxiliary systems processing payments in Romanian Leu (SENT, RoClear, VISA, MasterCard, DSClear);
- urgent or large-value (above 50,000 lei) interbank and customer payments;
- payments for the settlement of funds related to operations with securities;
- direct debiting of fees related to the participation in the three components of the electronic payment system (ReGIS, SaFIR and SENT).

The participants initiate credit transfers in the system via SWIFT messages, using the SWIFT FIN Y-Copy service (MT202, MT202COV and MT103).

#### 5. Low-value and large-volume retail payment SENT System

SENT is an electronic system for multilateral clearing of interbank payments in lei currency, low value and large volume (retail) payments made between the participants during several sessions each day.

The system became operational in 2005 being developed and implemented under

PHARE RO-0005.02 Project titled "Interbank Payment System".

This system processes both low-value, interbank credit transfers, direct debits and debit instruments (as cheques, bills of exchange, promissory notes) among banks, and ensures:

- the exchange of payment instructions among the participants running continuously during the clearing session;
- multilateral netting of the participants' payment instructions running continuously during the clearing session;
- automated initiation of final settlement in ReGIS system of net positions at the end of each clearing session;
- automated management of settlement guarantees (via automated interfaces with ReGIS and SaFIR systems).

#### 6. Conclusions:

As the operator of a payment system, a central bank offers settlement in central bank money. The central bank allows financial institutions to transfer funds which are held in accounts with that central bank among themselves. Central banks' payment systems are typically used for the final settlement of claims originating from interbank operations and so-called ancillary systems.

#### 7. Bibliography:

- [1] CPSS report "*Core Principles for Systemically Important Payment Systems*", Bank for International Settlement, January 2001
- [2] "*Glossary of terms used in payment and settlement systems* ", issued by the Committee for Payment and Settlement Systems (CPSS) of the central banks of the states members of the group G-10, Bank for International Settlements, Basel, March 2003, [www.bis.org](http://www.bis.org)).
- [3] [www.bcr.ro](http://www.bcr.ro)
- [4] [www.bnr.ro](http://www.bnr.ro)
- [5] [www.ecb.int](http://www.ecb.int)
- [6] [www.transfond.ro](http://www.transfond.ro)

## Purposes of Information Systems – Electronic Payment Systems TARGET2

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### Abstract

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**JEL Classification:** D80

### 1. Introduction

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### 2. The Trans-European Automated Real-Time Gross Settlement Express Transfer System

TARGET2 (*Trans-European Automated Real-time Gross settlement Express Transfer system*) represents the real-time gross settlement (RTGS) system for payments in Euro, offered by the Eurosystem (the European Central Bank and the central banks of the Member States that have adopted Euro).

The system is used for the settlement of central banks operations (including the operations of monetary policy of the Eurosystem), large-value interbank transfers in Euro, as well as other payments in Euro. Through the system, the funds transfers related to auxiliary systems (payments systems and clearing-settlement systems of the operations with securities) are also settled.

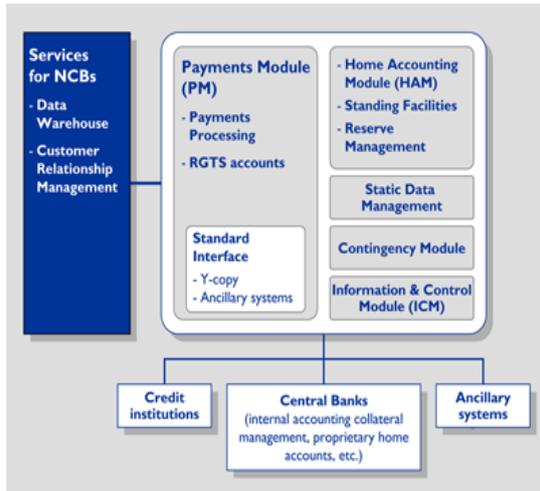
The system provides in real-time the processing of payments and settlement in accounts opened in central banks with immediate finality. TARGET2 system was launched on 19<sup>th</sup> November 2007, replacing TARGET system (that was functioning since 4<sup>th</sup> January 1999).

The system offers harmonized services and a common technical infrastructure, with increased efficiency, including in terms of cost recovery. The system was projects to allow ulterior modification because of the technological evolution, the continuous process of development of the Eurosystem.

Legally, TARGET2 system is structured as a multitude of national payment systems (referred to as national TARGET2 components), with harmonized operating rules.

The technical infrastructure and the single commune platform of TARGET2 is provided and technically operated, behalf Eurosystem by Banca d'Italia, Banque de France and Deutsche Bundesbank.

## TARGET2 ARCHITECTURE



Source [www.bnr.ro](http://www.bnr.ro)

TARGET2 is a system based on a singular platform and offers an improved and harmonized service. The use of system allows costs decrease and obtaining an optimum report between costs and efficiency. For all participants, no matter the place where they are- the services are of high quality, functionality and interfaces, as well as a structure of single price.

A modular approach was adopted for the development of single common platform (SSP). Each module in SSP is close related to a particular service. The payment module, for example, is used for payments processing. Some of these modules (Appropriate accountability module and funds management module) can be operationally used by the individual central banks.

The central bank that don't use these modules offer services, via the applications within the proper internal technical elements. The SWIFT standards are used in the communication harmonized between the system and its participants. Before introducing TARGET2, some central banks had proper payment systems. In the main, these were used to manage the minimum compulsory funds, the permanent facilities and cash retail, but also to settle the transactions of auxiliary systems. We have agreed that in the context of the new system, these types of transactions to be undertaken. However, some countries didn't allow that these systems to be moved quickly in SSP. Therefore, there was a period of transition of four years for affiliation to SSP.

**Payment Module (PM)** has the role to maintain the settlement accounts (RTGS) of the direct participants, through which all the payments TARGET2 (in Euro) are settled and assure the settlement services, the administration services of cash (cash limits, reservation, etc.).

**Information and Control Module (ICM)** The information and control module (ICM) allows to the users to access information directly and to obtain information concerning the balances and online payments. Via ICM, the users have access to the payment module and to the function of data management. The ICM users are able to select the information they receive and when. The urgent messages (for example, systems of transmissions from the central banks and notifications concerning the payments with a time indicator of debit) are automatically displayed on the screen.

**Standing Facilities Module (SF)** This module processes the operations related to the standing facilities in Euro granted by the national central banks to the participants.

The module allows: the administration of the deposits built from day to day and of the lending facilities (Lombard credit), transfer of the liquidities in the accounts built from day to day, credits grant built from day to day "at request" or automatically, the calculation and the settlement of the bonus interest or penalty interest, for the central bank and the commercial banks, deposits and loans repayment built from day to day.

**Home Accounting Module (HAM)** HAM accounts can be used for the commercial banks that don't participate directly in TARGET2 but they have to constitute minimal compulsory funds and /or they have cash operations (so, they need an account opened at the national central banks, excepting a RTGS system); operations specific for the direct participants depending on the situations of some countries.

The operations that can be made via HAM accounts are:

- Maintenance of liquidities (for example for RMO)
- Transfers between the accounts HAM maintained in the same central bank
- Transfers between the accounts HAM and those of RTGS maintained

- in the same central bank or in different central banks
- Cash retail from the national central banks
- Access to the *Standing facilities* module

**Static Data Module (SD)** The module offers to the central banks and to the participants a homogenous set of data available in a single database, daily actualized.

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themselves. Central banks' payment systems are typically used for the final settlement of claims originating from interbank operations and so-called ancillary systems.

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## The Importance of the Study of Algebras of Fuzzy Logic

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### Abstract

*In this paper I begin a systematic algebraic investigation of some algebras of fuzzy logic: BL-algebras and DRI-monoids; BL-algebras are particular residuated lattices; The origin of; BL-algebras is in Mathematical; LogicBL-algebras, introduced by P.Hajek, form an algebraic counterpart of the basic fuzzy logic. In the paper it is shown that BL-algebras are the duals of bounded representable DRI-monoids. This duality enables us to describe some structure properties of BL-algebras.*

**Keywords:** BL-algebra, MV-algebra, bounded DRI-monoid, representable DRI-monoid, prime spectrum.

**Jel Classification:** C02

### 1. Introduction

**Definition** An algebra  $A = (A, +, 0, \vee, \wedge, -)$  of signature  $\langle 2, 0, 2, 2, 2 \rangle$  is called a DRI-monoid if it satisfies the following conditions ( $x, y, z \in A$ ):

- (1)  $(A, +, 0)$  is an abelian monoid;
- (2)  $(A, \vee, \wedge)$  is a lattice;
- (3)  $(A, +, \vee, \wedge, 0)$  is an l-monoid;
- (4) if  $\leq$  denotes the order on  $A$  induced by the lattice  $(A, \vee, \wedge)$  then  $x - y$  the smallest  $z \in A$  such that  $y + z \geq x$ ;
- (5)  $((x - y) \vee 0) + y \leq x \vee y$ .

**Note:** Condition (4) is equivalent to the system of identities  $x + (y - x) \geq y$ ;

system of identities  $x - y \leq (x \vee z) - y$ ;

$$(x + y) - y \leq x,$$

Hence DRI-monoids form a variety of type  $\langle 2, 0, 2, 2, 2 \rangle$ .

The notion of a DRI-monoid actually includes also other types of algebras.

**Definition** A BL-algebra is an algebra  $A = (A, \wedge, \vee, \bullet, 0, 1)$  of signature  $\langle 2, 2, 2, 2, 0, 0 \rangle$  such that

- (i)  $(A, \wedge, \vee, 0, 1)$  is a bounded lattice with the least element 0 and the greatest element 1;
- (ii)  $(A, \bullet, 1, \vee, \wedge)$  is a commutative lattice ordered monoid;
- (iii) A satisfies the following conditions:
  - (1)  $z \leq x \rightarrow y$  iff  $x \bullet z \leq y$ , for all  $x, y, z \in A$ ,
  - (2)  $x \wedge y = x \bullet (x \rightarrow y)$ ,
  - (3)  $(x \rightarrow y) \vee (y \rightarrow x) = 1$ .

**Remark** a) The BL-algebras also form a variety of the type considered.

b) A BL-algebra could be also defined equivalently as an algebra  $A = (A, \bullet, \rightarrow, 0)$  of signature  $\langle 2, 2, 0 \rangle$

**Definition** A DRI-monoid  $A = (A, +, 0, \vee, \wedge, -)$  is called representable if it is isomorphic to a subdirect product of linearly ordered DRI-monoids (i.e. DRI-chains)

For instance, commutative l-groups and Boolean algebras are representable DRI-monoids. One can prove that a DRI-monoid  $A$  is representable if and only if  $A$  satisfies the identity  $(x - y) \wedge (y - x) \leq 0$ .

**Remark** Comparing two classes of algebras, it will be simpler to use algebras dual to BL-

algebras. Namely, an algebra  $A = (A, \vee, \wedge, \oplus, \ominus, 1, 0)$  of type  $\langle 2, 2, 2, 2, 0, 0 \rangle$  is called a dual BL-algebra if

- (i)<sup>d</sup>  $(A, \vee, \wedge, 1, 0)$  is a bounded lattice with the greatest element 1 and the least element 0
- (ii)<sup>d</sup>  $(A, \oplus, 0, \wedge, \vee)$  is a commutative lattice ordered monoid;
- (iii)<sup>d</sup> A satisfies the conditions
  - (1)  $z \geq x \ominus y$  iff  $x \oplus z \geq y$ , for all  $x, y, z \in A$ ,
  - (2)  $x \vee y = x \oplus (y \ominus x)$ ,
  - (3)  $(x \ominus y) \wedge (y \ominus x) = 0$ .

Let  $A = (A, \wedge, \vee, \bullet, \rightarrow, 0, 1)$  be a BL-algebra and let  $(A, \wedge_d, \vee_d)$  be the lattice dual the lattice  $(A, \wedge, \vee)$ , i.e.  $x \wedge_d y = x \vee y$  and  $x \vee_d y = x \wedge y$  for any  $x, y \in A$ . Further, set  $x \oplus_d y = x \bullet y$  and  $x \ominus_d y = y \rightarrow x$  for each  $x, y \in A$ . Then

$(A, \vee_d, \wedge_d, \oplus_d, \ominus_d, 0, 1)$  is a dual BL-algebra. Conversely, using the dual considerations, one can obtain a BL-algebra from a given dual BL-algebra. It is obvious that the above processes are mutually inverse and therefore there is a one-to-one correspondence between the BL-algebras and the dual BL-algebras.

**Theorem 1** Let  $A = (A, +, 0, \vee, \wedge, -)$  be an above bounded DRI-monoid with the greatest element 1. Then  $(A, \vee, \wedge, +, -1, 0)$  is a dual BL-algebra if and only if A is representable.

**Proof**

One can easily prove that if DRI-monoid A is bounded above then it is a bounded below too, and moreover, 0 is the least element in A. If this is the case, then the conditions (i)<sup>d</sup>, (ii)<sup>d</sup> and (iii)<sup>d</sup> (1) are trivially satisfied, and the condition (iii)<sup>d</sup> (2) follows from (5) of the definition of a DRI-monoid. If moreover A is representable, the condition (iii)<sup>d</sup> (3) holds. Conversely, if A is bounded DRI-monoid such that  $(A, \vee, \wedge, +, -1, 0)$  is a dual BL-algebra then A is obviously representable. Comparing the definitions of BL-algebras and representable DRI-monoids we get the following theorem

**Theorem 2** If  $A = (A, \vee, \wedge, \oplus, \ominus, 1, 0)$  is a dual BL-algebra then  $(A, \oplus, 0, \vee, \wedge, \ominus)$  is a bounded representable DRI-monoid with the greatest element 1.

**Remark** For the class  $DRl_1$  of bounded DRI-monoids (and especially for the class  $RDRl_1$  of bounded representable DRI-monoids) we will consider the greatest element 1 as a new nullary operation and thus we will enlarge the type of those DRI-monoids to  $(+, 0, \vee, \wedge, -, 1)$  of signature  $\langle 2, 0, 2, 2, 2, 0 \rangle$ . Hence the class DBL of dual BL-algebras is, from this point of view, a subclass of the class  $DRl_1$  which is, by Theorem 1 and 2, equal to the class  $RDRl_1$  of bounded representable DRI-monoids. This means that BL-algebras are in fact the dual algebras of bounded representable DRI-monoids, and therefore one can obtain some results on BL-algebras as consequences of those DRI-monoids.

**Definition** An algebra  $A = (A, \oplus, \neg, 0)$  of signature  $\langle 2, 1, 0 \rangle$  is called an MV-algebra if A satisfies the following identities:

- (MV<sub>1</sub>)  $x \oplus (y \oplus z) = (x \oplus y) \oplus z$ ;
- (MV<sub>2</sub>)  $x \oplus y = y \oplus x$ ;
- (MV<sub>3</sub>)  $x \oplus 0 = x$ ;
- (MV<sub>4</sub>)  $\neg\neg x = x$ ;
- (MV<sub>5</sub>)  $x \oplus \neg 0 = \neg 0$ ;
- (MV<sub>6</sub>)  $\neg(\neg x \oplus y) \oplus y = \neg(x \oplus \neg y) \oplus x$ .

As is known, MV-algebras were introduced by C.C. Chang as an algebraic counterpart of Lukasiewicz infinite-valued proposition logic.

If we put in any MV-algebra A  $1 = \neg 0, x \ominus y = \neg(\neg x \oplus y)$ ,

$$x \vee y = \neg(\neg x \oplus y) \oplus y, x \wedge y = \neg(\neg x \vee \neg y)$$

for each  $x, y \in A$ , then  $(A, \vee, \wedge, \oplus, \ominus, 1, 0)$  is a dual BL-algebra and so also a bounded representable DRI-monoid.

Moreover, MV-algebras are in a one-to-one correspondence with bounded DRI-monoids (the representability is not explicitly

required) which satisfy the identity  
(i)  $1 - (1 - x) = x$ .

Therefore we get as a consequence a known characterization of MV-algebras in the class of dual BL-algebras:

**Corollary 3** A dual BL-algebra A is an MV-algebra if and only if A satisfies  
(i')  $1 \ominus (1 \ominus x) = x$ .

**Note** This corollary corresponds to a definition, where MV-algebras are defined as BL-algebras satisfying the law of a double negation  $\neg\neg x = x$ .

**Remark** DRI-monoids (similarly as MV-algebras) in general lack additive idempotents. However, in Brouwerian algebras which are special cases of DRI-monoids, the operations + and  $\vee$  coincide, and hence, among others, all elements are additive idempotents. It is known that additive idempotents in any MV-algebra form a Boolean algebra. Now we can analogously describe the properties of the set of idempotents in any bounded representable DRI-monoid.

**Proposition 4** The set B of additive idempotents of any representable bounded DRI-monoid A is a Brouwerian algebra.

**Proof.** Let  $A = (A, +, 0, \vee, \wedge, -, 1)$  be a bounded representable DRI-monoid and  $B = \{x \in A; x + x = x\}$ . Obviously  $0, 1 \in B$ . Let  $x, y \in B$ . Then  
 $(x + y) + (x + y) = x + y$ ,  
 $(x \wedge y) + (x \wedge y) = (x + x) \wedge (x + y) \wedge (y + y)$   
 $= x \wedge y \wedge (x + y) = x \wedge y$ ,  
hence  $x + y, x \wedge y \in B$ .

For any  $x, y \in B$ ,  $x + (x \wedge y) = x \wedge (x + y) = x$ , thus  $(B, +, \wedge)$  satisfies both absorption laws. Therefore  $(B, +, \wedge)$  is a lattice with is distributive by the definition of a DRI-monoid.

Let A be a bounded DRI-chain. The order induced on B by the lattice  $(B, +, \wedge)$  is clearly the same as that induced on B by A. Hence  $(B, +, \wedge)$  is a chain, and so

$x + y = \sup(x, y) = \max(x, y) = x \vee_A y$   
for any  $x, y \in B$ .

Moreover,  $(B, +, \wedge) = (B, \vee, \wedge)$  is a Brouwerian algebra because for any  $x, y \in B$  we have  $x - y = 0$  if  $x \leq y$ ,  $x - y = x$  if  $x > y$ .

Let now a DRI-monoid A be a subdirect product of bounded DRI-chains  $A_i, i \in I$ . If  $a = (a_i; i \in I) \in A$ , then  $a \in B$  if and only if  $a_i \in B_i$  for each  $i \in I$ . ( $B_i$  is the set of idempotents of  $A_i$ .) Hence, if  $a, b \in B$  then  
 $a + b = (a_i + b_i; i \in I) = (\max(a_i, b_i); i \in I)$   
 $= a \vee b$ ,

and if we set  $a - b = (a_i - b_i; i \in I)$  for any  $a, b \in B$ , we get that  $(B, 0, \vee, \wedge, -, 1)$  is a Brouwerian algebra.

**Corollary 5** The set of multiplicative idempotents of any BL-algebra is a Heyting algebra.

If A is a BL-algebra then  $\phi \neq F \subseteq A$  is called a filter of A if

(a)  $\forall a, b \in F; a \bullet b \in F$ ;

(b)  $\forall a \in F, x \in A; a \leq x \Rightarrow x \in F$ .

Further, recall that  $\phi \neq F \subseteq A$  is called a deductive system of a BI-algebra A if

(a')  $1 \in F$ ,

(b')  $\forall x, y \in A; x \in F, x \rightarrow y \in F \Rightarrow y \in F$ .

One can easily prove that  $\phi \neq F \subseteq A$  is a filter of A if and only if F is a deductive system in A.

Let B be an arbitrary DRI-monoid. For any  $x, y \in B$  set  $x * y = (x - y) \vee (y - x)$ . Then  $\phi \neq I \subseteq B$  is called an ideal of B if

(c)  $\forall a, b \in I; a + b \in I$ ,

(d)  $\forall a \in I, x \in B; x * 0 \leq a * 0 \Rightarrow x \in I$ .

It is obvious that  $0 \leq x$  implies  $x * 0 = x$  for any x in a DRI-monoid B. Therefore if A is a BL-algebra then the filter of A and the ideals of the DRI-monoid  $A^d$  dual to A coincide.

Further, the ideals and congruence in any DRI-monoid are in a one-to one

correspondence, therefore this holds also for the filters and congruences of BL-algebras.

**Theorem 6** The filters of any BL-algebra form, under the ordering by set inclusion, a complete algebraic Brouwerian lattice.

**Corollary 7** The variety BL of BL-algebras is congruence distributive.

## 2. Some properties of BL-algebra

We denote by  $D_s(A)$  the set of all deductive systems of  $A$ . For nonempty subset  $M \subseteq A$  we denote by  $[M]$  the ds of  $A$  generated by  $M$  (that is,  $[M] = \bigcap \{F \in D_s(A) : M \subseteq F\}$ ).

If  $M = \{a\}$  with  $a \in A$ , we denote by  $[a]$  the ds generated by  $\{a\}$  ( $[a]$  is called principal).

For  $F \in D_s(A)$  and  $a \in A/F$ , we denote by  $F(a) = [F \cup \{a\}]$ .

**Theorem 7** If  $A$  is a BL-algebra, then the following assertions are equivalent:

- (i)  $(D_s(A), \vee, \wedge, *, \{1\}, A)$  is a Boolean algebra
- (ii) every ds of  $A$  is principal and for every  $x \in A$ , there is  $n \in \mathbb{N}$  such that  $x \vee (x^n)^* = 1$ .

### The spectrum of a BL-algebra

For the lattice  $D_s(A)$  (which is distributive) we denote by  $\text{Spec}(A)$  the set of all (finitely) meet-irreducible (hence meet-prime) elements ( $\text{Spec}(A)$  is called the spectrum of  $A$  and by  $\text{Irc}(A)$  the set of all (completely) meet-irreducible elements of the lattice  $D_s(A)$ ).

**Definition** A proper ds  $F$  of  $A$  is called prime if, for any  $a, b \in A$ , the condition  $a \vee b \in F$  implies  $a \in F$  or  $b \in F$ .

**Theorem 8** A non-degenerate BL-algebra contains a prime ds.

**Theorem 9**  $A$  is a BL-chain iff any proper ds of  $A$  is a prime ds.

**Theorem 10** If  $P$  is a prime ds of  $A$  and  $F$  is a proper ds of  $A$  such that  $P \subseteq F$ , then also  $F$  is prime.

**Theorem 11** The set of proper deductive systems including a given prime ds  $P$  of  $A$  is totally ordered with respect the inclusion.

## Conclusion

BL-algebras and DRI-monoids have important algebraic properties and they have been intensively studied from an algebraic point of view. BL-algebras form an equational class of residuated lattices.

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## Structural Changes in the Context of the New Knowledge-Based Economy

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### Abstract

*The present research intends to establish and outline the structural changes of the organizations in the context of the knowledge-based economy in order to maintain the human, material and financial resources, and meanwhile being capable to achieve economical growth. These changes were adopted by organizations, especially since changes occur in a dynamic increasingly accelerated where the order of the resources is another one.*

*The transition to the newly knowledge-based economy has proved that the old traditional structures, where the rigid hierarchies used to dominate, don't allow anymore the coordination of the activities that became increasingly complex. Switching towards a flat structure where the employees are encouraged to self-manage and self-organize themselves allows the organizations to better cope with the current economical environment.*

**Cuvinte cheie:** structural changes, knowledge-based economy, organizations  
**Clasificare J.E.L.:** D8, L1,

### 1. Introduction

The new type of society that sequences the industrial society makes changes also in the organizational models. Huber (1984) had examined the question of the nature and the designing of the new organizations. He estimates that the knowledge-based organization will make efficient three processes: decision making, innovation and

acquisition and distribution of the information.

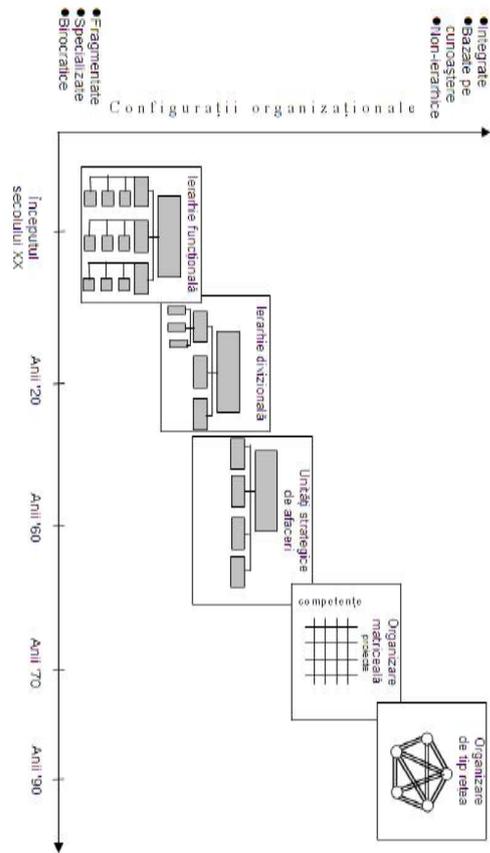
Drucker (1988) considers that the organizational model in the knowledge-based economy must be characterized by: the composition dominated by professionals, the small number of intermediate levels of hierarchy management, ensuring coordination through non-authoritative means.

The organizations of the new economy are based on the knowledge as their main resource, in a deeply and extensive way, with a real impact on the learning and innovation skills. On the basis of these entities are processes such as creation of new knowledge, assimilation of knowledge and sharing them. The sectorial composition of the European countries' economy has changed in the recent years, years when the information and knowledge assets became a priority for creating added value.

### 2. Models of organizational configurations

Palmer highlights in the figure below the evolution of the organizational structures succeeding from the beginning of the century to the structure of the knowledge-based organizations. It can be noticed how it's passing from functional hierarchy (bureaucratic and fragmented) to the network type organization (integrated, non-hierarchical)

Figure 1 - The evolution of the organizational structures



Source: Palmer J. – The human organization, in Journal of Knowledge, Management, nr.1/1998

**3. The sequence of the management practices generations**

Further on are presented the characteristics of knowledge-based organization by succeeding the generations of management practice.

Table 1 - Succeeding the generations of management practice

Characteristics of the organisation	1 <sup>st</sup> Generation	2 <sup>nd</sup> Generation	3 <sup>rd</sup> Generation
	Technology oriented	Projects oriented	Organizational oriented
Strategy	Disparate efforts of research and development	Focused on the main activity	Integration between technology and main activity

<b>The powers of changing</b>	Unpredictable	Intra-organizational interdependencies	Systematic effort of research and development
<b>Performance</b>	Research and development as auxiliary activity (support)	Co-participation in expenses	Risk-benefit equilibrium
<b>Structure</b>	Functional oriented hierarchy	Matrix	Distributed coordination
<b>Personnel</b>	Competitive relationships	Proactive cooperation	Structured cooperation
<b>Functioning</b>	Weak intercommunication	Project based relationships	Research and development focused on core business
<b>Technology</b>	Embryonic technology	Data based	Based on information

Characteristics of the organisation	4 <sup>th</sup> Generation	5 <sup>th</sup> Generation
	Client oriented	Knowledge oriented
<b>Strategy</b>	Coordination with customers in research and development	Interactive innovation systems
<b>The powers of changing</b>	Generalized change, fast, discontinuous	Dynamic type - Kaleidoscopic
<b>Performance</b>	The ratio between productivity and investments for computerization	Intellectual capacity and its impact
<b>Structure</b>	Professional communities	Symbiotic networks
<b>Personnel</b>	Emphasis on values and potential	Self-managed professionals
<b>Functioning</b>	Feedback circuits ; sustained information	In/out knowledge flows
<b>Technology</b>	Informatics – competitive force	Intelligent Knowledge Processors

Source : <http://www.entovation.com/assessment/fifthgen.htm>

#### 4. Structural changes in the primary, secondary and tertiary sector

Table 2 - The sectors contribution to the added value growth (1990-2011) % of GDP

	Years	Agriculture	Industry	Services
RO	1990	23,74	49,94	26,32
	1994	21,54	46,28	32,18
	2000	12,51	36,38	51,11
	2006	10,14	37,42	52,07
	2011	7,14	26,2	66,66
Aria Euro	1990	3,46	32,6	63,83
	1994	2,87	29,28	67,72
	2000	2,41	27,88	69,58
	2006	1,73	26,68	71,46
	2011	1,54	26,23	72,03

Data source: [www.worldbank.org](http://www.worldbank.org)

Figure 2 – Graphical representation - The sectors contribution to the added value growth (1990-2011) % of GDP for Romania

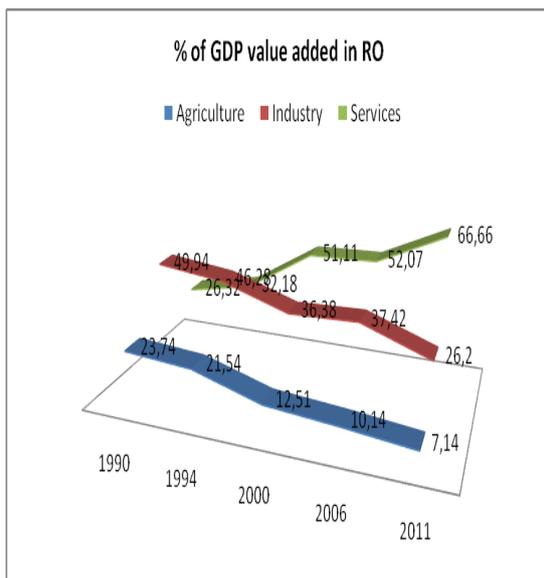
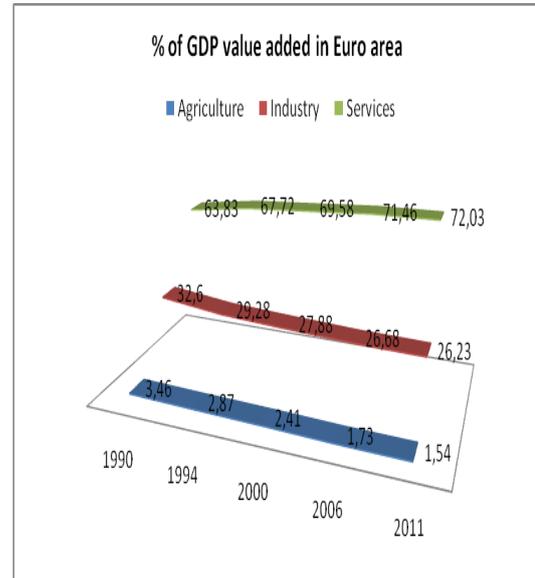


Figure 3 – Graphical representation - The sectors contribution to the added value growth (1990-2011) % of GDP for Romania



Structural changes occurred in the structure of economic sectors have caused an important source of economic growth and improvement on productivity. The weight decrease of the less productive sector (agriculture) and the weight increase in the more productive sectors (industry and services) have positively influenced the productivity on the macroeconomic level.

The new economy based on knowledge, brings a gradual increase of the tertiary and quaternary sector, these becoming dominants. Analysis of the economic convergence of Romania to the EU becomes relevant in the analysis of the two charts above. Can be seen that the sectorial structure of our country has evolved in order to reduce the share of agriculture sector and dramatically increase of the tertiary sector. It is true that the services contribution to the growth of the added value as a percentage of GDP, for our country is far below the EURO area rate.

The large companies' structures that are vertically oriented make the professional activity more complex and less effective. To achieve the objectives of the knowledge-based economy, the big companies have to modify these vertical structures in flat organizational structures. The organizations' vertical design (specific to the industrial era) makes difficult the implementation of the decisions and also reduces their quality.

Thereby, the transition to the flat organizational structure is recommended.

In the context of the new economy becomes imperative the transition to an organizational structure characterized by teamwork, liability and flexibility. The hierarchical structure is a structure in which excessive bureaucracy prevents the information flow while specialization of the processes, also excessive, discourages the integration of specialized knowledge, delaying the response time (Cross, 2000).

Among the benefits of the flat organization can also be included:

- The flat organization operates with a minimum of formal hierarchical levels for reporting;
- Decentralized authority on the team level and a better distribution of knowledge;

Strategies of flat organizations base their economic growth on innovation and creating networks that connects the customers, suppliers and competitors.

## 5. Conclusions

The organization of the new economy must be based on the new types of organization forms that could allow the access to information with no impediments occurred due to the hierarchical and functional structure. Informal relationships are also important, they smoothens the knowledge flow, facilitate the production of tacit knowledge, and increase the flexibility on the response to change.

The versatile organization specific to the new economy has the following features:

- flat organizational structure
- interactive partnership
- less structured networks, semiautomatic teams
- fewer levels;
- Operating multiple forms of collaboration with other companies, such as strategic partnerships.
- Reduce the barriers between the individual and organization.

**Acknowledgment:** This work was supported by the project "Post-Doctoral Studies in Economics: training program for elite researchers - SPODE" co-funded from the European Social Fund through the

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## Organizational Performance and Substantiate Organizations Work Mainly on Intangible Resources

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### Abstract

*The purpose of the paper is to present a detailed investigative study. The nature the study is theoretical as well as applied in the area of business diagnostics based on local knowledge.*

*The thesis of the study will be validated based on a survey. The survey contains questions that reflect the degree to which the studied organizations, based mainly in Constanta, base their activity on intangible resources.*

*Many researchers consider intangible assets to be the main resources of the organizations added value.*

**Cuvinte cheie:** organization, intangible resources, performance

**Clasificare J.E.L.:** D8, P47

### 1. Introduction

Intellectual capital comprises all intangible resources available to the company, which give the company an edge, and which in combination with other advantages can lead to possible future benefits[1]

**Intangible values** have become increasingly important for the managers of the new economy. Intangible assets have gradually become the most important resources of competitive advantage. Traditional factors of production (material resources, labor, capital) have gradually diminished in importance. At the same time intangibles assets such as knowledge, information, and creativity have increased importance. While land, capital, and labor are subject to decreasing returns, knowledge and information induce increasing returns

"To make the most efficient use of intangible assets, like new engines creating wealth, in a knowledge based society, we must distance ourselves as much as possible from the old engines of the industrial economy, which in turn, they had replaced the engines of the agricultural economy. [...] The real source of wealth of nations and businesses must be sought in people, in their knowledge and their abilities, in internal processes, and businesses reputation." [1]

In Romania, intellectual capital is not sufficiently exploited due to lack of adequate markets for knowledge. In Romania this problem is more the concern of academics, universities in general, the Chamber of Commerce and Industry of Romania and less of businesses and legislators[2].

The success of the countries in the new economy will become increasingly determined by how they manage to spur technological innovation, entrepreneurial relations, education, specialized skills and transition to all organizations, public and private, from the bureaucratic and highly hierarchical style to networks of learning[2]

In a knowledge society, there are four key dimensions of competitiveness, which are in close correlation:

- Resources and inputs (investments in Research & Development, technology acquisition, etc..)

- Intangible assets obtained by combining resources. This way we can see specific results such as knowledge, patents, brand names, reputation, and networks.

- Change management is one of the most important levels in implementing a dynamic perspective to introduce change in the entire organization.

- Development of competitive advantage and efficiency as key sources for macroeconomic and microeconomic performance

## 2. Method

Through my research I propose to formulate questions that will lead to answers useful to analyze the approach position Constanta organizations transition to knowledge-based organization.

### Hypothesis

**H1:** Organizations base their activities mainly on intangible resources

The investigation was carried out scientific research based on the evaluation questionnaire. Quantitative empirical research findings of this research is the foundation.

**Evaluation questionnaire** aimed at measuring and analyzing the views of employees on key practices and organization of the knowledge economy and the extent to which they are applied in local organizations. Questions were raised after a profound analysis of knowledge in the field. Their formulation is straightforward, using interrogation methods that lead to valid and representative results.

The sample investigated. Research unit is represented by employee organizations Constanta economic. The total number of investigated subjects was 35. The sample includes both employees who are part of executives, grassroots management and environmental management or top management. To ensure proper representation of the organizations investigated, their selection will be random on a voluntary basis.

## 3. Quantitative study through questionnaire

The questionnaire contains five questions leading to answers to review position in Constanta organizations approach to the economy and thus passing on knowledge based organization. For statements of the questionnaire interviewees answered YES or NO

### Questions

1. Organization has an important base of information resources (patents, patents, licenses, trademarks, etc..).

2. Within the organization to allocate a high proportion of revenues to research and development activities

3. The organization promotes the use of new information and communication technologies

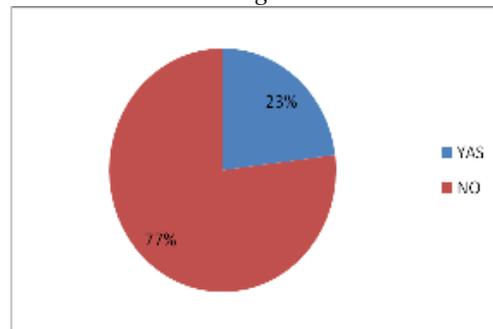
4. Employees have access to knowledge in various forms: databases, documents, reports, forums, e-learning platform, etc.

5. Employees are familiar with computer and Internet.

## 4. Research results

### Question 1

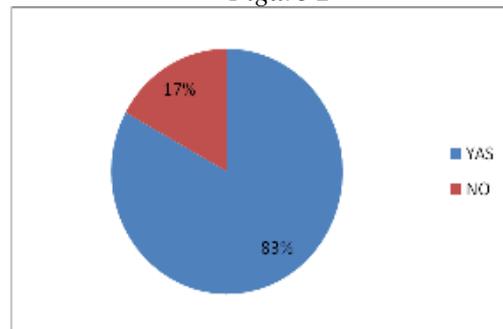
Figure 1



In terms of ownership of the organization of a major base of information resources, we can see that most of them do not have such a basis. 77% of respondents operate in organizations that do not have patents, patents, licenses or trademarks.

### Question 2

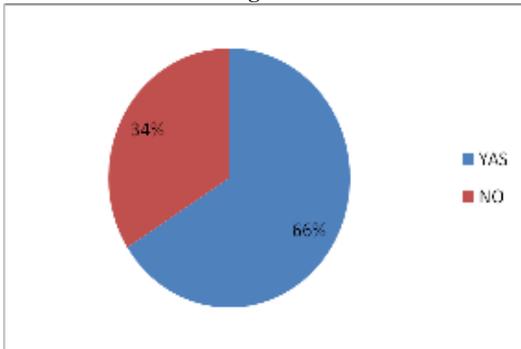
Figure 2



You can see that only 17% of respondents think the organization is assigned a high share of revenues on R & D activity. The rest, mostly, responded negatively to this statement. Most organizations do not allocate all funds Constanta in research and development.

### Question 3

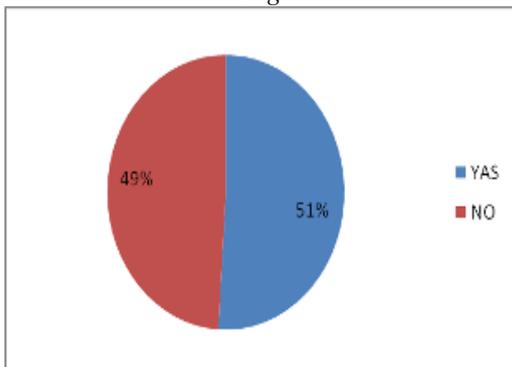
Figure 3



66% of responders believe that in the analyzed organizations promote the use of new information and communication technologies and only 34% of respondents believe that this does not happen. This shows that employees provide information technology organizations are aware of their importance.

### Question 4

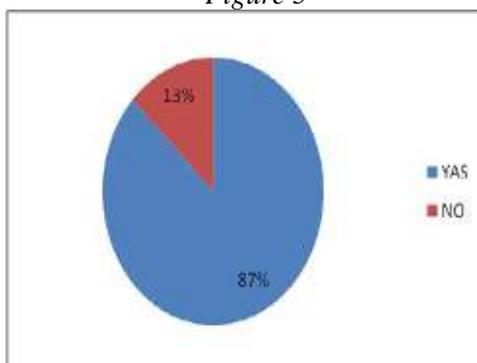
Figure 4



Half of respondents have access to knowledge in various forms: databases, documents, reports, forums, e-learning platform, etc.

### Question 5

Figure 5



87% of respondents believe that employees are familiar with computer and internet and only 13% of them have these skills. The organizations studied, there was most of the activities focus mainly focused on computer and Internet

## 5. Conclusions

Following the responses obtained can be concluded that, in organizations in Constanta the foundation of activities based on intangible resources are not predominant. However we see higher percentages for questions that concern in the use of computer and Internet activity and half of respondents have access to knowledge in various forms: databases, documents, reports, forums, e-learning platforms, etc..

Smaller percentages were obtained from questions that regarded the information resource databases and funds allocated to research and development. These low levels may be due in small part to the current context, namely the economic crisis.

However, an organization which does not effectively exploits its intangible resources cannot cope with competition based on knowledge which tends to become dominant in the current economic landscape.

**Acknowledgment:** This work was supported by the project "Post-Doctoral Studies in Economics: training program for elite researchers - SPODE" co-funded from the European Social Fund through the Development of Human Resources Operational Programme 2007-2013, contract no. POSDRU/89/1.5/S/61755.)".

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## Monetary Assumptions From the Classical School Perspective

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### Abstract

*Out of all the ideas and assumptions regarding the money and monetary theory, the classical liberalism was the first major paradigm that contributed to the development of the quantity theory of money.*

*This paper aims to express the first steps made by the Classical School economists in crystallization of the classical quantity theory. The interest rate is also studied in order to emphasize its effects over the macroeconomic stability.*

*What was the role of money in Smith’s view? What is the relationship between money and interest rate? Does money have an impact over the economic activity?*

**Key words:** money, interest rate, monetary policy, economic growth.

**J.E.L. classification:** E40, E52, O40.

### 1. The birth of a new paradigm

The seventeenth century brought forward a new current of economic thinking. It focused on the natural order of things and on economic freedom. Covered by the *laissez-faire* cloak, the classical liberalism will provide a new perspective on society and on economy. Being also named “the first major paradigm of economic thought history”, the current will eliminate everything that is insignificant in the economic analysis, and therefore, will always capture what is essential and what gives originality [5].

For Classical School representatives, the wealth of nations is a constant theme of economic science. Unlike mercantilists, classics will lean on production rather than the movement of goods on market. The division of labour is fundamental and so is the role of its productivity.

Among the leading figures of the new current, Adam Smith, David Ricardo, Robert

Thomas Malthus, John Stuart Mill or Jean Baptiste Say left their mark – through their works – on the functioning of the economy and the society of those times.

### 2. The early times of classical liberalism

John Locke (1632-1704) estimated that the wealth is represented by gold and silver money whose value remains stable in time. Locke – whose ideas will later be developed by Ricardo – has researched the monetary issue too, considering that the value of money is shown by the amount of money in circulation.

The Irish Richard Cantillon (1697-1734) spoke about the role of money and its role in economic development. He also studied the impact of the demand and money supply over the wealth of nations. Based on the idea that money is a commodity, according to Cantillon, its value is calculated as the value of any other commodity [5].

Unlike mercantilists, classics didn’t consider money to be so important. They thought that money didn’t have any impact on the economic equilibrium.

But the founders of the quantity theory of money are not the classics. Its origins are found somewhere in the middle ages and relate their existence to Jean Bodin (1530 – 1596). Bodin believed that there is a direct relationship between prices and the quantity of money in the economy, so that an increase of the amount of money will lead to higher prices and vice versa. More than that, he highlighted the inverse relationship between the purchasing power of money and the amount of money in circulation.

The famous formula  $MV = PT$  was established by mercantilists, who considered that money supply is the core of economic growth. Bodin agreed that money is not responsible for any macroeconomic change.

### 3. Classical School's perspective over money and monetary issues

The quantity theory of money was the starting point in shaping the opinion of the Classical School's economists regarding the money.

Smith, Ricardo or Say appreciated that money has a neutral role, being an intermediate in the exchange of products. Classics didn't "feel" the impact of money on the economy, considering that they have no influence over the balance between demand and supply.

The most important figure of the Classical School is British Adam Smith (1723 – 1790). For the author of *Wealth of Nations*, the free market is responsible for adjusting the money supply, not the government: "Upon every account, therefore, the attention of government never was so unnecessarily employed, as when directed to watch over the preservation or increase of the quantity of money in any country" [7].

He criticized the mercantilist doctrine that admitted that money and precious metals are synonymous with the wealth of nations. According to Smith, the goods represent the wealth.

Smith identified a double role of money: that of circulation and a measuring instrument of the value of goods. Although considers that paper money has a positive effect on the economy, ensuring national wealth, he doesn't believe that can help increase the money supply. In fact, he sees them as mere substitutes of precious metal money, which must not exceed in quantity, because, whenever we can face the danger of their devaluation: "The commerce and industry of the country, however, it must be acknowledged, though they may be somewhat augmented, cannot be altogether so secure, when they are thus, as it were, suspended upon the Daedalian wings of paper money, as when they travel about upon the solid ground of gold and silver" [7].

The interest rate has not been such an extensively studied topic by Smith. He showed the declining trend of interest and the indirect relationship between the interest rate and the economic development degree of countries.

Smith presented the interest rate from the borrowers' and the lenders' point of view. He

thought that the interest rate depends on the interactions between those two economic agents. The borrower will accept to take money, looking forward to make that investment to be profitable. The best deal for the lender that will determine him to give money will be when the lending interest rate is higher than the cost of funds. As mentioned by Choi (2011), these two decisions will have a great influence over the interest rate [1].

Adam Smith is well known in the economic literature as the inventor of the invisible hand theory. The doctrine states that it is better for everyone to behave for satisfying its personal interest, rather than to achieve the public interests. In this case, there is an invisible hand that helps the society to improve, to develop and to obtain great results [2]. In *Wealth of Nations*, Smith stated perfectly the core of the ideology: "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity, but to their self-love, and never talk to them of our own necessities, but of their advantages" [7].

One of the most important followers of Smith's ideas is David Ricardo (1772 – 1823) that saw money fulfil only the function of medium of exchange.

He admits the objective theory of value, but criticizes the Say's subjective theory. Through 1816's work, *Proposals for an Economical and Secure Currency; with observations on the Profits of the Bank of England, as they regard the Public and the Proprietors of Bank Stock*, Ricardo advocated for demonetization of precious metals, for using them instead of paper money and for setting a fixed exchange course by the monetary authorities, in order to eliminate the threat of money devaluation [6].

Ricardo's quantity theory of money can be illustrated through the formula  $M = PT$ , showing another time the positive relationship between money supply and the level of prices. In other words, if we had to quote Ricardo himself, "a certain production of goods and services results in a certain volume of transactions (T), at a certain medium price (P), taking into account the amount of money (M) available" [8].

Through his works, the French Jean Baptiste Say (1767 – 1832) continued and summarized Smith’s concepts.

Money market equilibrium – said the French classical economist – is a constant of the economy, being always there and at any time, because the goods are offered on the market, for money, which are further used to buy other goods.

In that case, on the money market, the total value of demanded goods is equal with the total amount of offered goods. Money market equilibrium is achieved; and this balance is permanent because the goods are exchanged for money, which are used to buy other goods. So, the monetary theory is excluded by the terms of this Say’s identity [8].

He is the author of the Law of Markets, which assumes that “products are paid for with products”, disregarding the role of money in the goods exchange. The identity appears because every supply creates its own demand, as goods are obtained from correct factors of production.

The British philosopher John Stuart Mill (1806-1873) – considered the last symbol of the classical liberalism – is credited with a synthesis of the Classical School’s ideas. For him, as for Smith too, the object of the economic science is the analysis of wealth.

Speaking about the interest rate, Mill said “The rate of interest will be such as to equalize the demand for loans with the supply of them. It will be such, that exactly as much as some people are desirous to borrow at that rate, others shall be willing to lend. If there is more offered than demanded, interest will fall; if more is demanded than offered, it will rise; and in both cases, to the point at which the equation of supply and demand is re-established” [4].

An increase of the interest rates leads, accordingly to Smith and Ricardo to an expensive credit and to a decrease of the purchasing power of money, creating the perfect framework for recession.

Like the mathematical model of Leon Walras – where money is a homogenization instrument – classical economists emphasized the idea of currency’s futility. So, Mill considered that money has no impact in the economic activity; on the other hand, the creator of the Law of Markets, Say,

admitted the idea that we need money not to keep, but to use it immediately.

#### 4. The development of the quantity theory of money

The quantity theory of money has progressed through two models: the transactions model and the cash balances model [3], [8].

The two models have emerged in the early twentieth century, when the quantity theory of money was not answering to that existing reality, and the economists were looking for alternatives.

The transactions model is based on the ideas of David Hume, who showed the equality  $PT = MV$ , where P is the prices level, T represents the transactions, M is the amount of money in circulation and V is the velocity of money.

Hume’s assumptions will be later updated by Irving Fisher in *The Purchasing Power of Money* (1911) through the mathematical equation of exchange:

$$MV + M^iV^i = PT, \text{ where}$$

M – currency in circulation,

V – velocity of currency in circulation,

$M^i$  – demand deposits (scriptural money),

$V^i$  – velocity of scriptural money (bank money).

Through this equation, Fisher shows how the money market works. We must not fall into the trap of believing that there is proportionality between variables, although that’s the case at a first glance. We are talking about a model, a copy of reality, but not the reality itself. *Money has here an active role, because they influence prices and not vice versa!* Fisher’s correlation is not only between money and prices, but with other factors too, such as population growth, technical progress or bank loan, bringing forward a touch of originality and improvement to the classical theory of money.

The idea of considering money as a first element in the analysis, even before prices, is showed by Fisher in *Appreciation and Interest* (1896), in *The Rate of Interest* (1907) and later, in *The Purchasing Power of Money* (1911).

The cash balances model is developed from the idea that people establish a certain reserve from their income that will be used for a future consumption of goods. The cash reserve size depends on the frequency of collecting the income, the needs of each individual, the preference for a particular good or their marginal utilities.

Arthur Cecil Pigou and Alfred Marshal are considered the parents of this model, which expresses the direct link between the money and prices. Keynes, will later update this model, promoting it in the monetary field as the Cambridge equation.

The Cambridge equation is based on Fisher's equation, the only difference being the K coefficient that represents a part from the income that people keep it as liquid currency, or, in other words, the average period for which money is kept:

$$M = KPT, \text{ where}$$

M – money supply,

K – the average period for which money is kept,

P – price level,

T – the volume of transactions.

The K coefficient may be associated with the inverse of the velocity of money from Fisher's equation.

The two models deal with pretty much ease the price dynamics, ignoring important issues that might influence the K coefficient, the amount of money or the velocity of money.

Comparing the two models, we see that Fisher focuses on the amount of money in circulation, so, on the money supply, while Keynes, emphasizes the K coefficient, so the purchasing power of money, or the demand of money. Any change in the K coefficient will lead to price fluctuations, but will have no impact on the amount of money in circulation, as the quantity theory of money stated.

In the Classical School perspective, the amount of money in the economy does not determine the market interest rate.

## 5. Conclusions

Classical School is one of the most important schools of economic thought that

contributed to the development of the quantity theory of money.

Although classic economists didn't give so much credit to money, having no impact on the economic equilibrium, their ideas were fundamental for the progress of monetary theory.

Money is futile in the economy and does not determine the market interest rate.

The transactions and the cash balances models had helped to the improvement of the quantity theory of money.

## 6. Acknowledgements

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## The Monetary Paradigm in the Misesian Theory

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### Abstract

*One of the leading figures of the Austrian School is by far Ludwig von Mises. Known better for his findings regarding the relationship between money, prices and interest, Mises brought originality and a new perspective over the monetary policy.*

*This paper is a tribute to the philosopher Mises, who focused on human acting and who enriched the monetary theory with an analytical perspective and deductive models, creating the so called Misesian theory.*

*What is Mises contribution to the development of monetary paradigm? Is expansionary monetary policy good? Is he for private initiative and free market rule? And most important how does the business cycle theory influence money?*

**Key words:** money, interest rate, monetary policy, business cycle theory.

**J.E.L. classification:** E40, E52, E30.

### 1. A new School at horizons

The second half of the twentieth century is dominated by a new economic thinking current, the Austrian School.

The base of this School's analysis is considered Carl Menger's work *Principles of economics*, in which he systematizes the entire Austrian theory [6].

Three stages can be seen in the evolution of the Austrian's current. The first Austrian School, represented by Carl Menger, Eugen von Böhm-Bawerk and Friedrich von Wieser had studied different approaches to prices, interests and production. This is the pioneer stage where the first Austrian ideas are born. Nevertheless, the true contribution in the development of this School is brought by the second Austrian generation, which is actually the most known one. So, Hayek, Machlup, Strigl or Haberler are the economists that

sprinkled the Austrian theory with a touch of originality. Ludwig von Mises is by far their leading figure. Through his business cycle theory, he reinvented the theory in economics. Anyway, the spread of the new Keynesian paradigm, together with the emigration of the representatives of this second generation of economists because of political issues, seemed to bury forever the treasure of the Austrian thinking. That is how Rothbard, Kirzner, Lachman or Garrison, inspired and attracted by Mises' works, revive the Austrian tradition in the United States, in the 70s, through the third generation of Austrian economists [6].

Declared opponent of Keynesianism, the Austrian School will focus on concepts like: methodological individualism, marginal analysis and opposition to socialism. Austrians have always kept in mind the individual and especially its preferences. For them, any analysis must take into account people's preferences. So, according to this School, people act and learn, facilitating the economic activity to be dynamic [6].

### 2. Mises's contribution to the development of the Austrian paradigm

Philosopher Ludwig Heinrich Edler von Mises (1881 – 1973) is the most known representative in the Austrian School. Being influenced by the works of Carl Menger, Mises had developed his entire work on praxeological method, studying *action* and especially, human action. What is praxeology? Well, the methodology used is unique. It is focused on how the human beings act and establish goals. So, *acting* is the best way to describe this method. And humans will therefore act towards goals and will do whatever it takes to reach them.

According to Manolescu (2007), there are two stages in developing the monetarist economic thinking. Along with new monetarism stage, there is another one, the

Austrian School. Menger, Mises and Hayek centered their studies on researching how the money supply will impact the phenomena of inflation and unemployment [2].

Mises criticized socialism, saying that in a planned economy there is no market, so prices can not form and therefore, any economic calculation is impossible.

However, the most outstanding contribution of Mises to the development of the economic theory remains the famous business cycle theory, which is masterly presented in *The Theory of Money and Credit*. Using elements from the Austrian capital theory, as well as from the wicksellian monetary policy, the business cycle theory believes that increasing the volume of loans or credits affect the economic expansion. The volume of loans increases due to lower interest rates. Business is encouraged, and investments are flourishing. However, a rise in the production goods prices will diminish profitability. The lack of credit will raise the prices of production goods, making them closer to the level of consumer goods prices. It is an undesirable situation, because in this way, the profitability objective cannot be achieved anymore. The premises of a crisis are set up. The goods cannot be sold and if it would, it would have been at low prices. An increase of the money supply is needed. As stated above, the business cycle theory developed by Mises, didn't offer an anticrisis solution. The Austrian School will oppose socialism and government intervention [6].

Salerno (2010) agreed that a general theory is needed, as a combination between monetary theory and value theory. This will better explain the market economy. One of his big desires in *Money, Sound and Unsound* was to emphasize the connection between Misesian theory and modern monetary theories [7].

### 3. The Misesian monetary paradigm

Ludwig von Mises is known to determine the relationship between money, prices and interest, although its contribution in monetary policy remained in the shadow of Alfred Marshall, Knut Wicksell or Irving Fisher. Appreciating the monetary imbalances as being the result of the fluctuations in the amount of money in the economy, Mises could be regarded as a monetarist.

Lawrence Moss (1976) considers that *The Theory of Money and Credit* is by far one of the most comprehensive approaches to monetary policy in the early twentieth century. However, Mises's work doesn't seek a suitable methodological framework to study monetary policy. Mises treats monetary policy from an analytical perspective, full of deductive models, recalling in this way the Austrian School, through its representatives: Carl Menger and Böhm – Bawerk [5].

In *The Economics of Ludwig von Mises: Toward a Critical Reappraisal*, Moss will recall Mises's relationship with Menger, Fisher, Wicksell and not least with Hayek.

Money is – in Menger's and Mises's view – the result of market economy. People buy and sell on the market in order to obtain goods for their existence [4]. Money is those goods accepted in any market.

Mises was detached from the unanimous opinion of the Austrian School when he said that for him, the purchasing power of money in the past affect their future value. Using the regression model in *The Theory of Money and Credit*, Mises shows how “today's” prices are explained through “yesterday's” prices [5].

In other words, a theory of money always takes into account the past behaviour of prices. He used this to show that countries that have experienced high inflation “the decrease in the value of the money has occurred faster than the increase in its quantity” [4]. He also states that “in a long run, a money which continually fell in value would have no commercial utility” [4].

Mises believed that between the interest rate and the amount of money that population has, there is no direct link [4]. Moreover, he believed that when the bond prices will rise, population will increase the money demand, so, that's why interest rate and money demand are inversely proportional.

Inflation occurs because of large amounts of money on the market. Mises had shown that, in fact, in prolonged inflationary conditions, the economy is experiencing a lack of money. *How can be explained this paradox?*

Individuals are currently reducing their amount of money they need because of an expected increase of inflation. Prices depend

on the future value of money. The decrease in the amount of money will be made until future revenues will cover this current reduction. A decision to reduce the growth rate of money supply by the monetary authorities will impact on future incomes that will not cover the population's decrease of cash. In other words, the economy will face a shortage of money. Monetary authorities are expected to come with the solution of less restricted policy, whose goal would be the increase of liquidity in the economy [4], [5].

Mises says that inflation *is doing very well* in the presence of cartels or trusts that set market prices. In times of inflation, people doesn't give up consuming and, moreover, decide to pay now the highest price rather than wait and pay a higher price later [4], [5].

Mises believes that a price increase is favourable to certain individuals, but disadvantages others. Suppose that we would have an increase of the money supply in the market. This will lead – according to Mises – to a raise of prices, in opposition to the wicksellian idea that any increase in the money supply has a neutral effect over commodity prices. Individuals who will receive money are disadvantaged because the prices rose and the real value of the money received fell.

Mises brings into question the idea that the state is winning during a monetary issue. Why is that? Because, usually, the state is the debtor in the economic activity and any monetary issue or any increase of the money supply will amplify inflation. As a consequence, the real value that the state has to pay to economic agents is diminished [4].

Wicksell's theory of cumulative expansion was analyzed by Mises too. By maintaining the market interest rate below the rate of profit, or the natural interest rate, banks open the lending gates, encouraging the demand for bank loans and increasing the commodity prices too.

*What if banks decide to keep this policy?* They will continue lending and prices will rise. In *Interest and Prices*, Wicksell sought a solution for timing the process. The stop button was the *interest rate for deposits*, which should not fall below a certain level. The banks increase the interest rates so the rising prices process is stopped, although their level is high enough. In order to avoid this situation, the equality between the

interest rate and the profit rate is needed, so the lending process is slowed down and so is the increase of prices. Mises believed that if the interest rate would remain below the rate of profit, the money supply should increase.

For Mises, an *expansionary monetary policy has inflationary implications*, and especially deadly for the social class, because it further impoverish the poorest people. Mises believes that hyperinflation has negative economic consequences, facilitating a total state control [4], [5].

Hülsmann (2008) considers that the entire work of Mises is based on two major themes: firstly, a free market competition that will lead to a monetary order focused on gold and reserve banking, and secondly, the theory of denationalization of money, which will be studied by Mises' student, Hayek [1].

Two monetary problems are revealed by Mises in *Money and inflation - A Synthesis of Several Lectures*: the first one is inflation and the second one is the cause of prices increase – the increase in the quantity of money.

The Austrian admits that “the government resorts to inflation, and that means an increase in the quantity of money. And this is the second monetary problem” [3].

If the monetarists admitted an immediate relationship between money and real events, based on a long term analysis, the Keynesians' short term analysis express the pessimism regarding this relation. What is the opinion of the Austrian School? De Soto (2009) thinks that the capital theory, which is the base of Austrian School thinking stands somewhere in the middle, between the perspectives of the two macroeconomic schools: “Austrians see a certain connection – a *loose joint*, to use Hayek's terminology – between monetary phenomena and real phenomena, a link which is neither absolute, as monetarists claim, nor totally non-existent, as Keynesians assert” [8].

#### 4. Conclusions

Mises remained in economic thinking through his works in the field of monetary theory and business cycle. Staunch opponent of socialism and Keynesian paradigm, Mises is one of the most prominent personalities of the Austrian School [6].

Regarding the monetary theory, Ludwig von Mises stated the elimination of state

intervention from the production of money or from banking field. Beside this, he emphasized that private initiative and free market are better than state interventionism. The system of Mises is based on gold-coin circulation and 100% reserve banking [1].

According to Austrian School, money is not neutral and banks should fight against “falsification” of relative prices, because these “lead to the widespread malinvestment of resources, and inevitably, to crisis and recession” [8].

The Austrian School’s policy is based on three pillars. *Firstly*, there are the stability of the quantity of money and the reduction of credit expansion, which are the most important conditions for creating a 100% reserve banking system. *Secondly*, a flexibility of the relative prices of goods, services and factors of production is needed in order to combat unemployment and corruption. And *thirdly*, there is the ability to predict any changes in the purchasing power of money, especially on long term [8].

In Austrian’s view, the market prices influence the production costs and the interest rate is a subjectively established price [8].

Mises didn’t see any link between the interest rate and the amount of money that population has.

Through his entire work, Mises brought a new vision over the monetary theory from the twentieth century.

The echo of his research will not be forgotten, because his ideas will be continued by Hayek, Rothbard, Kirzner and many more.

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## Impact of Intelligent Modern Technologies in Business

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### Abstract

*As it demonstrates evolution in recent years, intelligent agents technology is regarded as an essential tool in automating the decision-making functions and analysis as a means of facilitating and promoting organizational change, with significant potential in many areas of activity, including the accounting and finance domain. Within this area, the role of agents is oriented towards the automation of specific tasks which involve processing auditor, manual large volumes of financial data, which means that the staff member will be responsible for this processing, achieving continuous on-line. Thus, the relevant purpose during this paper is to highlight the role and benefits of using intelligent agent's technology as a fundamental tool in automating functions of financial analysis in a virtual environment.*

**Keywords:** intelligent agent, SEC, XBRL, web reporting and auditing.

**JEL Code:** G11, G17, M15, M21, M41, M51, O16, O33

### 1. Introduction

Intelligent technologies are becoming more attractive to many fields of activity because of the benefits they can bring. So, slowly but surely, the industry, in general and financial accounting in particular, are beginning to reap the advantages and benefits that intelligent technologies offers them generously.

Basically, becomes more and more obvious that the competitive advantages can

be gained only when all the economic actors involved (from simply hired and up to the entire economic branch concerned) they choose to adopt and to appeal to intelligent technologies, as the only viable solution to advancement on the specific technological scale in the 21st century, one that allows economic entities to survive and, especially to obtain important benefits and acquire successful businesses.

Within this work are of concern intelligent agent's technology, which currently is able to cover more areas, the overwhelming economic importance at the level of economic processes. In addition, it is clear to us that they are able to create important competitive opportunities for all economic entities which have grasped that their major role is and how it can be acquired and converted to value the benefits that they bring intelligent technologies.

The present work is a multidisciplinary approach to border areas computer science and accounting and focus on highlighting the impact of intelligent agents and the role of technology in the field of financial accounting, through FRAANK agent (*Financial Reporting and Auditing Agent with Net Knowledge*). The agent is able to guarantee access to large volumes of financial information available at different locations on the Internet, but also functionality and integration of their processing, too. Basically, the fact that we are able to access the available on-line financial information does not ensure success meant, but if the information is subsequently passed through electronic instruments, then business success can be guaranteed easily. So, as we look over the course of this work,

FRAANK is a modern solution that provides intelligent features and can successfully support human actors in the decision-making process. It improves the quality and accuracy of knowledge that can be obtained about the different organizations, allowing successful operation with smart technologies and picks all the benefits to which they are able to offer them.

FRAANK is an example of an agent that can be used to extract data from financial documents in text format, which they then converted into XBRL documents. This agent can be useful both in the field of statutory audit, as well as for different categories of users, as are investors or lenders, in the process of decision-making.

## 2. Actual context

Currently, in order to survive, each organization must be permanently connected to the virtual environment to have access to the information as soon as it needs. Thus, we can affirm, without the risk to fail that the expansion of the Internet has enabled organizations to be active in virtual mode too, offering the possibility of accessibility a growing volume of information available in on-line format. Furthermore, most organizations are reorganized and rethinking business processes around the Internet, just because of the benefits that it is able to offer. This reorganization will have as its main result the data sharing between companies, according to certain levels of authorization or access.

At the same time, it should be noted that there are already public data sources and accessible on the Internet (most notably in the context of the domain portion is the SEC Edgar data store, which contains reports of the SEC), and many portals such as Yahoo! provides access to specific data, for example, in financial markets, economists forecast of analysts and many other information relevant and important to the whole business. This virtual environment is an ideal space for exploitation and use by intelligent agents.

In recent years, intelligent technologies have achieved in online audit area, where it is found that the benefits can be significant. Traditionally, audit refers to checking the accuracy of reported data across the organization. In addition, auditing practices

provides quality because they are audited financial reports of organizations on different time periods. Furthermore, the information provided can be extremely useful for many categories of users (e.g., analysts or investors), which means that we must not be indifferent when these information are available. Thus, researches the past few years have been just to achieve that objective, and modern intelligent technologies began to have an increasing role.

Clearly, once available on the Internet, the information may be used in different ways, from the traditional analysis to complex interpretations by using the latest technologies. So, we can consider the FRAANK agent, whose main purpose is to achieve the integration of accounts, together with their values, and then, using other sources of information available on the Internet too, it can calculate various indicators of financial accountants to express and play themselves as closely as every organization's financial performance.

Thus, the availability of financial information in the virtual environment is the result of the latest trends in ensuring and guaranteeing the transparency of enterprises in business-web reporting financial information. Web reporting of financial information is a modern method, applicable in many countries around the world and refers to the use of websites specific to a company to distribute information about their economic performance. Web reporting of financial information of organizations may be a good marketing policy, whereby it is made known to all categories of interested users, having at least two direct economic implications:

- web reporting of financial-accounting information generates the need for standardization of its format, which led to the development and accelerated adoption of XBRL web reporting language, but also a considerable number of web applications that are able to analyze and process information in XBRL format reported in documents;
- the *Internet* affects information processing costs, and default the supply and demand for financial information on capital markets.

### 3. The modern information challenges in financial accounting approach: intelligent agents

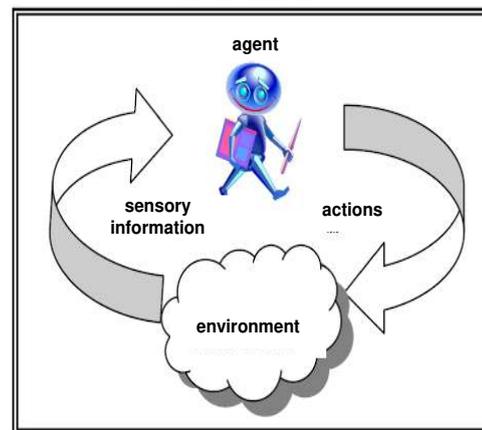
As shown in the literature, we can see intelligent agents as systems that operate autonomously to perform certain specific tasks without direct intervention on the part of the human factor.

In the field of accounting-financial audit, automating tasks human auditor enables him to deviate from the usual and customary duties and focus on the issues that really require expertise. Thus, human auditor is improving the quality of services provided and the time of their audit practice, expanding beyond its traditional limits.

Joint the decision-making capacity of the human factor with the results provided by intelligent systems can lead to extremely important benefits for all involved parts. At the level of intelligent systems, are neither neglected nor neural networks-based technologies, which earn them more and more land, especially in the process of preparation or decision-aid. Obviously, the goal of each and every computer system of modern technologies (especially those regarded as intelligent area) is to streamline the current work and to support more intense decision-making act accompanying the respective activity.

Although the field of intelligent agents is an active topic of research, including economic domain too, there is currently no universally accepted definition of all researchers about its. However, a consensus regarding their traits place in the spotlight the autonomy property which refers to the ability of an agent to act and to fulfill certain tasks without direct intervention on the part of the human actor [Wooldridge, 2002, p.35]. However, to be considered intelligent, an agent must accomplish the other two fundamental properties: *pro-activity* and *reactivity*. Reactivity refers to the ability of agent to perceive its environment and react appropriately to the changes imposed, while *pro-activity* refers to the functions of a agent who is not only limited to the reactions to the environment, but aimed at the fulfillment of its objectives. Thus, *figure 1* highlights the interaction of an agent with its environment.

Figure 1. Agent interaction with its environment



Source: (Wooldridge, 2002, p.16)

Intelligent agents specific audit accounts domains are considered to be sophisticated software systems that can perform complex tasks using specific knowledge in their dynamic environment where they operate.

In the study of literature we can conclude that, in order to be effective from the practical point of view, an application must be specialized in a limited number of tasks. For example, FRAANK agent has as its main objective to retrieve relevant information (as for example the number of accounts) in semi-structured documents as naturally text, from accounting or audit field.

An intelligent agent will require additional skills, in addition to those mentioned above, for financial reporting and auditing applications. In other words, an agent will must be able to interact with others. Ability to *communicate* can be or not required of an agent, depending on the tasks assigned to it. But, an agent who can communicate may then be able to *collaborate* with other agents. Collaboration is only possible when all agents use the same communication protocols, or when there is another intermediate agent specializing in „translation” of messages between agents. If the FRAANK agent would be endowed with communication skills, then we can receive requests from other agents and could provide financial data interpreted by others, such as those that automate financial analysis applications or banking loans solvability.

Mobility is another important property of agents; although this is not a necessary and sufficient condition for a society of agents, some researchers [Gilbert et al., 1999],

[Brazier et al., 2003] include it when discussing the agent's properties. Sometimes it is much more appropriate for an agent to interact with a remote computer, being several reasons why prefers such a form of interaction, and one of them is efficiency: network traffic can be reduced when the computer and agent are found at the same location. For example, when an agent requires a remote database, the data should be sent back to the database by the agent. This communication can be carried out locally, when agent and the system can be found at the same location and thus reduces network traffic. Another reason is that the data aren't exchanged via a public network, but can be processed locally; agents may act in a much more secure manner. In addition, remote systems allow agents to operate only local and thus forcing them to migrate to the remote location.

#### 4. XBRL web reporting

Today, XBRL is technology that revolutionizing business reporting because it allows us to share, transport and access to the information more efficiently, both in terms of time and cost involved, without interaction with the human factor and platform-independent, too. The adoption of this standard of reporting eliminates errors caused by man to (re)print of information for the purpose of reporting or decision making. XBRL is developed with the aim of achieving financial reporting since provide transparency in business management and fairness in reporting financial information, defining a new syntax for reporting.

XBRL technology allows that the financial information to be shared, communicated, understood and reused electronically, without human intervention. It is a language derived from XML, developed not only to display information, but also to specify the context of used it. XBRL, as an adopted reporting standard, presents important advantages, such as reduced costs, increased efficiency and accuracy, and increased safety to all parties who provide or use financial data.

Basically, to be able to analyze financial documents available on the Internet, it is need a standardization of the information contained in those documents to be specified because the heterogeneity of reporting

documents would make it impossible to achieve that objective. This task is in the responsibility of XBRL, which provides a standard vocabulary and one uniquely field that identifies each item in reporting documents. In this way, using XBRL, the information reported is no longer „locked” inside the document, but can be accessed using XBRL services, each data field within the document. In this way, it becomes possible through XBRL tools, the analysis of information that is published on the web.

The XBRL standard has been compared with the introduction of barcodes or ISBN number for books. Thus, the SEC has made some great strides in implementing XBRL; investors can require insurances during the process of wrapping and labeling of financial information. The Audit Committee of Public Companies (Public Company Accounting Oversight Board – PCAOB) are initiated general rules for the certification of commitments with respect to financial information XBRL, starting from the completion of certain files at the request of the SEC, which is based on manifesting understanding XBRL version by the auditor.

XBRL allows publication, exchange and analyze complex financial information business reports in dynamic and interactive world of the Internet. In addition, the standard provides a common platform for reporting processes of accounting and financial information and streamlines data communication between intern and extern users of the information. It also marks all necessary financial accounting information to all categories of users, both intern and extern decisions.

Research of the past years has shown that the benefits of intelligent modern technologies are important, it having a large impact on the various areas of activity. In this context, researchers from the informatics management showed more interest in the direction of using and adapting it in the economic field. A good example is the development of the XBRL standard for financial reporting, respectively the use of reactive intelligent agents technology, that can be made from the financial expert systems.

Starting from matters specified above, *E&Y CART* (Center for International Business Education and Research) has

developed a web site, designed as a resource center for specialists in accounting and auditing. Their experts have created an intelligent agent called FRAANK which has the task to get information and non-financial of 10 million reports of public companies. In order to maintain compatibility with the latest advances in technology, the FRAANK incorporates the XBRL language. Thus, software product called FRAANK-XBRL converts millions of reports from text format to a version with bookmarks based on XBRL USA taxonomy.

The main objective of FRAANK is to create a universal assistant for financial reporting and auditing to be able to interact with a multitude of sources of information, to learn the structure of web sites, to analyze the text in documents accounting or auditing and to formally represent and use the knowledge in the areas of accounting and the range of audit.

It constitutes the first step towards collecting financial data of organizations, data that are available on the Internet, which it then will use in order to provide value-added services. Once the agent returns financial information to the end user, it can be processed and combined using other artificial intelligence systems to obtain and provide real-time knowledge needed to the human actors in the decision-making process.

FRAANK is made up of many sub agents, each corresponding to the source of information used by it in real time. They are: Edgar agent, ticker agent, the agent of the quotation on a stock exchange and EPS agent. FRAANK's functional architecture allows its logic to be clearly detached of the end user interface, on the one hand, and the sources of specific knowledge of the financial accounting domain stored in a relational database, on the other hand.

Being mainly based on textual analysis of 10-Q reports, FRAANK is implemented entirely in Perl language, because this is the programming language that provides the most efficient pattern matching functionality. It is obvious that most of the source code of FRAANK is devoted to the implementation of the intelligent interpretation of structured text SEC reports.

## 5. Concluding remarks and future researches

Insurance provided by XBRL to financial statements is a certainty and is seen as a potential field of the development of scientific research carried out by specialists in audit, researchers or practitioners. Today, the XBRL data – obtained through SEC program of voluntary pick – does not require independent additional insurance, and guides to supplement information required by XBRL refers to audit information and recommended testing, if the financial aspects are labeled correctly. To control of the risk, in the case of XBRL commitments, relate more to the process of labeling of financial information, only the internal control on the process of counting.

Researchers in audit can provide potential solutions at important aspects in according with benefits of XBRL language and its implications in this domain. For example, owing to the nature and XBRL, automation will increase both the efficiency and the effectiveness of these commitments. Technological developments have potential in this area, such as the FRAANK, which has its origins in academic research. The ongoing development of XBRL is a certainty, this technological advantage which may be used in the process of assurance to facilitate it. XBRL – based technologies can be used in other auditing procedures, for example in the area of risk assessment and fraud or making comparisons of industrial very specific data. Overall, the benefits of XBRL audit increases the efficiency of audit process.

Concluding, we can affirm that the joint of intelligent technology with modern means of reporting and analysis of financial accounting information can lead to significant benefits and opportunities for all parts involved.

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## The Great Inflation of the '70s and Keynesian Economic Model

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### Abstract

*The great inflation of the 70s, triggered after two decades of stability and growth was explained as known, by the representatives of neo-liberal economic theory as due to the erroneous feature of state interventionism policies inspired by Keynesian doctrine, which have been mainly applied throughout this period. In particular, the regulatory activity of the financial monetary system and the cheap money policy have been accused, being regarded as obstacles to the market and its mechanisms of self-regulation.*

*Our exposé supports, conversely, that the hyperinflation of the 1970s, followed by economic stagnation and rising unemployment do not refute the theory developed by Keynes, but provides new arguments in its favor. Because, what was implemented was inspired either from a distorted view of it, or out of mainly political reasons, hence the proven inconsistency in applying the Keynesian economic model.*

**Key words:** Keynesian doctrine, money policy, hyperinflation,

**J.E.L. Classification:** E12, E31, E52

### 1. Introduction

Inflation is always a consequence of strong money supply growth, and this is accomplished either by increasing the monetary base or by increasing the broad money supply. By 1965, the main inflation threat came only from the monetary base growth, but since the mid 60s, the main threat comes from those financial innovations, which increase the amount of monetary means placed on the market [1].

The lack of effective control on the amount of such monetary means in circulation will also lead to a worrying increase in quantity, an increase that is in itself the expression of a visible inflationary potential. Postwar period of economic history shows the close relationship that existed between financial innovation, the emergence and expansion of speculative bubbles and inflation. Thus, it appears that any new U.S. financial innovation was followed by a visible increase in inflation, its rhythm increasing with the number of financial innovations.

The weakening of the financial system, resulting from the uncontrolled growth of the range of lending instruments will form the basis on which inflation will become a chronic and difficult to control phenomenon. A number of specific causes will be added later to this endogenous cause of the inflationary phenomenon in the U.S., such as the Vietnam War and the overbidding of the position held by the U.S. dollar in the international monetary system. The Vietnam War marked the significant growth of the public debt, a phenomenon with strong inflationary effects and the necessity of keeping the debt within fairly reasonable limits will increase the supply of dollars in circulation, for the moment this latter measure enjoying the gold standard protection.

The costs entailed by the war in Vietnam and the impetuous development of West European and Japanese economies, have determined the fact that large amounts of dollars were in possession of other states, which will represented a serious threat to U.S. economy, especially while the U.S. promised to ensure conversion of any quantity of gold dollars. The high pressure caused the Nixon administration to abandon

the gold convertibility of the dollar and to accept its free fluctuation. However, this represented, in fact, the strong devaluation of the dollar, a phenomenon with strong inflationary implications, which will be particularly felt in the economies of those countries that were in possession of large amounts of U.S. currency. Thus, the inflation started in the U.S. will spread to a global scale, affecting all world market economies.

Graphic 1 Annual CPI inflation – Germany



Source: ECB, Monthly Bulletin May 2010, *The “Great Inflation”: lessons for monetary policy*, p.3

In this inflationary storm that will affect the world economy, some islands of stability will appear however such as, for instance, the one represented by the West German economy. In order to curb the inflation, which seemed to be the most serious threat to the stability of their economic system, West Germans have sought the solution in the monetarist doctrine recommendations that is to exercise tight control over money supply.

Graphic 2 Annual CPI inflation – United States



Source: ECB, Monthly Bulletin May 2010, *The “Great Inflation”: lessons for monetary policy*, p.3

While North Americans lost all control over the inflationary phenomenon, not acting for the development of a strong anti-inflationary policy that would take into account the whole evolution of the economy, according to which to be able to anchor the inflationary expectations, FRG acted with all forces to print a predictable trend in inflation.

In this context, mention must be made that the phenomena of mega-inflation recorded in the first years after the war were still vivid in the memory of West Germans, so that were willing to accept any sacrifice in order to avoid updating them. At the same time, the FRG also had the means required to control inflation, specifically, they had a strong, dynamic and competitive economy, on the one hand, and on the other hand, they benefited from a strong and fully independent central bank, which had complete freedom in taking measures meant to ensure currency stability and the rigorous application of existing regulations in this regard. The results of this realistic policy will be identified in the lowest level of inflation ever recorded in this country, in comparison with those found in the rest of Western countries.

## 2. Results and failures in applying Keynesian policies

The strong inflation of the 70s affected the market economy in all its joints, negatively affecting both the economic growth rate and the employment of labor. If up to that time, the moderate inflation of the first two decades was associated with a slight economic growth and low unemployment, the now incomparably higher inflation is linked to the economic stagnation and rising unemployment.

Table 1 Evolution of unemployment and economic growth between 1965-1985

Years	Unemployment		Economic growth	
	U.S.	R.F.G.	U.S.	R.F.G.
1965	4.5	6.4	0.7	5.4
1966	3.8	6.5	0.7	2.8
1967	3.8	2.5	2.1	-0.3
1968	3.6	4.8	1.5	5.4
1969	3.5	3.1	0.7	7.5
1970	4.9	0.2	0.6	5.0
1971	5.9	3.4	0.7	3.1
1972	5.6	5.3	0.9	4.3
1973	4.9	5.8	1.0	4.8
1974	5.6	-0.6	2.2	0.9
1975	8.5	-0.2	4.0	-0.9
1976	7.7	5.4	4.0	4.9
1977	7.1	4.6	3.9	3.3
1978	6.1	5.6	3.8	3.0

1979	5.8	3.1	3.3	4.1
1980	7.1	-0.3	3.3	1.4
1981	7.6	2.5	4.8	0.5
1982	9.7	-1.9	6.7	-0.4
1983	9.6	4.5	8.1	1.6
1984	7.5	7.2	8.1	2.8
1985	7.2	4.1	8.2	2.3

Source: U.S. Department of Labor, Bureau of Labor Statistics, Washington, D.C., 2012, www.bls.gov

What is also interesting is the fact that the North American state continued to appeal, even after the outset of the Great inflation, to the same Keynesian prescriptions in order to overcome this crisis. But unlike the past, they do not have the expected results.

The failures of these economic policies in the new monetary and financial circumstances will be interpreted as the denial of the validity of Keynesian doctrine. Cheap money policy postulated by Keynes, which worked in the first decades, has now proven insufficient or inappropriate to the current circumstances, which will cause opponents to insist on the idea that the solution would be a renunciation of Keynesianism and crossing the border to neo-liberalism. If for Keynes, state interventionism represented the main means of settling failures and strengthening the economy, for the advocates of neo-liberalism, the strong renunciation to interventionist policies was considered to be the best solution.

The neo-liberal schools, in particular the monetary school, believed that the policy of cheap money was the real cause of failure and implicitly, of the strong deadlock reached by Western economy after nearly three decades of Keynesianism. Cheap money encourages the spirit of adventure, unprofitable investments, hedge games. Therefore, expensive money policy would be a healthy way of economic development, and expensive money means safe money and controlled inflation.

Despite the exaggerations that can be blamed on the neo-liberal schools of this time, they are however right when they highlight the dangers of rampant inflation and draw attention on the ongoing control of money supply. Their great error will however be their absolute confidence in the market's

capacity to solve all problems without the state intervention.

As for the alleged failure of Keynesian doctrine, one can see that it is not its failure, but merely a distorted interpretation and failure of an inconsistent application. Economy has not reached this state of inflation due to excessive state intervention and regulation, but rather due to insufficient regulations in relation to accelerating innovations in all areas of economic and, especially in finance. Keynes recommended budget deficit as a temporary solution to increasing aggregate demand and overcoming moments of recession, while the support of economic growth will come from private sector investments, as beneficiaries of the cheap money policy.

On the other hand, cheap money policy can achieve its goal only if there is a continuous monitoring of the rules' observance for granting loans, only in this way is there a guarantee that money will be directed to socially useful investments that will contribute to real economic growth and high efficiency. Otherwise, cheap money will fuel speculative bubbles, as it happened first in the North American economy and then in other Western economies, where money has skyrocketed. For the first time during the post-war period, the strong advancing of the GDP growth of broad money (in time of peace) meant to introducing a profound gap between money and production.

It should be noted that the major danger was not the increase of the money supply, but rather its change in structure in favor of the quasi-currency, those financial instruments that will serve as the main sources of credit. As, it was precisely this abundance of the quasi-currency that has opened the door to excess lending and financing speculative bubbles, which is the most powerful means of undermining the economic stability. This situation would not have become possible if the financial regulatory policy innovations had operated at maximum, which proves that the cause of failure is not the overregulation, but the insufficient regulation.

The recommendation regarding the aggregate demand was applied in a unilateral way by increasing the public deficit, as it is essential the way in which expenditures underlying deficit growth are targeted. If such costs are directly aimed at stimulating

investment in certain areas, then their effects will be beneficial and the line of considerations will be found in Keynes's theory. If, on the contrary, it retains only the formal aspect of the problem, in that it increases the budget deficit, yet with all external causes of economic development, then the impact will be negative, and instead of stimulating economic growth new dysfunctions will be registered. As equally important as it is the extent to which public debt is allowed for, so that it stimulates growth. Recent experience has shown that in the case of each state there is a level at which the increase of public debt is a serious threat to economic stability and national security.

### **3. Inconsistencies in the recommendations of Keynesian theoretical model**

Inconsistencies in the recommendations of Keynesian theoretical model resulted primarily due to a misinterpretation of the principles of Keynesian theory. If for Keynes, instability was the fundamental feature of market economies, those who will implement practical recommendations will start from the premise of the stability of this economy and its capacity for self regulation, thus creating an artificial synthesis between the classical theory and the one developed by Keynes. Yet, starting from such a premise means to ignore the main factors of instability and therefore not to give them due consideration. In such a situation it is likely to retain only the formal aspect of practical recommendations and to isolate from context the measures initiated by the state in order to increase the aggregate demand.

Secondly, Keynes's view on the economy is a systemic one, in which each component has a well-defined place, constantly interacting with others, suffering their influence and influencing them in turn. Therefore, when initiating a measure in a specific area one must take into account also its inevitable effects on the other, hence the requirement to adjust activities in those areas.

What was not retained sufficiently was the importance of the financial system, the fact that the health of the economy depends on its health, an aspect highlighted by Keynes repeatedly. This unintentional omission will cause that attitude of indifference of the state authorities against those innovations in the

structuring and functioning of the financial system, which had from the outset a strong destabilizing potential. Or, to apprehend from Keynes only the idea that that cheap credit is a basic condition of economic recovery, without any concern for the soundness of the system in which credit is made, is acting with half measures and reaching results totally contrary to the targeted objective. But in this case, the guilt cannot be placed on the cheap money policy advocated by Keynes, but on the application of this policy, which was totally contrary to what Keynes recommended.

In Keynes's view, the economic policy was only part of the general policy and the latter had to meet the requirement of achieving three fundamental objectives: *“economic efficiency, social justice and individual liberty. The first is a critical need for caution and technical knowledge, the second, an enthusiastic and bright soul with love for all his peers, the third, of tolerance and scope, of assessing the virtues of variety and independence, that prefer above all to give unlimited possibilities to those exceptional and aspiring”*. Unfortunately, however, both the general and economic policy have focused mainly on the economic efficiency, without sufficiently worrying about how this efficiency is capitalized, and whether it ensures an overall prosperity, or if it represents the basis of social justice and the fundamental condition of individual freedom.

Ignoring the social dimension of economic development has led to the violent divorce between the ideals of democratic societies based on market economy and the results of developing this economy, thus leading to greater social inequalities, to the concentration of economic and political power and to restricting individual freedom.

Keynes considered, indeed, that the main objective of economic policy must be to fully employ the available work, but it reported this objective to the ideal goal of full affirmation of human personality. A useful and effective work, which allows individuals to give full measure of his skill and creativity, is meant not only to insure his livelihood, but also to help affirm itself creatively, this affirmation being achieved in close unity with the entire community welfare.

Therefore, reducing unemployment to the lowest level is meant not only to provide decent livelihoods for all able bodied members of society, but also to provide the recovery of their creative potential. If the purpose of Keynes's objective is limited to ensuring livelihoods, the problem can be considered as completed and if the unemployment rate is high, the unemployed do not suffer because they are the beneficiaries of unemployment compensations. Such a formula, although necessary in the context in which unemployment cannot be reduced, is not desirable. Because, just as many important economists will notice, the entire social security policy which includes the unemployment aids, contribute to increasing the *transfer payments*, payments made from the state budget, but which do not contribute to the GDP growth. This continuous increase in the volume of transfer payments to the state budget structure is in itself a factor to reduce the efficiency of budgetary expenditures and increase awareness on the fragile financial structures. Disregarding the fact that transfer payments will have a higher influence on the public debt growth. However, for inflation, contracting a large government debt represents a ticking bomb, the inflationary consequences unfolding only at the time when government securities are redeemed, during the boom.

Government intervention in economy is nowadays a visible objective requirement, but this action itself must be made based on the principles of organization and functioning of a fair democratic society. If that particular intervention will be made in favor of certain influence groups that manage to have an even higher influence on policy makers, a situation common in all Western societies in the recent decades of the twentieth century, then the state will also become the prisoner of these interest groups, mainly acting on their behalf. Thus, this inadmissible twinning between economic power and political power became possible, the first financing the election campaigns of those who will hold political office, while the latter will subordinate the economic policy of the state to serving the preferred interests of those that have funded their political campaign.

#### 4. Conclusions

Most economic theories, with influence on European politics, which have brought harsh criticism on the Keynesian economic model following the inflation of the 1970's, ruling for promoting without any restraints the market fundamentalism have identified contradictory elements of market economy, presenting it as a coherent and capable of self-regulation. The diagnosis of different stages of its evolution is inevitably wrong, so that economic policy decisions will be insufficiently adequate and not always effective enough. The main cause of instability in the capitalist economy after 1960 was due to the so-called limits of Keynesian theory, but that was due to the continual weakening of the financial system, which was started in the mid 60s. As one can see in the current presentation, the fragile financial structures and their deepening instability were based on the financial regulations. As for the attitude of growing tolerance for more and more violations of the existing regulations, this in itself was due to the unfounded belief that a strong economy excludes the possibility of serious disruption when they violate restrictions that were introduced during a time of crisis. On the other hand, during this period of time specialists began to reconsider the interpretation according to which the ability of the market economy is self-limited, a central point in Keynesian theory and which is to justify the need for state intervention in economic life, including its quality of judge on the competitive market. As such, the ideas according to which a fully stabilized market must be allowed to move freely will become increasingly influential resulting in the only such full exploitation of the self-regulated potential. This explains, in our opinion, the reduction of the activity of monitoring the compliance with the existing regulations in finance, the beginning of the manifestation of factors with strong inflationary effects, an overall process generated by the obvious contempt of Keynes's recommendations.

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# The Necessity of Nuclear Energy Development in the Context of Global Economy

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## Abstract

*Energy is one of the most important elements of the global economy, being in the same time the basic unit of world economic development as a whole. In the energy mix, nuclear energy, more than any other type of energy, generated and will always generate a series of controversies.*

*The energy system extends its applicability in many areas and, wherever is situated the obtaining of the finished product, it has direct consequences worldwide. Due to these considerations, in this field it is not possible a unilateral view. The division of energy in subdomains is difficult to do because of their interconnections, each element having a specific influence on the others.*

*Although the notion of sustainable development is manifested increasingly stronger, economic issues involved in energy processes cause most countries to implement energy policies in such a way as to not sacrifice the balance against any of these items. The practice of many countries shows that every decision has an economic foundation that is never unheeded.*

**Key Words:** energy, nuclear, economic development

**JEL Classification:** Q41, Q43, Q47

## 1. Introduction

Energy has always been a major factor in global politics, an element of paramount importance and a component that represents a major cost in the context of economic and social development worldwide, thus resulting a high degree of concern for major international forums in this domain of activity. The limitation of resources has always been a debate problem for economists. This is considered to be the

starting point of all the problems in this field: energetical resources are limited. That is why the objective of production, supply and energy consumption in a most efficient way is essential.

Economic and social development worldwide is characterized by an increase in energy consumption. Due to the possibility of being easily transported over long distances, but having also the advantage of the multitude of forms that it can take, electricity has had an important role in human progress. In terms of historical time which marked the beginning of electricity was on September 13, 1882, when Thomas Edison switched on in New York, the first power plant, on which there were connected a few dozen of subscribers. [1]

## 2. Economic implications of using different types of energy resources in the European Union

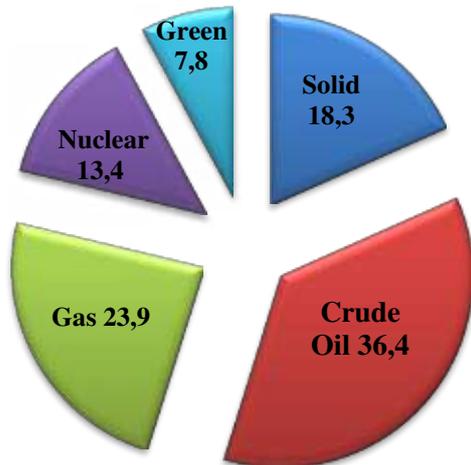
European Union countries use a diversified energy mix based on a range of reasons, most important of which are internal resources, the price of imported resources and the needs of the population. In terms of energy dependence, European Union was dependent, in 2011, at the rate of 59% of external energy.

The most pressing problem for the European Union on this matter is the security of supplying resources of energy, given its dependence on a single exporting producer, namely Russia. The economic and financial crisis has added more and new pressures, their results being materialized in decreasing the provisions for critical energy projects or discouraging results obtained in operational internal market for energy, carbon reduction, energy saving and efficiency.

Underinvestment in networks, capacity of production, transport and clean technologies can lead to a shortage of supplies of hydrocarbons, which would determine easily

the energy prices to rise and slows down the rhythm of recovery of communitarian economy. These issues demonstrate the economic importance of the energy system.

Figure 1: Type of Fuel Used in the European Union in Order to Produce Electric Energy (2010)



Source: <http://www.hidroelectrica.ro>.

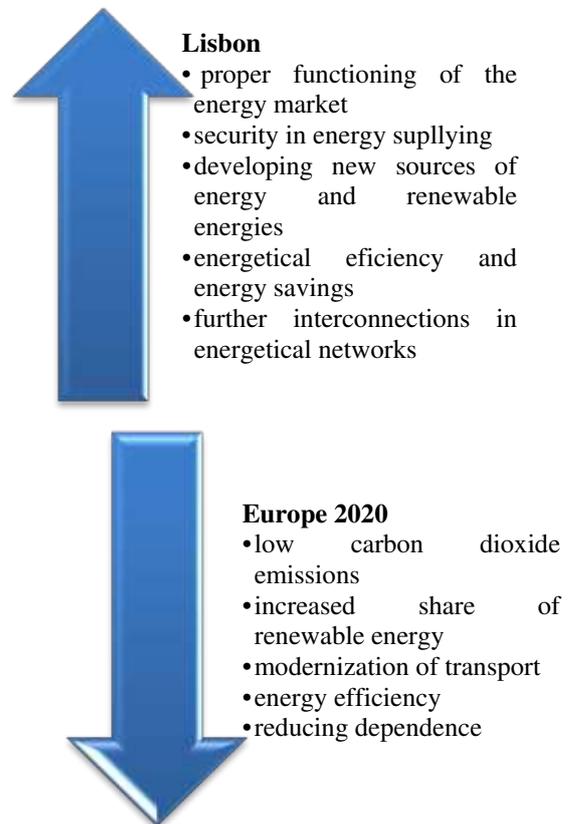
Except for Denmark, all other European countries are dependent on imported hydrocarbons. Dependence on energy imports is increasing both in most member states and at the level of European Union. Based on different scenarios emitted by the officials in Brussels, EU-27 energy dependence will increase from 56% in 2010 to 64% in 2020 and 67% in 2030. Energy dependence is very important in terms of community safety, but especially in terms of costs involved, the great owners of resources having the freedom of delivering their products according to their own wishes. [2]

From a legal perspective, at the communitarian level, there have been outlined two documents that contain elements of European energy strategy: the Lisbon Treaty and Europe 2020. The most important energy provisions can be summarized by the 2020 energy targets, known as "20-20-20 targets", which refer to the following:

- reducing greenhouse gas emissions in the EU by at least 20% from 1990;
- 20% increase in the share of renewable energy in overall EU energy consumption;
- 20% reduction in primary energy consumption, to be achieved through

energy efficiency, to the extent that consumption would have reached without such measures. [3]

Figure 2: Energy Stipulations in Lisbon Treaty and in Europe 2020 Strategy



Sources: Lisbon Treaty, Lisbon, 13th of December 2007, [www.consilium.europa.eu/uedocs/cmsUpload/20-cg14.ro07.doc](http://www.consilium.europa.eu/uedocs/cmsUpload/20-cg14.ro07.doc); European Commission, Europe 2020 Strategy, Brussels, 3rd of march 2010, [http://ec.europa.eu/eu2020/pdf/1\\_RO\\_ACT\\_part1\\_v1.pdf](http://ec.europa.eu/eu2020/pdf/1_RO_ACT_part1_v1.pdf).

All legislative measures taken have two major final goals: reducing pollution and reducing long term costs. Although these measures do not provide precise economical reasons, they imply different economic sides in all the points of application. Thus, the major costs generated by the measures are show in medium term, by the level of investments required and in long term, by the level of results.

### 3. Nuclear energy in the new European legislative context

European legislation on energy focuses on reducing pollution, increased use of

renewable energy and energy efficiency improvements. From these points of view, the usage of nuclear energy is marked by a number of advantages and disadvantages.

Advantages include low running costs and that is less polluting. Of disadvantages, the most important is the degree of danger the population and environment are exposed to. This is why, at the level of EU, while nuclear capacity decreased by 6000 MW during 2000-2011, the capacity of plants based on natural gas and wind power increased by 15000MW.

Regarding the degree of danger on which the population and the environment are exposed to, it is a true fact that nuclear energy is the most dangerous type among all. Thus, considering the situation manifested worldwide, 16% of the electric energy is produced in nuclear power plants, and considering the situation in the EU, 35%. The evolution of the use of nuclear fuel had several major steps at the level of EU:

- Austria - 1978 – the stopping point in constructing nuclear power plants was established by referendum;
- Italy - 1987 – the nuclear energetic sector was closed up.
- Belgium – limited the life period of reactors to 40 years and forbade the construction of new ones;
- Germany – has 17 production units; limited the duration of life to 32 years and has the intention to relinquish until 2020 to the usage of civil nuclear power;
- Spain – has 8 nuclear reactors, being forbidden the construction of new ones;
- Denmark, Greece, Portugal, Ireland, the Baltic States, Poland, Cyprus, Malta, Luxembourg – had never used nuclear energy nor have this intention.[4]

Therefore, most Western European states agree not to use nuclear energy in their territories. However, for states with developing economies, supporting energy production using nuclear fuel is an option worthy of being taken into account. This rule seems to apply to the European Union, the only exception being France, European leader in energy use with 58 nuclear reactors, which supports nuclear power in its territory due to shortages of fossil fuels.

According to statistical data, in early 2011, in Europe there were 195 nuclear power reactors and 9 units under construction or

scheduled to be built. Non-EU countries who have nuclear power units are Switzerland, Ukraine and Russia. Globally, the biggest energy consumers are China and the United States, being in the same time the greatest supporters of nuclear energy. U.S. has 104 nuclear reactors providing 20% of the country's energy needs, being the largest supplier of nuclear power in the world. China is the largest developer of nuclear construction in the world. Consequently, the largest energy consumers worldwide are the biggest supporters of nuclear energy.

#### 4. The costs of nuclear energy

Energy obtained by nuclear fuels is controversial both in terms of ecological conditions, but also economically.

*Table 1: The Average Cost of Energy, Depending on the Type of Fuel Used (2010, cents / kWh)*

Country	Nuclear	Coal	Gas	Wind
<b>Japan</b>	5	8,8	10,5	11
<b>France</b>	5,6	10	10,5	9
<b>Germany</b>	5	7,9	8,5	10,6
<b>Romania</b>	5	6	8	17

*Source: International Energy Agency, Nuclear Energy Agency, OECD - Projected Costs of Generating Electricity, 2010 Edition, disponibil la adresa <http://www.oecd-nea.org/pub/egc/docs/exec-summary-ENG.pdf>*

The final product obtained using different fuels has its lowest cost for nuclear energy. Exceptions are few in number worldwide, one of them being United States, where wind energy has the lowest cost. In calculating the cost for nuclear power, experts in the field of sustainable development raise the question of so-called "hidden costs", pretending these costs usually are not counted. These include the following:

- The amounts necessary to fund decommissioning; few nuclear plants have been decommissioned, but more and more plants will reach the end of productive life in the coming years and will be closed. Experience has shown that this procedure is extremely expensive.

For example, decommissioning Yankee Rowe in the United States was expected to cost 120 million dollars, but actually cost about 450 million.

- In case of accident, many states do not have a special fund created for this purpose;
- The costs involved in the construction of a nuclear waste repository, which exists nowhere else in the world, the first such deposit being scheduled for the year 2055.[5]

Consequently, experts sustain the idea that nuclear energy costs are enormous, although not shown in the price of electricity, because many costs are financed by society as government subsidies. If the nuclear industry should bear only the costs of decommissioning, waste management, risk insurance etc., it would be a very expensive energy source.

Another important aspect is that nuclear costs increase while green energy costs decrease due to the numerous improvements in technologies.[6] Uneven global development determines nuclear energy to be a reliable option for the economical developing states such as Romania, green energy development level not reaching a high enough lever in order to be able to meet the needs of consumption.

## 5. Conclusions

Nuclear energy is an economic reality success, globally recognized as such, confirmed by data, level of development and social benefits. The main advantage of nuclear energy is efficiency - constantly energy supply at a low price. The two greatest economical powers of the world, China and U.S.A, also sustain nuclear energy, even if the degree of risk-taking of owning nuclear reactors is high.

Another value of nuclear power is the ability to transform communities, to provide opportunities for urban development and public access to many facilities. These opportunities result not only from regular payment of taxes and other direct obligations of the local budget, but with attention focused on the direct benefits of the people in communities that host nuclear power plants.

No other industry, regardless of social impact, during and after the investment, does

not offer so much to the communities in which they develop. Nuclear benefits come in various forms: jobs decently paid, collective and individual development, increased local budgets, heating at an unbeatable price, infrastructure.

Although the risks involved in construction and operation of such plants are large and generally recognized, not only the existence of legislation in the field and strict adherence to these regulations, but also a proper assessment risks at regular intervals make taking a compromise to be a reliable option.

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## Theories of Consumption – The Persistent Influence of Past Consumption on Present Consumption Patterns

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### Abstract

*Ever since it has been proclaimed “as the sole end and purpose of all production” consumption has been performing an essential role in economic theory. Although consumption was approached by economists prior to Keynes, it is only in his work that consumption gained its due importance, starting with the famous formulation of the psychological law. Subsequently, several other theories brought consumption to the centre of the economic research the most widely acknowledged being the contributions brought by James Duesenberry, Milton Friedman, Franco Modigliani and Richard Brumberg. The aim of this paper is to analyse some of the most important theories of consumption from the perspective of the past influences on current consumption patterns. The notion is certainly easy to assimilate at an intuitive level, it is present in the economic theory, and may be rather conveniently applied to consumption.*

**Keywords:** consumption theory, consumption patterns, past consumption, persistent influence

**J.E.L. Classification:** B22, E21

### 1. Introduction

The assumption that past influences continue to impact current economic conditions is certainly not new, it has made its way to the economic theory ever since Marshall’s *Principles of Economics* [1]. Moreover, in the case of consumption, it is only natural to assume that present consumption is subject to both the influence of present factors, as well as to the influence of past factors. The aim of the paper is therefore to briefly revisit the most important consumption theories and point out the

acknowledgement of the past factors’ influence on present consumption patterns.

### 2. Main Theories of Consumption and the Past Revisited

Consumption is one of the main determinants of the aggregate demand of an economy and plays an important part in the economic theory ever since has been proclaimed by Adam Smith as “the sole end and purpose of all production” [2].

But although consumption was certainly present in the works of Jean Baptiste Say, Thomas Malthus and Alfred Marshall it was not until the development of the Keynesian system that it claimed its place in the theory of the whole economic process [3].

The modern consumption theory begins therefore with Keynes (1936) formulation of the psychological law on which consumption behaviour is founded in the *General Theory of Employment, Interest, and Money*:

“The fundamental psychological law, upon which we are entitled to depend with great confidence both a priori from our knowledge of human nature and from the detailed facts of experience, is that men are disposed, as a rule and on the average, to increase their consumption as their income increases, but not by as much as the increase in their income” [4].

Keynes suggested a function of consumption after conducting a detailed analysis of potential determinants impacting individual consumption patterns. The function is also known as the absolute income hypothesis and in its most simple form may be written as follows:  $C_t = c Y + a$ , where  $C_t$  is the total consumption,  $c$  is the marginal propensity to consume,  $Y$  is the disposable income, and  $a$  is the autonomous consumption (assumed to be positive).

Taken into account the enunciated fundamental psychological law the

Keynesian view may be summarized as follows: consumption expenditure is a function of disposable income; the marginal propensity to save is positive and lower than 1; when income increases, both the marginal propensity to save and the average propensity to save decline; and the marginal propensity to save is lower than the average propensity.

Although the theory of consumption proposed by Keynes was rapidly embraced, it was soon contested by Kuznets (1946) who used U.S. statistic data for the period between 1869 and 1938 and revealed that the average propensity to consume remained constant for the tested period [5].

This empirical puzzle led not only to a revision of the Keynesian hypotheses but also to the genesis of several new hypotheses, the research conducted by economists leading to reformulations of the consumption to include new facets in order to ensure a better forecasting of consumption behaviour.

One of these newly emerged hypotheses is that of James Duesenberry (1949), the so-called relative income hypothesis, considered to be a promising theory which subsequently lost its amenity. His relative income theory of consumption states that consumption patterns are motivated by the eagerness to “keep up with the Joneses”, in other words Duesenberry introduces the idea that consumption is based on a demonstration or imitation effect. Goods are therefore consumed not only due to their capacity to satisfy certain needs, but also because are looked upon as symbols:

“The strength of any individual’s desire to increase his consumption expenditure is a function of the ratio of his expenditure to some weighted average of the expenditures of others with whom he comes into contact” [6].

Another important pillar of Duesenberry’s work is the conclusion that in the event of household income decrease, the savings are to be diminished in order to preserve the living standard. Or in other words, households are assumed to be reluctant to reduce consumption when confronted with falling income, with their present consumption depending on the past peak level of income. This is the so-called ratchet effect which prevents the consumption level to drop significantly when the income decreases, and states the dependence of

consumption on the highest level of income previously reached.

Brown (1952) gives an even greater importance to the influence of the past on present consumption. Based on previous research conducted by James Duesenberry and Franco Modigliani, he explains that due to some inertia in their actions consumers fail to react promptly to income changes [7]. The tests conducted by Brown revealed that in both cases of increase and decrease of income, consumer expenditure lagged behind inducing the idea that consumer demand was related to income or other cyclical variable. Brown uses the term “hysteresis”, asserting that “the habits, customs, standards and levels associated with real consumption previously enjoyed become “impressed” on the human physiological and psychological systems and this produces an inertia or “hysteresis” in consumer behaviour” [7]. The term “hysteresis” itself is used by economists to describe the persistent influence of past economic events and was popularized by Nicholas Georgescu-Roegen who presented an application to consumer behaviour in his work, *The Entropy Law and the Economic Process*, of 1971, acknowledging that physical behaviour sometimes depends on past experience [8]. In his paper, Brown replaces in the consumption function the level of past disposable income present as variable in the work of Duesenberry and Modigliani with the previous real consumption actually experienced [7].

In 1957, Milton Friedman introduces his new function of consumption, based on the hypothesis of permanent income and not current income, as main factor impacting final consumption. Friedman considered that the main determinant factor of consumption is not regular income, but permanent income, represented by the amount which the unit could consume without decreasing its wealth [9]. He asserts that people adapt consumption to their expected long-term or permanent income and fluctuations in income level impact consumption only if were anticipated. The ratio of current income not anticipated, called transitory income, is destined for saving. His hypothesis is based on the perception that individuals would wish to smooth consumption and avoid its fluctuation caused by fluctuations in income. He

therefore formulated the hypothesis that individuals' consumption behaviour is based on a longer term view of an income measure, a lifetime view or at least a view over a reasonable time horizon. The hypothesis encloses the idea that individuals consume only a fraction of their permanent income in each period and therefore the average propensity to consume would be equal to the marginal propensity to consume.

At the beginning of the 1950's, Franco Modigliani and Richard Brumberg elaborated the life cycle hypothesis, according to which consumption in a certain period depends only partially on the current income, but on a life time income expectations. The hypothesis brings to light the idea that income tends to fluctuate during an individual's life time and the individual's personal saving behaviour is determined therefore by the phases of the life cycle. At the beginning of the active life saving is negative, subsequently during the active life the savings become positive while the individuals save up to retirement, and following retirement the individuals start dissaving.

The life cycle framework is rather generous and encompasses many models going beyond the rather simple representation that agents make sequential decisions to achieve a coherent goal by doing the best they can with the currently available information. This enlarged framework includes the “buffer stock” model developed by Deaton which assumes that agents cannot borrow and that they are impatient, and can include habits, imperfections in capital markets, possible disagreements between the members of the family about the amount to be saved, limited computational powers, at the same time ruling out a series of psychological and behavioural explanations [10].

Starting from the life cycle permanent income hypothesis yet another theory was developed by Hall (1978) [11] and entitled rational expectations hypothesis, in which there are added variables to the consumption function based on past values. The test in Hall's model adds therefore a series of explicative variables to the consumption function related to its past value. His conclusion shows however that basically no other variable besides present consumption is useful in predicting future consumption.

### 3. Conclusions

The idea that the ascendant of past factors continues to influence economic equilibria, their impact leaving noticeable traces has been present in the economic theory since the work of Marshall at end of the 19<sup>th</sup> century.

It is a notion easy to assimilate related to economic phenomena and consumption does not make an exception. The acknowledgement of the notion at an intuitive level has been doubled by the empirical evidence that current consumption does indeed depend on past influence factors. Starting from this evidence, the paper briefly reviewed the most significant theories of consumption emphasising those particular elements of the theories that are related to the persistent influences of past factors on present consumption patterns.

### 4. Acknowledgement

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## The Role and Powers of Competition

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### Abstract

*The Competition Law empowers the Competition Council with instruments to achieve the ultimate goal of protecting and stimulating competition to ensure a normal competitive environment so as to promote consumer interests. Competition Council examines the anticompetitive impact that it has or might have the notified merger, unless there are serious doubts on the compatibility with a normal competitive environment and will eventually authorize the eventual merger by means of a decision of non-objection, in the sense that the authorization is applied without any expressed conditions.*

**Key words:** council, law, competition, market, powers.

**Clasificare J.E.L.:** C70 – General

Competition Council was established by the Competition Law no.21/1996, according to ulterior changes and annexes as independent competition authority. As regards the corresponding organization, the Competition Council was offered independence in point of the status of decision-making in the respective field. Thus, The Competition Council, as an autonomous administrative body, operates, deliberates and makes decisions in plenary and committee. Plenary decisions are taken by majority vote, provided that each member of the Competition Council shall have one vote and in case of a tie, the solution of the President prevails.

The Competition Council consists of seven members: a president, two vice presidents and four competition councilors. Competition Council members are appointed by the President of Romania, by decree at the Government proposal; the length of mandate is an interval of about five years. The above mentioned members have at their disposal a

number of two mandates. As independent public competition institution, includes specialized structures that are involved in investigations on competition and state aid, analysis of notifications in cases of economic mergers and state aid covered by the law, research and market surveillance, inventory, reporting and monitoring of state aid, European integration area and international relations.

The role of independent administrative authority that is imposed by the Competition Council has two dimensions, as follows: a preventive one, monitoring the market and surveillance of economic agents conduct, so that by its corresponding intervention to avoid a significant distortion of market competition and involvement in the legislative process, the outcome being the elimination of anticompetitive disposals, while the other one, the corrective dimension implies the establishment and maintaining of a normal competitive environment.

The Competition Law empowers the Competition Council with instruments to achieve the ultimate goal of protecting and stimulating competition to ensure a normal competitive environment so as to promote consumer interests. Experience has demonstrated that a functioning market economy based on competitive mechanisms is the best method towards the wealth of consumers along with all the drawbacks that might appear.

In a competitive market the law of supply and demand works effectively, and the buyer is offered the possibility to choose products with lower prices and higher quality. It is known that a normal competitive environment provides both consumer satisfaction and an efficient allocation of resources in the economy. In order to maintain these mechanisms functioning certain specific rules and institutions are necessary to ensure permanent compliance so as to intervene when particular acts or facts

might result in elimination or significant distortion of the competition. This role of "guardian of the market economy" corresponds to the Competition Council.

It should be emphasized that the Council's role is to protect competition, while the entry on the market is free, not restricted by any artificial barriers and inefficient operators out of the market, through bankruptcy. Operators must "defend themselves" by increasing the efficiency and respecting the rules of the game.

The powers of competition and state aid are mainly the following:

- regulatory;
- investigation;
- decision;
- sanction;
- the formulation of opinions, recommendations and proposals.

The main duties of the Competition Council according to the Competition Act, are:

1. Investigates the application of the law in point of to anticompetitive practices or economic mergers, on its own initiative or following a complaint, intimation or notification.

Complaints and intimation are an essential source of information for detecting infringements of competition rules. When the information available is not sufficient so as to justify an investigation, the Competition Council issues a decision of rejecting and the decision shall be preceded by the hearing of the applicant's arguments. Notification represents the adequate instrument by means of which the economic agents transmit, in particular cases, necessary information to the Competition Council so as the law to be applied, in respect of accords and mergers that regard the agreements they intend to conclude or have already completed.

2. Makes decisions for breaches of law as outcome of the investigations that are executed by order of the President of the Competition Council by the authorized competition inspectors;

3. Certifies, at the request of the economic agents or associations of economic agents, on the basis of investigations and existing evidence that there are no grounds for

intervention in an agreement, decision or concerted practice;

Before establishing an agreement, decision or concerted practice, or before assuming a position as regards the market, the involved economic agents or associations of economic agents concerned might require to the Competition Council a prior certification that no grounds is present for an intervention as regards the expected competitive conduct.

4. Makes decisions in merger cases. Competition Council examines the anticompetitive impact that it has or might have the notified merger, unless there are serious doubts on the compatibility with a normal competitive environment and will eventually authorize the eventual merger by means of a decision of non-objection, in the sense that the authorization is applied without any expressed conditions. The above mentioned Council might grant, on demand, an exception to the rule regarding the interdiction of the implementation of an economic concentration activity up to the moment when the Council issues a decision.

5. Ensures the effective implementation of its decisions.

6. Performs on its own initiative, investigations in respect of a better understanding of the market.

7. Refers to the Government about the existence of a monopoly case or other situations that are subject to the law and propose the necessary measures to remedy the faults.

8. Refers to the courts in point of cases they are competent on.

9. Refers to the Government as regards the interference of central and local public administration bodies as regards the application of competition Law, namely the respective actions of central and local administration bodies, the object of which might result in the prevention, restriction or distortion of competition, in particular the adoption of decisions that limits the freedom of trade and economic autonomy, or establish discriminatory conditions for the activity of economic agents.

10. Issues assent (required) in point of draft legislation that might have anticompetitive impact and propose amendments with similar outcome. In this way the control of correlating the provisions of other laws with those of the Competition

Act is ensured, thus concurring with the request of the European Council to provide the Competition Council power to oppose proposals for regulatory affairs and state aid in situations in which a breach of rules competition appears.

11. Makes recommendations to the Government and local government bodies to adopt measures to facilitate market development and competition.

12. Proposes Government and public administration bodies disciplinary action against the subordinating staff, if it does not comply with mandatory provisions of the Competition Council.

13. Adopt regulations and guidelines for the application of competition law in respect of: authorization of economic mergers, exemption of certain categories of agreements, decisions of associations of economic agents or concerted practices, exemption regime, report and apply sanctions that are provided by law.

14. Performs studies and prepares reports on its activity and provide the Government, the public and specialized international organizations information on this activity.

15. Represents Romania and promotes the exchange of information and experience in dealing with specialized international organizations and institutions and cooperates with foreign competition authorities and community.

The Competition Council elaborates and communicates the corresponding views on any aspect of competition policy, at the request of one of the following: President of Romania;

✓ parliamentary committees, senators and deputies;

✓ local and central public administration bodies;

✓ professional, employers and Union organizations, including among them the Chamber of Commerce and Industry of Romania;

✓ organizations in point of the protection of consumers;

✓ Courts and prosecutors. The Competition Council draws up an annual report on its activities, the competition and the manner in which economic agents and public authorities comply with competition rules. The report is adopted in the Plenary Council and is, eventually, made public.

The area of competence as regards the Competition Council includes the authorization in terms of effects on competition of any state aid any form it might take and regardless the beneficiary. Terms of the authorization, approval, inventory, monitoring and reporting of state aid are governed by Law no.143/1999, as amended and supplemented (hereinafter *State Aid Law*).

The powers of the Competition Council as regards the application of state aid law are mainly the following:

-Make decisions following the examination of notification as regards the intention to grant new aid or modify an existing state aid;

After analyzing the received notifications, the Competition Council might decide: as the notified measure should not constitute state aid;

- to authorize state aid, unless there are doubts about its compatibility with state aid Law;

- to authorize state aid, thus imposing by its decision conditions or obligations to ensure that it does not distort the normal competitive environment and does not affect the proper application of international agreements to which Romania is a party;

- to begin an investigation in case that the notified measure raises doubts about the compatibility with State aid Law;

- prohibit State aid if it distorts the competitive environment and affect the proper application of international agreements to which Romania is a party;

When the Competition Council makes a decision to prohibit a State aid, and it is, however, granted, the cancellation and recuperation of the aid or reimbursement by the beneficiary is required. Competition Council might request the Court of Appeal, the jurisdiction of which is in the corresponding territorial headquarters of the provider or the beneficiary of state aid, to cancel the administrative act by which the aid and, consequently, the recuperation, reimbursement or adjournment of its payment.

The interval the Competition Council is entitled to request the recuperation of State aid is of about 10 years, thus being taken over the limitation that is regulated at Community level in this field.

- monitor actual State aid, the Present State Aid represents an individual aid or an aid scheme which meets one of the following conditions: to function before the law takes effect, was authorized by the Competition Council or the one for which the Competition Council did not take legally one of the decisions required by law. If after the supervision of existing State aid is found that such aid distorts the competitive environment or affects trade between Romania and EU Member States, the Competition Council requests aid provider to take appropriate measures to eliminate the corresponding incompatibility.

Competition Council's request might include a recommendation to cancel or amend the existing aid. If measures are not taken adequately by the provider, the Competition Council might decide to stop the existing state aid or impose certain conditions and obligations to ensure that the aid is compatible with state aid law.

-observes effective enforcement of the corresponding decisions;

- notices the issuing authority of a normative act that establishes non-notified State aid measures or prohibited by a decision of the Competition Council and, simultaneously, informs supplier and recipient of state aid as regards the notification that is sent to the issuing authority.

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## Approaches of the Entrepreneurship Development in South-East and South-West Oltenia Regions

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### Abstract

*The entrepreneurship is the engine of the private development in any market economy. Human initiative and creativity haven't found a more favourable place of development than within the private sector. The study presented here is part of a complex research that was initiated by the managerial team from the project called “Be a manager for your business!”, project developed through the European Social Fund, Sectorial Operational Programme Human Resources Development 2007-2013.*

*Prior axis: 3 – The growth of employees' and enterprises' adaptability.*

*Major field of intervention: 3.1 – Promoting the entrepreneurial culture  
ID project POSDRU/92/3.1./S/49297*

*The entrepreneurial activities can have different shapes, begging with individual projects of a natural and legal person and finishing with creating big enterprises at national and international level. The present study aims to realise a parallel between the entrepreneurial development in the two regions South-East and South-West Oltenia.*

**Key words:** counties, entrepreneurship, private sector, local activities, size classes

**J.E.L. classification:** L52

### 1. Introduction

Knight F. H. (1967) [4] and Drucker P. (1970) [2],[3] defined the entrepreneurship as activity of some persons who are willing to

dedicate their carrier, activity and the funds they dispose in order to transpose into practice a new idea. Both theoreticians and practitioners as well as decision makers give a primary importance to entrepreneurship, stimulating the entrepreneurs to introduce new products, processes and organisational forms[6]. As the factor globalisation influences more powerfully the world's economy and the technological process, generating even bigger uncertainties in the economy and in the society, the entrepreneurship's dynamism is considered as a factor able to contribute to the strengthening of the new economy based on knowledge, to resolve environmental, economic and social challenges. More and more, the specialists consider that entrepreneurship and the innovation represent the keystone of the national economy's competitiveness[1],[5]. Politics within entrepreneurship are more and more tied up to the new ones, the characteristics and the common particularities of the two types of politics being concentrated on creating some goods, processes and new services under a mutual improvement.

Currently in Romania, the economic development trend is based on extending the services and diminishing the industrial activities. In our study, we concentrated on the following indicators:

- number of local unities from: industry, constructions and services;
- active local unities on size classes;
- active local unities on counties.

The role of the analysis of these indicators is to compare the development degree of the

private sector (on these branches taken into consideration), in the two regions South-East and South-West Oltenia.

## 2. Materials and methods

In order to realise the study we boned up on the private sector from the two regions South-East and South-West Oltenia. In that direction, we studied: The statistical Yearbook 2010, Statistical bulletins, we consulted documents from the Statistical Departments.

The methods used were those specific to statistical research: observation, grouping, processing, presentation and analysis of data. Also, we modified the questionnaires that were given to the entrepreneurs who registered in the project “Be a manager for your business!”

## 3. Results and discussions

**South-East** is a region of development of Romania, created in 1998, situated in the south-east part of Romania, covering 35.762 km<sup>2</sup> or 15 % of the total surface of the country; the region is the second in size from all 8 in Romania. In 2004, the region had a population of 2.850.318 inhabitants, representing 13,1 % from the country’s population; the density of 79,7 inhabitants/km<sup>2</sup> is under the average per country (90,91 inhabitants/km<sup>2</sup>), the biggest population density being in Galați county (139,5 inhabitants/km<sup>2</sup>), dominated by the industrial and commercial centre with the same name and the smallest, in Tulcea county (29,9 inhabitants/km<sup>2</sup>), where the natural and economic conditions are less favourable (figure 1).

Figure 1 South-East Region



Source: <http://ro.wikipedia.org>

Forced industrialisation after the war led to the population concentration in towns like Galați, Brăila and Constanța. The biggest town of the region is Constanța (309.965 inhabitants), followed by Galați and Brăila (over 200.000 inhabitants), Buzău, and Focșani (over 100.000 inhabitants), as it can be seen in table 1.

Table 1 Counties from South-East Region

County	Population	Urban	Rural
Brăila	365.628	237.922	127.706
Buzău	488.763	202.090	286.673
Constanța	716.576	506.852	209.724
Galați	617.979	350.759	267.220
Tulcea	253.383	124.563	128.820
Vrancea	392.619	148.247	244.372

Source: <http://ro.wikipedia.org>

**South-West Oltenia** is a region of development of Romania, whose administrative limits coincide a lot with the limits of historical Oltenia. The region encompasses five counties: Dolj, Gorj, Mehedinți, Olt and Vâlcea. It has a surface of 29.212 km<sup>2</sup> and a population of 2.330.792 inhabitants, figure 2.

Figure 2 South-West Oltenia Region



Source: <http://ro.wikipedia.org>

The most important towns are the county seats: Craiova (300.182 inhabitants), Râmnicu-Vâlcea (111.701 inhabitants), Drobeta Turnu-Severin (109.444 inhabitants), Târgu Jiu (96.318 inhabitants) and Slatina (80.282 inhabitants). The most important industrial centre is Craiova, followed by the other county seats.

In the paper, we studied:

1. Organising small and medium enterprises on counties and on size classes, depending on the main branches: industry, constructions and services, in the both regions South-East and South-West;

2. Organising the enterprises from the industry sector on counties and depending on size class, from both regions;

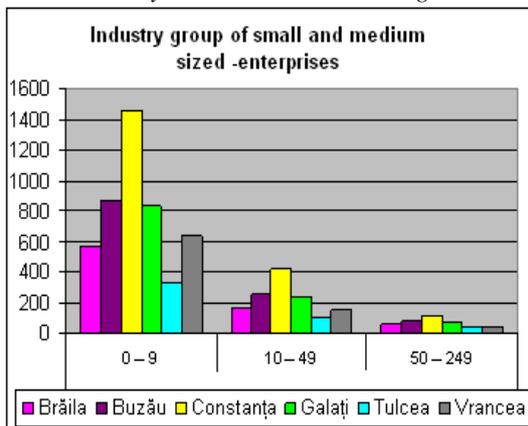
3. Organising the enterprises from constructions sector on counties and depending on size class, from both regions;

4. Organising enterprises from services sector on counties and depending on size class, from both regions;

5. Comparing the level of the indicators studied from South-East and South-West Oltenia regions.

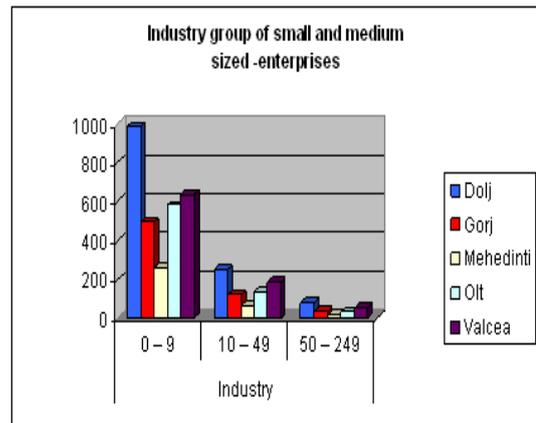
Trying the current tendency of diminishing the industrial activities, big consumers of natural and material resources, in all counties of the south-east region, we can observe the reduction of their weight on size class 50-249, under 100 as a number. They still remain dominant at size class level 0-9, over 1400 as a number and they are situated under 400 as number, on size class 10-49, figure 3.

Figure 3 Organising small and medium enterprises on branches on size classes in industry sector in South-East region



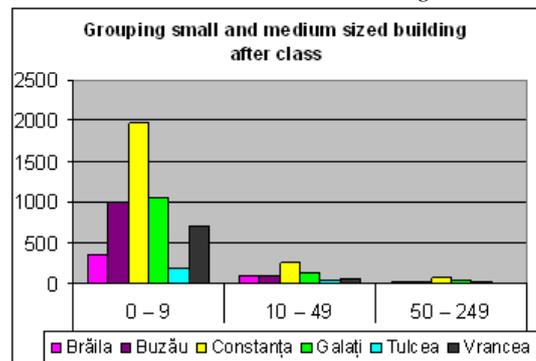
No matter the size class we are in, the dominant county is Constanța, the least represented being Tulcea and Vrancea counties.

Figure 4 Organising small and medium enterprises on branches on size classes in industry sector in South-West region



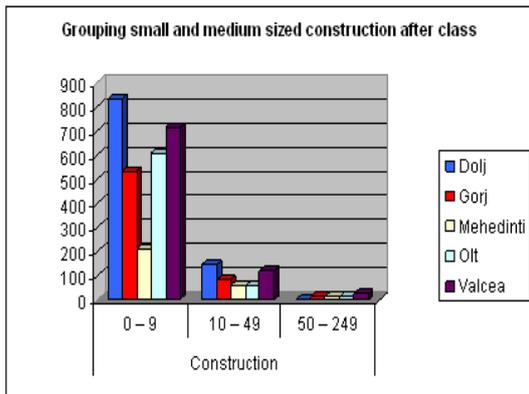
Realising the industrial sector hierarchy in south-west Oltenia region, on the first place was situated Dolj county with 1235 unities, followed by Vâlcea (821) and Olt county (710). Less developed from this point of view is Mehedinți county (320).

Figure 5 Organising small and medium enterprises on branches on size classes in constructions sector in South-East region



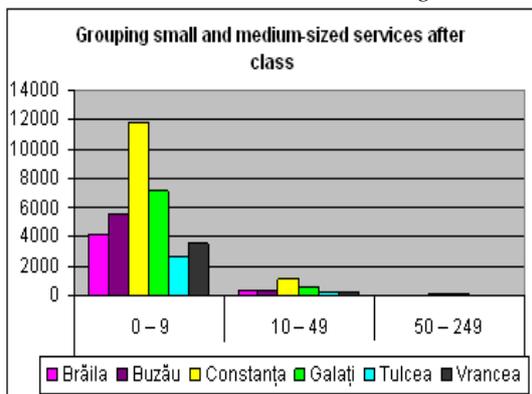
At size class 0-9 level all counties are well represented, among them Constanța county is noticed with about 2000 enterprises in constructions sector, followed by Galați and Buzău counties with 1000 enterprises each, Brăila and Vrancea with under and over 500, and Tulcea county is the last one, with less than 250 enterprises in constructions sector, aspect demonstrated above. On size class 50-249, in this sector the number of enterprises is insignificant, and on size class 10-49, the only one that is remarked is Constanța county.

Figure 6 Organising small and medium enterprises on branches on size classes in constructions sector in South-West region.



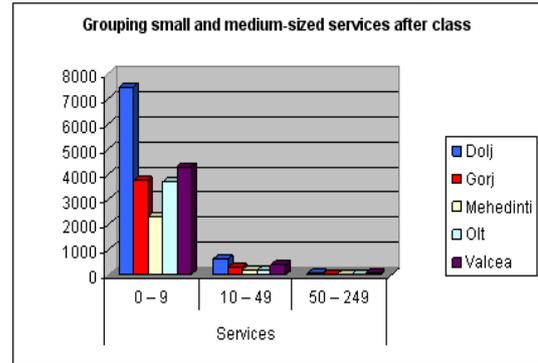
On counties, the constructions sector is representative for Dolj, Vâlcea and Olt counties. In Mehedinți county, compared to the other counties, constructions have a very low weight. As a general observation, constructions sector is dominant on the segment of the size class 0-9.

Figure 7 Organising small and medium enterprises on branches on size classes in services sector in South-East region



In services sector unlike constructions sector, we can notice its fade out towards size class 50-249, being represented the best on size class 0-9, trying again the population’s predilection towards family businesses. Among all counties, Constanța remarks itself with over 10000 enterprises in services sector, followed by Galați with more than 6000 and Buzău with about 5000. The lowest number of enterprises is in Vrancea (3000) and Tulcea with less than 2500.

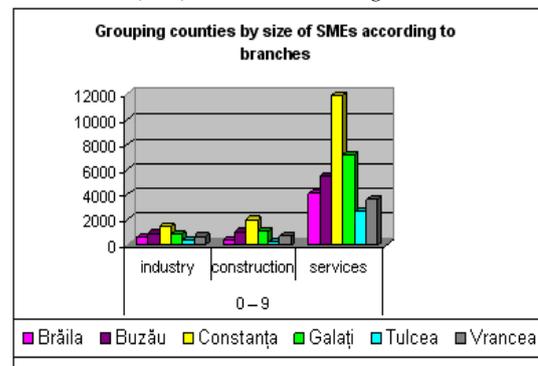
Figure 8 Organising small and medium enterprises on branches on size classes in services sector in South-East region.



Services sector is developed all over the region, Dolj county being the most remarked (8162), followed by Vâlcea (4726) and Gorj (4025). The segment where services sector is dominant in all counties is that of microenterprises. On the last place is situated again Mehedinți county (2477).

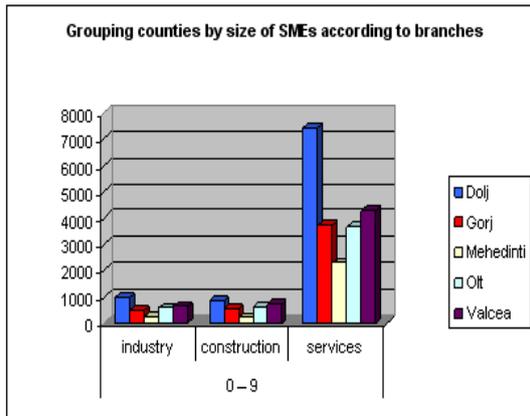
Another aspect was represented by the study of small and medium enterprises on size classes, as it can be noticed in the following figures.

Figure 9 Organising small and medium enterprises on branches depending on size class (0-9) in South-East region



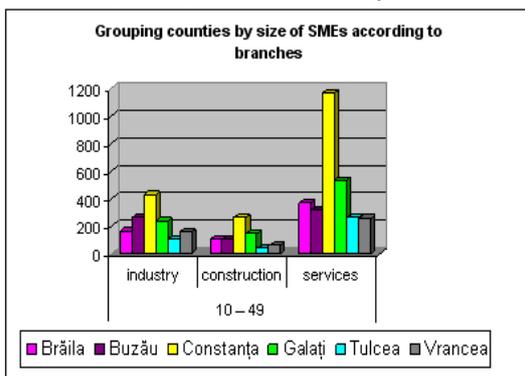
The aspects presented until now are confirmed by the repartition depending on size classes of the three branches studied, the industry being the sector that diminished and that is continuously diminishing; constructions sector is very close to industry in number and the one that is well represented- the services sector has between 2000 and over 10000 microenterprises.

Figure 10 Organising small and medium enterprises on branches depending on size class (0-9) in South-West region



Although on the segment of the size class 0-9, we can notice its development in all the three activity sectors that were analysed, the services sector has the highest weight. Among all counties, representative is Dolj county, followed closely by Vâlcea, Olt and Gorj. In small enterprises' segment, the situation is a bit different, all sectors being well represented. As in the case of microenterprises on the segment 10-49, the services sector is still dominant, as it is noticed in the following figures.

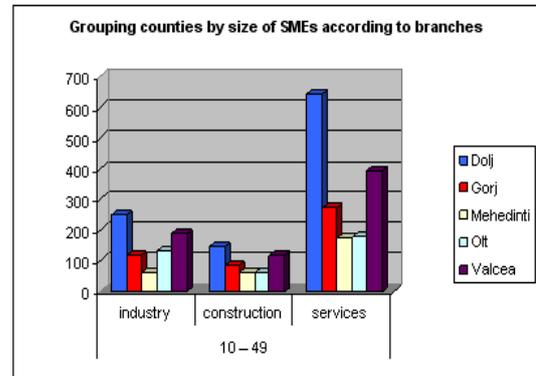
Figure 11 Organising small and medium enterprises on branches depending on size class (10-49) in South-East region



The industrial sector is better represented here than within the microenterprises, their number being between 200 and 400 small enterprises. Constructions sector is almost the same represented as in figure 5, except that Brăila and Buzău counties have almost the same number of enterprises. Very well represented is the services sector, where the hierarchy maintains the same, specifying that

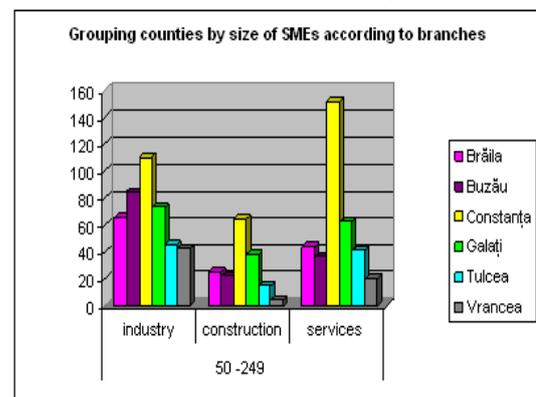
Brăila and Buzău are equal, as same as Tulcea and Vrancea.

Figure 11 Gruparea întreprinderilor mici și mijlocii pe ramuri după mărimea clasei(10-49) în regiunea Sud-Vest



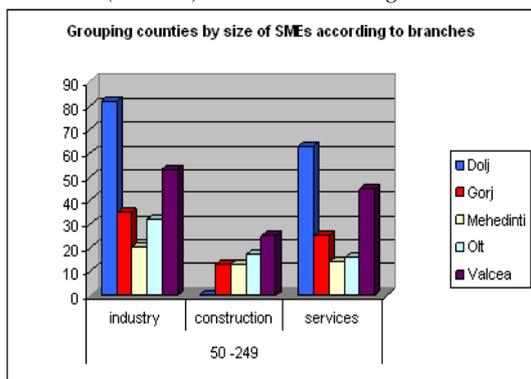
We can notice that on the segment for the size class 10-49 all the three sectors taken into account are well represented. Also, the industrial sector in small enterprises is much better represented than in microenterprises.

Figure 12 Organising small and medium enterprises on branches depending on size class (50-249) in South-east region.



Unlike size classes represented until now, where the industry is low represented by the microenterprises and by the small enterprises, which shows also the complexity of the installations, natural resources plants, materials used for work here, on the segment 50-249 we notice that the industry is very well represented in each county.

Figure 13 Organising small and medium enterprises on branches depending on size class (50-249) in South-West region



In medium enterprises, very well represented is the industrial sector. On the first place is Dolj county, followed by Vâlcea county. The services sector is also well represented in the same counties described above.

#### 4. Conclusions

The conclusions we can drag from this study are the following:

1. For microenterprises, dominant are the services that can be usually started as a family business. Once with the growth of the employees' number, their weight is reduced, ceding the place to constructions sector, and finally on size class 50-249 dominant is the industrial branch.

2. The situation is inverted where on size class 50-249 the services' presence is almost inexistent.

3. No matter the situation presented, Constanța county, beside Dolj are on the first places in all the sectors studied (industry, constructions et services).

4. The repartition on counties of the microenterprises, the small enterprises and the medium enterprises depend on the economic situation of each county, on relief, on the natural resources it disposes, on the number of the population in the area.

5. The constructions sector is well represented in all the region's counties, being so a sector that has grown a lot in the last 8 years, but which has come to a standstill once with the growth of the general crisis.

6. According to the existent tendencies at national level, those of reduction of the industrial activities, this tendency is noticed also in the south-east region, the industry

being present more in size classes 50-249, as it includes developed technology, installations and complex plants and it integrates high qualified labour force.

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# A Model of Human Capital Management in the Frame of Knowledge Assets Management

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## Abstract

*The paper aims to suggest a model of human capital management in the frame of the knowledge assets management and correlated to the organizational performance. The paper proposes to insert the system of human capital management into the knowledge management architecture. The inputs of the human capital management (education, training on the job, job experience and continual learning) are generating specific outputs (current jobs, training needs and expertise) through acquiring, sharing, creating, developing and using knowledge. These processes are specific to the knowledge assets management.*

**Key words:** human capital management, knowledge management

**J.E.L. classification:** J24, M 12

## 1. Introduction

It is well known that the most economic activities rest on knowledge, not only the present society but in all forms of human societies. In the knowledge-based economy the main resource is the knowledge are viewed as generating competitive advantage on the long run. Knowledge is embodied in technology and in people, as assets. Without people and their human capital, business and organizations cannot exist.

The strategic role of human capital management in the knowledge assets management is derived from the determinant position of the organization's human capital (knowledge, skills and abilities) to achieve business goals. People and their human capital are able to: acquire, create, share, develop and apply knowledge.

In the knowledge based organization, the policies and practices belonging to human

capital management is an intrinsic part of the knowledge assets management.

The aim of the paper is to emphasize the role of the human capital management in the framework of the knowledge assets management. A model of human capital management, inserted into the frame of the knowledge assets management is proposed and discussed.

The paper is organized as follows: section 2 presents a short literature review on theoretical references on knowledge based economy and firm, the section 3 describes the content of the content and architecture of the knowledge management, the section 4 explains the position of human capital within the knowledge assets management, the section 5 expose a model of human capital management inserted into the knowledge assets management and the last section is dedicated to conclusions.

## 2. Knowledge-based economy and firm

There is a rich literature on knowledge based economies, based on the fact that knowledge has become an important resource in today's economy. For example, World Bank's pioneering report on Knowledge-based Development [21] observes that today's most technologically advanced economies are truly knowledge based. . . "and as they generate new wealth from their innovations, they are creating millions of knowledge related jobs in an array of disciplines that have emerged overnight".

The Organisation for Economic Corporation and Development (OECD) Report [12] defines a knowledge economy as one that is "based on production, distribution and use of knowledge" and "that utilizes knowledge as a key engine of economic growth".

According to Brinkley (2006), every economy is a knowledge economy since

there can be no economic activity without knowledge.

The following key characteristics of a knowledge-based economy have been outlined in the relevant literature:

- Greater share of high tech industries and services in the market;
- Greater percentage of persons engaged in knowledge-based occupations;
- Greater information and communication technology (ICT) usage;
- Increase in percentage population which is better educated and skilled and engaged in jobs such as R&D, software development and technology-based front room and backroom jobs etc;
- Increased percentage of knowledge consumers;
- Ability to foster collaboration among various entities (universities, firms, educational institutes, R&D units) concerned with creation and use of knowledge.

The rise of the knowledge-based economy has created the knowledge-based organizations, where intellectual capital is an integral part of organizational assets and creation, development and capturing of value from knowledge and competencies became a critical issue.

By definition, human capital focuses on the individual, whereas most knowledge management work is concerned with groups, communities, and networks. Nevertheless, knowledge management builds on human capital ideas and has, as one of its tasks, to continue making the value of human capital clear to organizational leaders while developing tools and techniques for investing and reaping benefits from it. However, it is becoming more concerned with group knowledge and the processes of social capital that undergird group knowledge [6].

### **3. Knowledge management: content and architecture**

Knowledge architecture can be defined as a logically set of principles and standards which guides the engineering (high level design, detailed design, selection, construction, implementation, support, and management) of an organization's knowledge management system infrastructure [1]. Knowledge structures lead to easier navigation, organization and retrieval of

knowledge. As Plessis (2007) points out these structures should be very flexible and must be able to adapt as the business environment changes.

Defining knowledge management is not easy because it can refer to several different activities in an industrial firm, such as data collection, data analysis, data storage, data dissemination, and data utilization [10]. Knowledge management is to discover, develop, utilize, deliver, and absorb knowledge inside and outside the organization through an appropriate management process to meet current and future needs [16]. Knowledge management is the process through which organizations extract value from their intellectual assets.

Knowledge management is regarded as process involving various activities. According to Rumizen (2002), cited by Kazemi and Allahyari (2007), "knowledge management is the systematic processes by which an organization identifies, creates, captures, acquires, shares and leverages knowledge", knowledge management process has six major activities. These knowledge management activities may vary depending on organization and the industry sector.

Bixler (2002) indicates that knowledge processes should be incorporated into employee's daily work activities and integrated into business processes so that they become common practices in an organization and allow seamless flow of knowledge in the business life.

According to Gupta et al. (2000) knowledge maps are actually classification that identify where knowledge resides and which knowledge needs to be shared with whom, how and why within and outside the organization's boundaries. Organizations need to have these knowledge maps and ontology defined to ensure standardization and integrity of the development of the repositories as well as to facilitate maintenance and controlled growth of these repositories [11].

According to O'Leary (1999), the principle functions of a knowledge management system are to facilitate: conversion of data and text into knowledge; conversion of individual and group's knowledge into accessible knowledge; connection of people and knowledge to other people and other knowledge; communication

of information between different groups; creation of new knowledge that would be useful to the organization.

In the debates regarding the IT models of the knowledge architecture, the focus is lodged in the structure of knowledge captured in systems. It is closely related to infrastructure because infrastructure is focused on the systems that capture and store structured knowledge. Two key development fields are: knowledge modeling and knowledge ontologies. Knowledge modeling regards various strategic models for organizing knowledge-based systems, referencing such kernel theories as smart objects for data and knowledge representation [19]. Another example is a worldwide knowledge grid that represents knowledge in a three-dimensional space comprised of: knowledge category, knowledge level, and location. Knowledge management is the activity of managing globally distributed knowledge resources by locating these as a point in the three-dimensional space [22]. The knowledge ontologies, are based on drawing structure using web ontologies[13],[14]. An ontology is ‘a shared and common understanding of some domain that can be communicated across people and computers’[2]. Since most knowledge-based systems contain several knowledge bases, and these in turn rely on ontologies for clear specification of their characteristics and views, knowledge management ontologies are good candidates for creating intelligent knowledge retrieval components [8].

Summarizing the above considerations, the architecture of knowledge assets management is, usually, including the following activities: linking knowledge management activities to business process; continually improvement and developing of knowledge; sharing and storing of knowledge; knowledge structure; obtaining and creation internal and external knowledge; applying internal and external knowledge.

#### **4. Human capital within the knowledge assets management**

Knowledge assets are often referred, in the relevant literature, to as intellectual capital. This concept embodies a theory that emphasizes the value of knowledge within

the organization. Nowadays, the physical capital of an organization, particularly in the rising service sector, is of less relative importance for competitive advantage than intangible assets like know-how and personal sales networks. The market value of many service organizations is far too much larger than the value of their physical capital [17]. Intellectual capital has been defined as the difference between the book value of the company and the amount of money someone is prepared to pay for it. Intellectual capital theory is about assets: assets like trademarks and customer loyalty that give the company power in the marketplace; assets like patents and copyrights that give the company property rights ‘of the mind’; assets like corporate culture, structure, and IT style that give the company internal strength; and assets like employees’ knowledge and personal networks that enable company processes [5]. Organizational knowledge is viewed as a capital asset. This view implies that knowledge management regards balancing a knowledge portfolio. Thereafter, the portfolio is coordinated and exploited for maximized return-on-investment [20].

The general recognized categories of intellectual capital are:

- human capital;
- social capital (including customer capital);
- process capital; and
- intellectual property.

We presume that the knowledge assets management includes the following processes:

- knowledge identifying, capturing and collecting;
- knowledge storing;
- knowledge sharing;
- knowledge developing;
- knowledge applying or utilization;

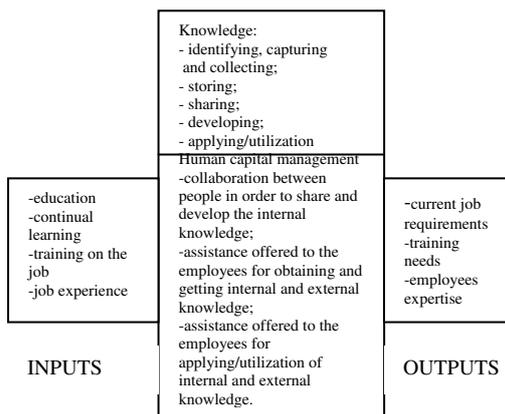
The knowledge management processes which are mediated through the human capital management are:

- facilitating the collaboration between people in order to share and develop the internal knowledge;
- assistance offered to the employees for obtaining and getting internal and external knowledge;
- assistance offered to the employees for applying/utilization of internal and external knowledge.

## 5. A model of human capital management inserted in the knowledge assets management

If we see the human capital management as a system, we can suggest a model of this system, having inputs, management processes and mechanisms and outputs. Figure 1 provides a picture of a suggested model for the human capital management inserted into the frame of the knowledge assets management. The inputs are: initial education, training on the job, job experience and continual learning of the employees. These are human capital specific resources that can create business value for the organization.

**Figure 1 A model of human capital management inserted in the knowledge assets management**



**Knowledge assets management**

Source: own author's view

The main processes which included in the knowledge assets management and using these inputs are: sharing, developing and applying/utilization of the knowledge assets, getting internal and external knowledge. These processes are carried out through the employees, according to specific procedures and rules. The human capital outputs of the knowledge assets management are: current job requirements, training needs, and employees expertise.

The human capital management has a strategic position in the frame of the knowledge assets management, due to the fact that the knowledge is embodied in people, in humans. Technologies are

incorporating knowledge, as well, but this resource cannot be active or useful without humans.

## Conclusions

Nowadays, knowledge has become a critical asset and potential strategic resource for contemporary firms. Facing the advent of knowledge-based economy, it is important to know how to effectively manage and integrate various kinds of knowledge resources in order to survive and keep competitive advantages. In this view, knowledge management is considered to be a pressing and important issue, organizations must manage their knowledge bases and repositories effectively to gain long-term competitive advantage

Human capital management strategy is conspicuously linked to business performance, as measured in terms of growth and profitability. Using knowledge management strategy by itself, and ignoring the crucial part of human capital cannot lead to successful attainment of higher business performance.

## Acknowledgment

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# Methods to Estimate Human Capital Stock: a Comparative Analysis

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## Abstract

*The paper identifies three general approaches to human capital measurement: (i) using proxies for educational variables, (ii) income-based and (iii) cost-based methods and presents a critical review of them. The measurement of human capital stock is important for assessing its impact on economic growth and for external effects generated by the production of human capital.*

**Key words:** human capital, economic growth

**J.E.L. classification:** J 24, O 47

## 1. Introduction

Originating from Schultz (1961), human capital was defined as knowledge and skills that people acquired during their lifetime. Over the years, with the intakes of many economists, the concept was enriched and extended, resulting nowadays a complex concept, having multiple facets.

The main components of human capital are educational and health capital [18]. For the purpose of this paper, only the educational component will be discussed.

It is generally accepted that human capital is a crucial determinant of the economic growth. A general finding of several empirical studies was that the impact that human capital has on the economic growth is sensitive to the measurement method. Different methods capture different aspects of human capital, going from educational variables, resources devoted to human capital accumulation or cost, neglecting the valorization of human capital on the labour market. Different human capital measures generate mismatch in cross country comparisons, very different results and conclusions.

The objectives of the paper are to identify

the main approaches, existing in the relevant literature, for the measurement of human capital stock in the economy, and compare them, in a critical review.

The paper is organized as follows: the section 2 describe the estimation methods for the stock of human capital in the economy, the section 3 offers a summary of methods estimating human capital stock, a comparative and critical review of the human capital estimation methods is exposed in the section 4 and the final section is dedicated to conclusions.

## 2. Main approaches to estimate human capital stock

In the relevant literature focused on the estimation of human capital stock in the economy, there are three main strands: (i) methods using different proxies of educational variables, (ii) income-based methods and (iii) cost-based methods.

### *Literacy variable as proxies for human capital stock*

In the early studies dedicated to estimation of human capital stock, one of the first approximation was to equate human capital to formal education. This approach estimates human capital based on such educational output indicators as literacy rates, enrolment rates, dropout rates, repetition rates, average years of schooling and test scores.

A very large number of empirical studies were developed using literacy and formal education data for proxy of human capital.

Adult literacy rates offer meaningful information about a country's general educational status. This indicator has been used in early empirical studies that control for human capital in growth equations, including Romer (1989) and Azariadis and Drazen (1990). This variable has shown a limited power of explanation in cross-country growth regressions. The reasons are: the

inconsistent definition of the content of adult literacy across countries and the miss of knowledge and skills specific to secondary and tertiary education.

Studies that used school enrolment rates as proxies for human capital in augmented growth models include Barro (1991), Mankiw et al (1992), Levine and Renelt (1992) and Gemmell (1996). These proxies have major limitations. First, literacy cannot measure the growth of human capital in secondary and tertiary education[35]. Second, the enrolment ratios in secondary and tertiary education can be seen as a better proxy of human capital growth. For example, a low level of primary enrolment rate could be accompanied by a higher secondary enrolment rate. Enrolment rates can be seen as a good approximation of the yearly addition to the human capital stock, being a good proxy for the growth of human capital, but not for the human capital stock.

A third proxy proposed for human capital was the ‘average years of education’ or ‘average years of schooling’, capturing the population’s average educational attainment. This measure has been used in many empirical studies such as: Benhabib and Spiegel (1994), Islam (1995), Barro and Lee (2001), Temple (1999), Krueger and Lindahl (2001), and Barro and Sala-i-Martin (2004).

The studies that have attempted to develop data series on years of schooling can be divided into three groups based on the method they employ: the census/survey-based estimation method, the perpetual inventory method and the projection method [35].

Psacharopoulos and Arriagada (1986, 1992) were the first to compile data on average years of schooling for countries, using the formula:

$$\bar{S} = \sum L_i D_i \quad (1)$$

where: where  $L_i$  is the proportion of labour-force participants with the  $i^{th}$  level of schooling and  $D_i$  the duration in years of the  $i^{th}$  level. Data on  $L_i$  were available directly from national censuses and surveys for 66 countries. A drawback of this method is the limited number of censuses (once in every 10 years). Later on, Barro and Lee (1993; 2001) suggested solving this problem by interpolating the census data to obtain

estimates of ‘average years of education’ for every fifth year. They constructed education data from census information where available, and for missing information used enrolment data and the perpetual inventory method for updating.

First, based on a Perpetual Inventory Method (PIM), estimates the total years spent with formal education using sufficiently long series of enrolment data[16],[24]. This estimate is corrected by correcting factors such as: mortality, repeaters, and drop-outs rates, and finally divided by the number of working age population yielding the average years of education. The method is sensitive to the availability of data for these correction factors, though, which are in most cases available for a few years only and are usually interpolated by a regression. Therefore, the accuracy of the method is suspect.

In 2004, Portela *et al* argued that the use of inventory perpetual method for the construction of education data per country leads to systematic measurement error and they suggested a methodology correcting this error. De la Fuente and Doménech (2000) and Cohen and Soto (2007) revised and upgraded the Barro and Lee's work for a larger set of countries.

The projection method, based on assumptions regarding the relationship between enrolment and educational attainment, is developed by Kyriacou (1991), which calculates the ‘average years of schooling’ from mid-1970s censuses for a few benchmark years and then uses lagged enrolment ratios to interpolate average years of schooling in the labor force for the missing years.

A popular way to improve the ability of educational attainment variable to capture the real differences in human capital endowment and the market value of human capital is based on a Mincerian approach. Mincer (1974) applied an earnings regression to estimate the return to schooling:

$$\ln w_i = \beta + rS_i + \dots + u_i \quad (2)$$

where:  $w_i$  and  $S_i$  are earning and the educational attainment of an individual  $i$ ;  $r$  denotes the rate of returns to an additional year of education.

This equation was used by other authors (i.e. Pritchett, 2001) to estimate the human capital stock, as follows:

$$h_{i,t} = e^{r_{i,t} \cdot s_{i,t}} \quad (3)$$

where:  $h_{i,t}$  denotes the per capita human capital in country  $i$  in year  $t$ . In this equation, a country with either no educational attainment, or no returns to education, has a per capita human capital stock 1.

Indicators of quality of schooling, as pupil-teacher ratio or class size, teachers' salaries, length of the school year, teachers' characteristics, parental characteristics, family background, drop-out rates, repetition rates, test scores were examined in studies developed by Kanushek and Kimko (2000), Barro and Lee (1996), Lee and Barro (2001).

Wößmann (2003) makes further improvements by incorporating Hanushek and Kimko's quality measure into stock measures. First, he expresses Hanushek and Kimko's estimate for each country as a ratio to the estimate for the US. This relative measure can be used as quality weights for a year of schooling in a country, with the weight for the US being unity. World average rates of return to education are finally integrated to arrive at a quality-adjusted measure of human capital stock:

$$h_i^Q = e^{\sum_a r_a Q_i s_{ai}} \quad (4)$$

where  $r_a$  denotes the world average rate of return to education at level  $a$ ,  $Q_i$  refers to Hanushek and Kimko's educational quality index for country  $i$  relative to the US value, and  $s_{ai}$  is average years of schooling at level  $a$  in country  $i$ .

#### Costs-based methods

These methods measure human capital as the sum of all costs incurred during the formation of human capital. Engel (1883) was the first to apply this method when he estimated human capital from the costs of rearing a child [19]. His approach was extended by Schultz (1961) and Machlup (1962). A more popular application (see for example Pyo and Jin, 2000) of the cost-based approach has been developed by Kendrick (1976) who estimated the human capital stock for the United States in the period 1929-1969 by summing the tangible costs (rearing a child until age 14) and the intangible costs (health, safety, education, and the opportunity costs of students

attending school) [19]. This method has its limitations too, but it partly solves the problems associated to 'average years of education' by incorporating qualitative aspects of human capital. This approach is similar to the measurement of physical capital stock. Judson(2002) suggested to calculate per capita stock of human capital stock at its replacement costs:

$$h_{ijt} = \sum_j d_{ijt} a_{ijt} \quad (5)$$

where:  $d_{ijt}$  is the public expenditures on education per education level  $j$  in country  $i$  in year  $t$ ;  $a_{ijt}$  denotes the share of the labour force in year  $t$  with a certain level of education;  $h_{ijt}$  denotes the average per worker human capital stock.

#### The income-based methods

These methods are estimating the value of human capital from the future (expected) earnings(incomes). This method originates with Petty (1690) who calculated the human capital of England as the difference between his estimates of the national income and property income, capitalized in perpetuity at a 5% interest rate [19]. The modern versions of income based estimations define the (expected) value of human capital as the total income that could be generated in the labor market over a lifetime [17], human capital being treated as an investment. Dagum and Slottje (2001) applied this income-based approach to estimate of the average human capital stock of the USA in 1982.

The idea that wages reflect differences in efficiency and ultimately human capital endowment has been used by other authors as well to develop their methods. Jeong (2002), following Mulligan and Sala-i-Martin (1997), estimated a human capital index for 39 countries. He assumes that all countries have the same Cobb-Douglas type production function, and therefore the difference in the observed real wages must be attributed only to differences in human capital endowment and aggregate output[19].The following equation was used:

$$\frac{H_i}{H_j} = \frac{Y_i}{Y_j} \cdot \frac{w_j}{w_i} \quad (6)$$

where:  $H_i$  and  $H_j$  denote human capital

stock in countries  $i$  and  $j$ , respectively;  $Y_i$  and  $Y_j$  denote aggregate income;  $w_i$  and  $w_j$  are real wages in countries  $i$  and  $j$ , respectively.

Recognizing that every method has its limitations, some researchers combined different methods, resulting an *integrated approach*.

For example, Tao and Stinson (1997) integrated the cost and income methods. The investments in human capital determine the human capital stock, which can be established by the cost method. Human capital, in turn, determines earnings through the income-based approach:

$$Y_{s,a,e} = w_t h_{s,a,e} \quad (7)$$

where:  $h$  and  $Y$  are respectively human capital and earnings,  $s$ ,  $a$  and  $e$  denote the sex, age and education level of an individual, and  $w_t$  is the human capital rental rate in year  $t$ .

Another example of methods combination is given by Dagum and Slottje (2000) which define human capital as a dimension less latent variable:

$$z = L(x_1, x_2, x_3, \dots, x_p) \quad (8)$$

where  $z$  is a standardized (zero mean and unit variance) human capital latent variable, and  $x_1, x_2, x_3, \dots, x_p$  are standardized indicators of human capital. An accounting value of human capital for the  $i^{th}$  economic unit is given as:  $h_i = e^{z_i}$  (9)

Dagum and Slottje estimated the human capital,  $H_x$ , of the average economic unit aged  $x$ . The monetary value of human capital of the  $i^{th}$  sample observation is:

$$H_i = h_i \frac{\bar{H}}{h} \quad (10)$$

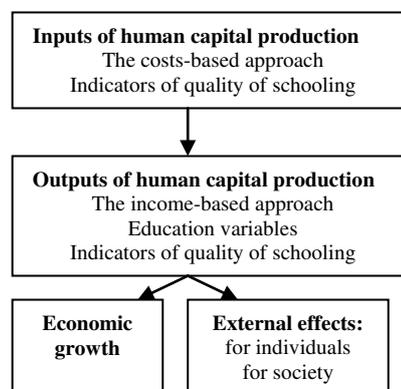
where:  $h$  and  $H$  are respectively the average values of  $h_i$  and  $H_x$ .

We can conclude that the monetary value of a person's human capital is equal to the average lifetime earnings of the population, weighted by the level of human capital that he has relative to the average human capital of the population.

### 3.Summary of methods measuring human capital stock

The three different approaches described above are interrelated.

**Figure 1: Common approaches to human capital measurement**



Source: adaptation by [25]

Figure 1 shows how these models are connected. To measure the inputs in the human capital production process, the cost based method (private and public spending on health, mobility and education, opportunity costs of attending school) is used and indicators of quality of schooling (pupil-teacher ratio or class size, teachers' salaries, length of the school year, teachers' characteristics, parental characteristics, family background).

The outcomes of human capital production can be measured through educational variables (literacy rates, enrolment rates, years of schooling), indicators of quality of schooling (drop-out rates, repetition rates, test scores) and the income based method (productivity, earnings).

Human capital is seen by many economists as a tool for explaining economic growth across countries and producing positive external effects on individual level (earnings, personal development) and in the society, as a whole (better public health, reduction of crime, unemployment, higher civic, social and political participation).

### 4.A comparative and critical review of the human capital estimation methods

#### *Educational variables method*

Years of schooling has been widely used in human capital studies, at both micro and macro levels and became the common proxy for human capital in growth models. But is to

mention the low explanatory power of cross-country growth regressions, due to the imperfections of this indicator. First, years of schooling does not incorporate the costs and returns to education, that varies from level to level. Second, does not reflect the differences in quality of education across time and space. Third, it ignores that workers with equal years of schooling can be in different education categories. Fourth, it ignores other human capital elements as informal schooling, training on the job, work experience, health.

#### *Cost based method*

The main shortcomings of the method are: cross - sectional and temporal comparisons are not always reliable, due to the fact that the value of human capital is determined by the demand for it, not by the cost of production; the components entering into the production of human capital and their prices can not be easily identified and it is difficult to distinguish between investment expenditures and consumption expenditures.

#### *Income based method*

A main drawback of the method is the assumption that differences in wages truly reflect differences in productivity. But, in practice, wages may vary for other reasons. Under such circumstances, income-based measures of human capital will be biased. Another disadvantage of the income-based method is that data on earnings are not as widely available as data on investment. This is especially the case for developing countries, where the wage rate is often not observable.

#### *The integrated approach*

The integrated approach of Dagum and Slottje assumes a standardized normal distribution of human capital, that is not realistic. Moreover, as with the income-based method, results are very sensitive to assumptions regarding the retirement age, discount rate and real income growth rate.

### **Final conclusions**

Each approach is more or less subject to limitations and shortcomings: it does not always adequately reflect key elements of human capital or data on the measure are of

poor quality. Therefore, properly measuring human capital remains a challenge for further research.

### **Acknowledgment**

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## New Considerations Concerning the Need of Knowledge to Pupils, Students and Elderly People

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### Abstract:

*A new business requires top priority during the entrepreneur, the emotions, and loyalty. Thus, the consequence for the commitment and determination is usually personal sacrifice. Commitment to an entrepreneur can be measured in several ways - through the availability to invest a substantial portion of his or her net income in the business, the willingness to give up salary since he or she will hold a large share of business, and other large sacrifices in lifestyle and family circumstances.*

**Keywords:** entrepreneurial, income, wages, business

**JEL:** M21 - Business Economics

### “1. Introduction”

Financial crisis in 2008 in Romania has led to the diminished of revenues for each family, with devastating consequences for elderly people, unless they take precautions during the active life. It is obvious that Romania is currently experiencing a difficult period and if no action is taken, Romania, the country is likely to fail and then disappear as a country [1].

### “2. Entrepreneurship in Romania”

Each family in Romania suffered financial contract, meaning that after 2008, family incomes have declined significantly in terms of purchasing power. Reduced costs for the family budget adjustment must be made in consensus by both partners. Decreased revenues may lead to lifestyle changes a

couple times in the relations of interest are more likely to fall apart.

Entrepreneurial skills offer to pupils, students and people in old age tools to think creatively, to solve financial problems, due to the crisis, effectively, to analyze a business idea objectively and to communicate, to establish ties in the workplace, conduct and evaluate any given project.

Pupils, students and elderly people are feeling more confident about setting up their own business.

### “3. Crisis of debts”

After the Second World War has followed a period of prosperity in which people have prospered differently depending on resources, intellectual elite, family tradition, and regional habits. During this period from 1945 to 2005 were acquired and consolidated conflicts of interest that led to unprecedented changes brutal regimes (Romania, Libya, Egypt, Serbia) or to changes in velvet, but deep (Czech Republic, Italy - Silvio Berlusconi, Greece - Georgios Papandreou, Ireland - Brian Cowen, Spain - José Luis Rodríguez Zapatero).

Are almost certainly France, Germany, Bulgaria and, last but not least, Romania.

Funding prosperity during 1945 - 2005 was based on the concept of inflation to moderate positive impact on prosperity.

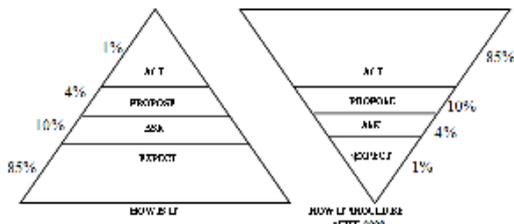
Let's imagine that a country produces goods and services and puts them all in a bathtub. In the fall open mainly to fund four valves covering goods and services on two levels: value of goods and property value plus some (extra pocket urges you to buy). While money supply exceeded the value of assets as a percentage of common sense, 2 to 3%,

economies prospered. But when funding sources, particularly loans were based on toxic securities, overvalued, sovereign debt crisis erupted which caused Greece to be close to bankruptcy, Berlusconi to resign and Hungary to use their knees, the Fund money.

Romania can not make an exception to European models (see Spain, Ireland, Greece, Italy, Portugal) and sooner or later will go bankrupt after several sets of Government change.

At the level of common man, the only way to defend is to reverse pyramid options [2].

Figure no. 1: Options pyramid



**We propose to operate and purchase gold as a form of protecting the value of savings and ensure a decent pension!**

#### „4. NORICUM GROUP”

S.C. Noricum Group SRL was founded on May 30, 2011 and is engaged in the brokering precious metals. Is a company included in a group of companies based in Austria based company operating in 12 countries in Europe.

Noricum is the concept of specialized products and financial services in Austria, Germany and other European countries.

Field of interest of the company, based in Austria is to ensure a stable property to the highest possible protection against the risks of financial markets. To meet the credit needs, many companies opt for financial investments recommended by us or use our concepts.

On request provide the full spectrum of financial services in the areas of investment, insurance and finance and, in some asset management services and asset management. Listings posted on the company's change 3 times daily.

Romanian version of the site is available at [www.Noricum-Group.Ro](http://www.Noricum-Group.Ro) (currently only a blog site is in process) gives more detailed information.

See below in the table and figures presented, that the gold price evolution has followed a continuous upward trend, indicating that gold related businesses are some of the proposed recommended to all those interested.

Thus, it requires some notions of entrepreneurship at all levels, from student to senior people.

Noricum Group Exchange traded gold Vienna from 20 to 25 of each month. On Romanian market, the trading price at the end of each year in recent history was:

Table no. 1: Trading price development as quotations NBR

Period	NBR gram gold, XAU quote
Dec. 2008	78,7536
Dec. 2009	108,0324
Dec. 2010	145,0274
Dec. 2011	179,0155
Jan. 2012	183,9433

Figure no. 2: Gram gold rate graph NBR, XAU quote

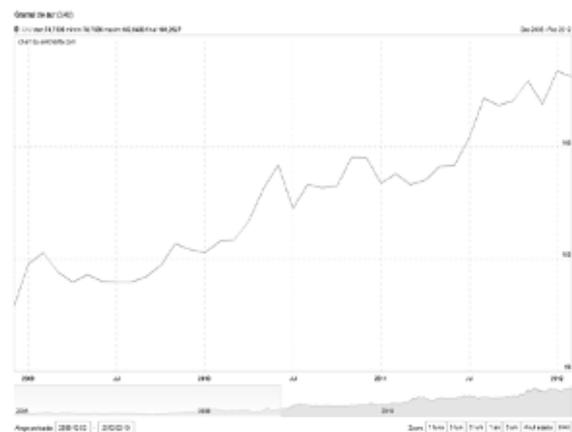
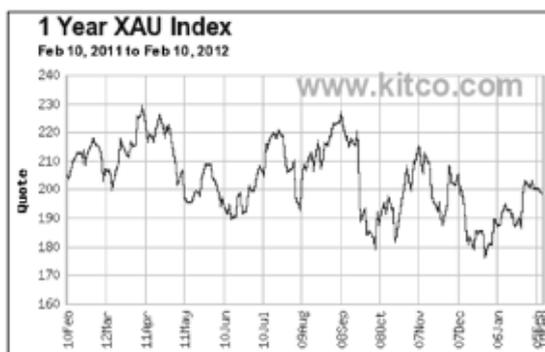


Figure no. 3: Chart evolution gold price  
as Kitco.com



### „5. Conclusions”

Most successful entrepreneurs seem to anchor their vision of future business in certain philosophies and attitudes (e.g., attitudes about what is a team that is mission, and how they will be rewarded).

Entrepreneur's ability to build a vision and then to lead, inspire, convince, and get the key people to register and submit to make an enormous difference between the dream of success and failure.

Effective managers have a reputation for developing human capital (e.g., they care and other managers increase efficiency by their example and mentoring) [3]. Binding of a plan to increase human capital in the middle management and supervisory levels of business strategy is an essential first step.

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## Consumption – Complementary Factor of the Saving

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### Abstract

*An objective of this analytical approach is to demonstrate that alike the income, the expenses vary also depending on the life cycle of individuals, living environment, and some personal characteristics, too, based on these criteria, major differences in household consumption expenditure resulting. Thus, the main purpose of the expenditure incurred by the population, being the consumption of food and nonfood supplies, services and transfers to the public and the social security budgets. This guidance is based on public expenditure action of objective and subjective factors, that incite individuals do not consume much of the income, but to save.*

**Key Words:** the savings, consumer, influence factors

**JEL Classification:** E2, E21

### 1. Introduction

Economic literature committed to saving is continuously enriched with new and new contributions, attraction domain results from its pragmatic inclination to subject theories of "proof of facts" and investigating their consonance with contemporary realities. The work on which we stopped is the most cited, constituting the core of scientific concerns of this kind.

An important factor influencing the savings process of population is the consumption.

### 2. Consumption-saving arbitration

Gradually, it was realized that there is an interdependence between the income of the population and spending money. However, daily realities highlight the complex nature of the interaction between income and expenditure in the sense that there is no identity and no absolute causal relationship, or of automatism. Thus, we consider that the relationship between revenues and expenses is a subject of the action of a multitude of factors that exert a complex action, often in contradictory ways.

Increasing the population's money incomes do not lead to uniform increase of all components of costs from prior periods. Overall, dynamics and structure of consumption expenditure recorded different rhythms and meanings in relation to income growth, in that with traditional spending, new requirements arise that leads to the formation of new categories of expenditure. Factors influencing consumption are those elements of economic and social human nature, objective and subjective, which increase or decrease in consumer spending at a time, or for a certain period of time and in a geo-social space.

Thus there are two categories of factors (subjective and objective) that influence consumer demand. The first category of factors of influence is the result of conditions generated by economic life.

What distinguishes this representation? We have the answer in the following concluding:

- the decision to consume is made in close connection with the size and personal net income developments;
- unexpected changes or physical obsolescence caused by the different elements of fixed and circulating capital and / or increased restrictions on some natural resources can affect the price and therefore the consumer decision;
- in terms of decrease in purchasing power of money, although the expenses for the present consumption will be increased, the real consumption is reduced. Also, the increasing purchasing power of money due to reduced consumer prices, the real consumption increase now because you can buy a larger quantity of goods with the same money or less expense. The risks is related to the uncertainty of life - that influence the possibilities to benefit from future goods, external uncertainties for the future, the payment of unreasonably high taxes, with confiscate character, etc. We can say that this factor is identified with interest rate evolution. It is considered that the size of consumption spending changes in inverse relation to the interest rate.
- changes in tax policy can increase the propensity to consume or it can reduce it, if a significant part of the budgetary funds are used to pay the debt.
- consumption credit affects consumer spending via interest rate. Between consumption and interest rate, for the loans for purchase of consumption goods, there is a negative relationship. On the other hand, a low interest rate for consumption credit will result in a high present consumption of credit, with an impact on reducing the future consumption.
- Consumer expectations are about the evolution of relations between present and future income, between the current and future prices, the current supply and future consumer goods. Thus, if it is anticipated that

revenues will increase, the present consumption will decrease, increasing the propensity to save. If it is anticipated that future consumption prices will increase, the present consumption will increase too, and if it is anticipated that the prices will be reduced, the current consumption will occur normally. So it is with the expectations of the amount of consumer goods on a market: if it is expected a decrease, present consumption will increase and vice versa.

In conclusion, all those objective factors influences the size of spending on personal consumption, but added the subjective needs: psychological dispositions, individual habits, motives concerning prudence, foresight, thirst for prosperity, independence, business spirit, pride and avarice, and relating to:

- a) people's desire to create a contingency money reserve (this reduces the current consumption spending, in favor of future consumption);
- b) establishment of cash reserves for old age insurance or protection of certain persons;
- c) the desire to gain interest or other benefits by participating in some activities on which future business projects will be realised;
- d) the instinct to raise the living standards of people by gradual increase in consumer spending, based on money reservations made over time;
- e) the feeling of independence and freedom of movement on the existence of large amounts of money saved;
- f) the desire to leave the property to the heirs;
- g) expression of avarice in some people, reflected in decreasing consumer spending.

The second category of influential factors, subjective factors, is the result of psychological inclination, of peoples customs and traditions. These factors include: the desire of people to create a cash reserve for contingencies, which reduces the desire for current consumption expenditures in favor of future consumption, creation of reserve funds

for old age insurance or for the protection of certain people, the desire to gain interest or other benefits by participating in some activities on which will be carried out in future business projects, sense of independence and freedom of movement based on the existence of big amounts of saved money, the desire to leave the property to heirs, etc. ..

If we synthesize, we can find that all these motives, and many others that I have not stated, but that act to decrease consumer spending, private prudent, thirst for prosperity, independence, business spirit, pride and avarice.

Overall, subjective motives which prompt the individuals and the local and central power do not consume a part of income, generated positive savings. But it may appear some negative savings, as savings for old age insurance, unemployment benefits financed by borrowing, etc..

Because of the action of these objective and subjective factors, consumption and saving evolution is governed by fundamental psychological law made by JM Keynes, that with the increase or reduction of income, people tend to increase or to reduce the consumption, respectively the savings, but to a less extent, respectively higher.

It is obvious that the volume of consumer spending in a period of time depends on the evolution of the prices and tariffs for goods and services at the time, and therefore, the determined consumption is expressed by the cost of living.

Also, post-communist transition generated major changes in all spheres of socioeconomic life. One of the areas that have experienced the most dramatic change is that of consumption. On the one hand, immediately after 1989, there was an increase in volume and a diversification of supply of goods and services, with a social impact especially important since this phenomenon occurred in a very short time, consecutive to the pronounced poverty period, characteristic to the last years of communism. On the other hand, household income saw a sharp differentiation process, leading to a concomitant process of differentiation of consumer behavior.

### **3. Consumption structure and its evolution over the period 2001-2010**

The process of population needs satisfaction suppose the transformation of money income in goods and services. Thus, consumer demand differs from one social class to another. Thus, employees demand structure differs from that of farmers whose incomes are formed not only in money but to some extent in products, and therefore much of the peasants consumption not involve cash movements. Therefore the increase of employees income will be directed generally to other goods than a corresponding increase in farmers. At the same time demand structure varies significantly within the same population groups according to income level.

Increased cash income is accompanied, necessarily, by the changes in the structure of consumer demand, meaning that while increasing in absolute consumption values of essential goods to meet normal physiological needs, a decrease of their share in total expenditure occurs, increasing the share of expenditure for products of high value costs and durable, that improve living conditions and comfort.

Analyzing the evolution of household consumption expenditure in the period 2001-2010 it can be seen an increase, although significant, growth which is supported by analyzing the economic behavior of people through the theories formulated by Modigliani and Friedman on life cycle savings and permanent income.

This increase in household consumption goods can lead to a weight reduction of theoretically considered "normal" (goods that have positive elasticity according to income, but subunit - for example food goods) for the "superior" goods (goods characterized by marginal propensity to consume higher than average propensity to consume). The risk comes from the fact that these trends in changing consumption structure shows that the population will increase spending on goods engaging the most to finance by resorting to loans, which may increase the indebtedness of the population. However, if the Romanian economy will not provide the qualitative and quantitative goods required by the population, consumption will be met by imports, which will have repercussions on the current account deficit.

If we consider the structure of public spending in recent years 2007-2008 it can be

said that the largest share is hold by the consumer spending (71.1%) of total expenses.

The main uses of population expenditure are the consumption of food goods, nonfood, services and transfers to the public, private and social insurance budgets, income taxes, contributions, fees, and expenses necessary for household production (birds and animals feed, work payment for household production, seeds, veterinary services, etc..). Investment expenditure, for the purchase or construction of housing, land and equipment purchase necessary to household production, shares purchasing, etc. have a small share of total household expenditures.

Some characteristics in terms of size and structure of consumption expenditures are determined by the residence. Thus, while the expense of monthly average consumption per household is higher in urban areas to 500 lei, the food consumption is increased by only 80 lei. This derives from the fact that, in rural, 41.2% of the food consumption represents the equivalent consumption from own resources. The urban food consumption from own resources covered 18.1% of the total food consumption.

According to the standard classification of consumption expenditure by purpose (COICOP), food and soft drinks were served in 2011 on average 40.8% of household consumption, down 1.2 percentage points from first quarter, and respectively, by 2.5 percentage points from second quarter of 2011. A component of consumption, with relatively high share of expenditure is related to the dwelling (water, electricity, gas, fuel, furniture, household equipment and maintenance). In the third quarter of 2011, it was allotted 19.3% of consumer spending. Most of the housing costs (18.6% in the first quarter, 15.3% in the second quarter and 15.1% in the third quarter) was absorbed by the utility consumption for the operation and home heating (water, electricity heating, gas and other fuels).

Health spending by households (4.8% of consumer spending) and especially with education (0.4%) had a low level, especially

because these needs of household members is done in the largely through public services they receive in social security system or not.

#### 4. Conclusions

Conclusion that emerges is that the savings depends on a large proportion of consumption, and saving can therefore be regarded as the mirror image of consumption. The aknowledge of population consumption behavior, especially its response to exogenous shocks affecting demand determinants, is an important source of information for understanding short-term fluctuations and long-term trends that manifest in an economy, including savings fluctuations understanding . Thus, saving is a necessary objective factor to expanding the consumption. In other words, higher living standards and changes in consumer demand patterns necessarily leads to savings, which is an objective process, with statistical regularity nature.

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## Competition – the Premise of a Sustainable Business Model: Meanings and Types

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### Abstract

*In terms of market economies increasingly complex competitive environment reflects a prerequisite in ensuring transparent competition. This paper proposes an overview of the main meanings and characteristics of the competition, from a perspective of a viable and stable economic environment. Elements such as the transparency of market, regulations on entry and exit a given market, economic development opportunities or the possibilities to stimulate, are decisive vectors in boosting and potentiation of competition. That competition importance is expressed by the functions it fulfills in the implementation of market relations. Depending on the evolution of these relations, competition has extended its influence on multiple elements of market economy.*

**Key Words:** competition, competitive environment, price, level of development, consumers.

**JEL Classification.:** D40, F10.

### 1. General considerations on competition

Along with demand, supply and price, competition is one of the variables defining the market, an essential feature of it.

Competition is the specific behavior of some subjects interested in property, and wish, to achieve their objectives, enters into relations of cooperation and confrontation

with others, being the expression of free enterprise.

Competition is both confrontation and cooperation between economic agents [2] for better conditions of production, sales, purchasing consumer goods, by making cash transactions, foreign exchange, financial, etc. It's a race to get the benefits (or at least reduce the likelihood of risk).

In competition, each acts of interest. For example, the buyer "run" to find sellers with the lowest price, highest quality, most favorable terms of delivery of consumer goods and factors of production. Sellers are competing among themselves for "client money" to attract as many buyers with high economic force, set in procurement, responsive to price and other favorability. From this competition, normally, comes out the winners.

Conditions of competition are: freedom of price formation and the existence of private property, and property rights are strictly defined and guaranteed. Competition has evolved over time and space, and its magnitude is influenced by: ● demand and supply agents number and economic power; ● degree of differentiation of the offer and preferences; ● degree of market transparency; ● the extent to which society, the economic, social, political, cultural, are able to stimulate initiative, creativity, risk, competitive spirit, and cooperation; ● regulations on entry / exit a given market; ● degree of substitutability and complementarity of economic assets; ● The amount of income and the mechanisms by which they are obtained; ● economic

development, cultural and spiritual and moral members of society; • nature of economic policies; • scale and typology of anticompetitive practices; • training level of the operators.

A market is more competitive with the more limited ability of every firm to influence it through price, quantity and method of marketing. Theoretically, competitiveness is maximum when each firm has zero power to influence the market.

For example, if company A increased the price of good "X" by 10% and the market demand is reduced by 0.1%, it means that the property market "X" is a competitive market. Conversely, if by that measure market demand shrinks by 4%, it means that the market is less competitive.

*Like any competition, the market competition takes place under certain rules, being, as the market, social conscious creation.*

In all the countries with competitive market economy there are legal regulations regarding the rules on development of the competition, penalties applicable to those who violate them, authorized bodies to supervise and enforce punitive measures (in Romania, competition regulation is achieved by numerous acts of which is detached Commercial Code, Law no. 21/10 April 1996, competition Law, Law no. 31/1996 on State monopoly regime; competition institutions in Romania are: the Competition Council and competition Office). In the lack of supervision and regulation, competition can destroy itself, it can lead to monopolies and other economic anomalies.

## **2. Competitive environment - specific objective framework of contemporary market economies**

In the specialised literature, the notion of competition is treated through the juxtaposition of two theoretical approaches: structuralist approach and behavioral approach.

In the structuralist approach, competition is defined as a state and a market structure. Therefore, in this approach, competition is identified with a situation that contributes to free price formation and operation of the laws of supply and demand in a market, a situation in which the number of consumers

and businesses occurred onto the market is so large that they can not individually influence price formation.

Structuralist approach was largely own to classics and neoclassics which, in support thereof, have developed models of pure and perfect market competition and imperfect competition. Subsequently, this approach has been assigned a static character, as it is based, in particular, on the study of market structure determined by the number of operators.

The behavioral approach (behaviorist), present especially among neoliberal and postkeynesists, the focus is on another aspect of competition, the subjective side, caused by human behavior. Competition is defined as a concept that meets the following behaviors: report, interaction, fights, rivalry, competition for operators to achieve goals such as minimizing price, winning customers, gaining productive resources (human, physical, financial), labor leadership, increase profits. The French economist, A. Jackemin, in his work on industrial and competition policies, defines competition as a set of interactions between agents, who consider that agents behaviors and conditions are data. Russian scientists - A. Iudanov, defines market competition as a battle between companies for the limited capacity of consumer solvency, and I. Rubin, highlights rival interests, treating competition as a permanent struggle for leadership in the production market, for the possibilities arising from this for distribution and consumption.

The most common definition of competition in the literature used by Romanian economist Dobrotă Nita, can also be attributed to behavioral approach: "Competition is a confrontation, rivalry of private economic agents to attract the customers consuming the most convenient prices through better quality goods, in order to obtain the greatest and secure possible profits".

It is considered that the behaviorist approach is a dynamic character, as reveal changes in economic behavior over time and how these changes transform the environment in which they act. We believe that both the structural (static) and the behavioral (dynamic) approach are correct. Moreover, they are complementary. Indeed,

on the one hand, market competition is a condition characterized by parameters such as number of firms and consumers, the degree of homogeneity of goods, mobility of factors of production, possibility of enter the industry, market transparency, and on the other hand, it defines the relationship between economic character by adopting different strategies of action, all in the context of specific market structures (the market structure we mean perfect and imperfect forms of competition: pure and perfect competition, monopoly, monopolistic competition, oligopoly, oligopolistic competition, monopsony, etc.).

Sometimes, the notion of competition is confused with another notion, which originated in the competition - competitive. In the past, competitiveness was attributed exclusively to the ability of firms to sell goods and services in national markets. Today, with the processes of internationalization and globalization of economic, competitive spread over the nation, representing its ability to sustainably improve the living standards of its people and to get them a high level of employment and social cohesion (official definition of competitiveness, proposed by the Consultative Group on the competitiveness of the European Commission). Moreover, competitiveness is generated by practicing free market competition. The free competition is one of the conditions of emergence of competitiveness.

Another term, almost indispensable term to competition research is competitive environment. It is a coordinated system that includes: the number of producers and consumers in the market, the diversity of the sold goods and services, the organization of markets, the existence of the legal, government intervention, etc.. Normal competitive environment creates favorable prerequisites of a viable growing market.

### **3. The evolution of functions and competition types in the contemporary economy.**

Typically, competition is in terms of three components: function, typology and mechanism. These three components have evolved over time and other factors. Determinants factors of modern economy,

which generated changes in competition, are the globalization and the regionalization of economic life.

The competition importance is expressed by the functions it fulfills in the implementation of market relations. Depending on the evolution of these relations, competition has extended its influence on multiple elements of market economy.

Usually, in economics textbooks are listed the functions performed by competition, not to delineate their evolutionary nature. Following investigations, we concluded that it would be logical to tie them into two categories according to the period they occurred. By this we want to emphasize that competition functions do not remain unchanged and in each stage of economic development, they achieve new goals. Classical functions of competition, characteristic to economy up to globalization and regionalization are:

- satisfaction of consumer demand;
- autonomous adjustment of supply and demand;
- optimal allocation of resources;
- fair distribution of income.

#### *1. Satisfaction of consumer demand.*

Manufacturers aim to profit, while consumers express their choices for the goods and services offered by manufacturers to meet their needs. Directing the operators to produce what is desired and demanded by consumers at lower costs in the given circumstances, competition ensures the expected prices and profits for the producers and satisfaction for the consumer.

#### *2. Independent adjustment of consumer demand and producer supply.*

The competition is held to stimulate the concern of the producers to increase, diversify and improve the quality of offered goods, in order to prevent, adapt and meet the needs of consumers.

#### *3. Optimal allocation of resources.*

This feature is one of the key features of competition. It decides the parameters within which it is obtained the highest degree of satisfaction of the society members, both as consumers and producers. Optimal allocation

of resources is obtained by determining the following parameters:

- what kind of goods and how much should be produced;
- how the goods produced to be distributed among the members of society;
- what will be the set of resources in producing goods and what will be the used production methods.

The function of the income distribution is reflected in the fact that, as the result of free competition, the operators are rewarded for their work. Consequently, the more skilled companies organized their activity better, obtained higher profits, and the less performant obtained a lower income.

Simultaneously with the development of market relations, the unprecedented increase in the level of production and in international trade, most generated by processes of regionalization and globalization, competition has acquired several new features that we call *modern features*:

- promoting the innovation;
- limiting the economic and political power;
- influence on the economic agents psychology.

4. Promoting innovation can be considered a new feature of the competition, because it increases predominantly in the contemporary economy conditions, subject to regionalization and globalization. This function is achieved by stimulating economic and technical progress. Competition gives to firms a strong reason to develop advanced products and discover ways to produce with a lower cost, to maintain traditional markets and to win international markets. Entrepreneurs are free to introduce a new product into production or to use a manufacturing technology which opens prospects more favorable than those used so far. The novelty of ideas put into practice must face the verification required by consumers. If consumers like the novelty that brings this idea, so as to cover the cost of goods or services proposed by the company, new business will prosper and succeed. Otherwise it will fail.

Reality shows that a manufacturer trader to succeed in a competitive market should have the ability to anticipate, identify and adapt quickly to new ideas. And by

continuing competition between operators, the competition favors the best-performing and destroys the weak, the unable to adapt to the market.

5. Limitation of economic power, and thus, the political power. In a market economy competition is free, it is part of free enterprise or freedom of action, which means that economic agents act to achieve their own interests, and the economy, as a whole, is the result of this action. Origin of each interests is in economic- competition environment, in which the central place returns to property and market. Thus, competition freedom expresses freedom to act in the economy whose functioning takes the form of market. The importance of this function is particularly significant in modern economy, as traders appear (monopolies, transnational companies) seeking to influence certain business processes, such as consumer decision, the free prices, access to resources, political decisions, etc. .

6. Competition influences economic agents psychology. This function is determined mainly by changing strategies of competitive rivalry in the modern economy, expressed through actions related to the influence of the consumer by different advertising or public relations actions. This causes changes in the value system of consumers, the options for new lifestyles and, ultimately, the more clear shaping of their personalities, which reflects on his behavior. There is a growing requirement of the consumer to consumption, due mainly to the concern for keeping in shape and intellectual, to health, but also to more timely and comprehensive information on consumer alternatives. Under the influence of globalization / regionalization, consumer value system changes as a result of the internationalization of the consumption of certain goods and services.

#### 4. Conclusions

Thus we can say that in terms of active and dynamic competitive environment, the advantages offered by the development of competition are very important. All defining and determining elements entail a guarantee of increased competitiveness and a deeper

economic development with a direct influence in increasing the productivity and economic yields regardless of the degree or the level of their development.

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## Activity of Collective Administration Organizations on the Market of Copyright and Related Rights in Romania

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### Abstract

*In the context of development of the utilization techniques of a work or of those utilizations of a work that can be hardly monitored by the rights owners, the collective administration organizations are essential in the exploitation system of copyrights and related rights. Mandating the collecting societies by the right holders is the legal solution for the authorization of the uses of a work. By this, on the one hand, there are respected the rights and the remuneration of the rights holders and, on the other hand, users are provided with legal certainty for the use of a work as well as economic advantages from it.*

**Keywords:** collective administration organization, copyright, related rights, the market work.

**JEL Code:** K11, O34

### 1. Introduction

In the regulation system of Law no. 8/1996, the owners of copyright and related rights may exercise their rights recognized by law individually or by proxy, by collective administration organizations in accordance with the law. The development and, especially, the advantages of the technical means of reproduction and dissemination of works led to the regulation of collective management of copyright.

The administration organizations are defined by Law no. 8 / 1996 on Copyright and Related Rights, subsequently amended and supplemented, as non-profit association established by rights holders and which have as main activity the collection and distribution of appropriate remuneration for the rights granted by mandate from the members or by law.

The collective administration organizations may be established under the endorsement of Romanian Copyright Office (O.R.D.A.) and must comply with specific legal provisions stipulated in Law no. 8 / 1996 on Copyright and Related Rights, subsequently amended and supplemented. Thus, the legislator has provided special conditions governing the status of collective administration organizations, rules applicable to collective administration as well as obligations of the collective administration organizations in relation to the public, to the authors, the users and ORDA. The most important of these provisions refer to:

- establishing rules of distribution of collected remuneration in the status of collective management body, on the basis of proportional distribution of collected remuneration to the use of the work;
- decisions regarding important aspects of collective management should be taken by members in general meeting;
- the requirement to have a website as well as specifying the minimum information that should be posted on it;
- Limiting the management fee payable by the rights owners, which are members of the collective administration organization, fees which are used to cover its operating expenses, at 15% of the amounts collected annually. The collective administration organizations must have sufficient income to carry out its duties effectively, especially when the managed rights cover a vast repertoire and there are required several distribution and payment operations, which generates costs.
- the management fee will be deducted from the amounts distributed to members after calculating individual repair;
- the amounts collected by collective management organizations are not and

cannot be treated as their income, because the most important duty as a collecting society is to allocate appropriate amounts to the rights holders according to the use of their works. Collecting societies would not discharge this burden if, instead of making payments to holders of rights, would use these resources to provide funds and reserves for other purposes.

- complying with the principle of equal treatment of the rights and work holders. For example, in the case of collecting societies, all or at least most of the collected money will be transferred abroad under reciprocal agreements concluded with similar bodies. Must however be stressed that all management societies are obliged by law and by the concluded reciprocal representation agreements with similar foreign companies to comply with a strict equal treatment with regard to any national or foreign works.

## 2. The collective administration organizations in Romania

The collective administration organizations can be created separately for different categories of rights management corresponding to different areas of creation as well as management of rights belonging to different categories of owners. Currently, in Romania there are operating a number of **12 collecting societies**, designed to manage different categories of rights, i.e. copyright and related rights, as follows:

### Copyright category:

**COPYRO** – manages the authors’ rights of written works

**DACIN-SARA** – manages authors' rights of cinematographic other audiovisual works

**PERGAM**- manages the authors’ rights of scientific works

**UCMR-ADA** – manages the authors’ rights of musical works

**VISARTA** – manages the authors’ rights in the field of visual arts

### Related rights category:

**ADPFR** – manages the authors’ rights of phonograms producers

**CREDIDAM** – manages performers' rights

**AGICOA ROMANIA** - manages producers’ rights of cinematographic and other audiovisual works

**ARAIEX**- manages performers' rights

**UPFAR-ARGO** – manages producers’ rights of cinematographic and other audiovisual works

**UPFR** – manages the authors’ rights of phonograms producers

**UPVR**- is the body that administers neighboring rights that belong to the producers of videograms.

**COPYRO** - collecting society of copyright. COPYRO is a member of IFRRO and has signed reciprocal agreements with the collective management organizations RAO (Russia), SOPE (Greece) and SGAE (Spain).

Concerning the number of members, this collecting society now has 1664 members, managed based on mandates and a total of 521 managed works.

Currently, COPYRO collects the remuneration of the written works’ authors from the following sources: the compensatory remuneration for private copying in the graphic field, sole collector for: compensatory remuneration for private copying rights holders - copy paper, compensatory remuneration for private copying rights holders - devices and other media, broadcasting by radio and television broadcasting organizations, broadcasting via cable retransmission, publishing reproduction, public communication (theaters).

**DACIN-SARA (Society of copyright in cinematographic and audiovisual - Romanian Society of Audiovisual Authors)**, manages the rights of authors of cinematographic other audiovisual works, being approved to operate as a collecting society by Decision no. 1 / 1997 of the General Director of O.R.D.A.

**PERGAM (Romanian Society of Authors and Editors of Scientific Works)** manages rights of authors and publishers of scientific work, being approved to operate as a collecting society by Decision no. 98/2009 of the General Director of O.R.D.A. (published in the Official Gazette, Part I no. 579/20.08.2009).

The collective administration organization PERGAM collects the remunerations of authors and publishers of scientific work

from the following sources: broadcasting, cable retransmission, communication to the public, private copying, public borrowing, making derivative works.

**UCMR – ADA (Union of Composers and Musicologists from Romania - Copyright Association)**, the most important collecting society in Romania, manages the rights of authors of musical works; established by free association between composers and lyricists.

UCMR-ADA is a member of CISAC (International Conference of Societies of Authors and Composers) and BIEM, and has signed over 50 mutual agreements with similar foreign bodies (e.g. SIAE - Italy, MCPS - United Kingdom, AMRA - U.S. ASCAP - U.S.).

The fundamental principles on which UCMR-ADA operates are:

- UCMR-ADA is a collective administration organization, open to all holders of copyrights in music from Romania and abroad.
- In exercising their functions, UCMR-ADA will comply with Romanian legislation, international agreements to which Romania adhered, and the principles and methodologies applied worldwide.
- UCMR-ADA treats with the same rules all works whose rights have been entrusted to management, whether it was mandated directly by the authors or by their representatives.
- UCMR-ADA guards the moral rights of authors. In this respect, the UCMR-ADA will only manage related rights as secondary activity.
- UCMR-ADA guarantees its members access to information and data required by them about managing their rights.

Currently, UCMR-ADA collects the remuneration of authors of musical work from the following sources: public communication (cinema), public communication (ambient and lucrative), broadcasting by radio and television broadcasting organizations, cable retransmission, private copying from the sound and audiovisual field, reproduction of musical works on phonograms, reproduction of musical works on videograms, the use of musical works as ringtones and on the Internet.

**VISARTA** (Collecting society of copyright in visual arts), manages the rights of authors in the visual arts. The operation of collecting society VISARTA was approved by Decision no. 8 / 1999 of the General Director of O.R.D.A.

VISARTA collects and distributes the remuneration of its members from the following sources: cable retransmission, private copying in the graphic field, reproduction; remuneration determined by direct negotiation with the users, resale right.

**A.D.P.F.R.** is constituted and functions as a collecting society for the related rights of its members - producers of phonograms in the musical field, according to decision of the General Director of ORDA no. 206/30.06.2006, published in Official Gazette no. 589/07.07.2006.

A.D.P.F.R. collects and distributes the remuneration of its members from the following sources: public communication (ambient and lucrative); broadcasting phonograms published for commercial broadcasting by radio; broadcasting phonograms published for commercial broadcasting by television; cable retransmission, private copying from the sound and audiovisual field (sole collector).

**CREDIDAM (Romanian Center for Performers Rights Management)**, managing the rights of performers and acts as collecting society since 1997.

CREDIDAM is open to all related rights holders, Romanian or residing in Romania or in other countries, as well as foreign citizens. The activity of CREDIDAM is the collection and distribution of their remuneration from commercial recordings broadcast in Romania by radio, cable, TV, in restaurants, hotels, discos, etc.

CREDIDAM collects and distributes the remuneration of its members from the following sources: broadcasting phonograms published for commercial broadcasting by radio, broadcasting phonograms published for commercial broadcasting by television, broadcasting artistic performances by television, cable retransmission, private copying from the sound and audiovisual field, public communication (cinema), public communication (ambient and lucrative).

**The Union of Phonogram Producers of Romania (UPFR)** is a nonprofit professional

association founded in 1996 in order to defend and promote the professional, cultural and moral interests of its members under a mandate given by them to manage their related rights and involvement in activities relating anti-piracy.

UPFR gathers the myriad of today's most important producers and importers of phonograms in the Romanian market and is open to all those who, in accordance with the interests of current members, express their willingness to adhere to the principles that animate the work of all the legal producers.

UPFR collects and distributes the remuneration of its members from the following sources: public communication (ambient and lucrative), broadcasting phonograms published for commercial broadcasting by radio, broadcasting phonograms published for commercial broadcasting by television, cable retransmission, private copying from the sound and audiovisual field.

**UPFAR-ARGO (Union of Film and Audiovisual Producers of Romania - Romanian Association of Audiovisual Works management)** manages the rights of producers of audiovisual works and is a collecting society established by Decision no. 9/ 1999 of the General Director of O.R.D.A.

UPFAR-ARGO collects the remuneration of producers of cinematographic and other audiovisual works from the following sources: public communication (ambient and lucrative), broadcasting by television; cable retransmission, private copying from the audiovisual field.

### 3. The analysis of the amounts collected

*Table no. 1. The evolution of the amounts collected by collective management organizations in 2004-2009*

OGC	TOTAL
2004	32,793,457
2005	46,611,666
2006	87,798,674
2007	111,456,985
2008	157,085,742
2009	152,873,851

Source: <http://www.orda.ro>

From the analysis of total incomes made by the collective management organizations it results a considerable increase from 2004 to 2008. In 2009 a decrease was registered also due to the crisis affecting the world economy. Taking into account the evolution in those six years leads to the conclusion that this form of management of copyright is in continuous development and growth due to the market where these organizations operate and to the legislative regulations which enhances the use of these assets. In a 6 year period there was a five time increase in the amounts collected, which shows the evolution of this way right holders obtain remuneration through collective management organizations.

*Table no. 2. The evolution of the amounts collected by each collective management organization in 2008-2009*

OGC	2008	2009	EV.(%)
UCMR-ADA	98,135,921	94,449,479	-3,76
COPYRO	4,313,981	3,535,122	-18,05
DACIN-SARA	3,407,724	7,109,119	+108,62
VISARTA	721,810	631,949	-12,45
CREDIDA M	24,786,130	22,113,841	-10,78
UPFR	15,460,859	18,515,988	+19,76
UPFAR-ARGO	9,280,777	5,622,986	-39,41
ADPFR	483,158	895,365	+85,32
AGICOA	0	0	0
PERGAM	0	0	0

Source : <http://www.orda.ro>

In 2009, for the first time in the period 2004-2009 there has been a decrease in total incomes. From the analysis of the table above it can be seen the amounts collected by each organization. The biggest share in total income belongs to UCMR-ADA, of 61.78%, followed by CREDIDAM with 14.47% and UPFR with 12.11%. Significant increases were registered at DACIN-SARA – 108% and at ADPFR – 85.32%. This increase did not have a significant influence on total

incomes because the percentage was significant, not the value of the incomes.

#### 4. Conclusions

In Romania, it has been developed a complex system of collecting and collective administration organizations must continually align to the practices of collecting societies in other EU countries and must face the new challenges caused by the use of works and products bearing copyrights and related rights in the modern society.

The value of the copyrights and related rights market has dramatically increased between 2004 and 2009. This growth is also due to the way the authors' creations, who evolved and developed, could be publicized. This growth is entirely understandable because it is supported by the existence in Romania of such organizations which can judiciously manage these rights. The copyright holder is not a specialist in the market, but through these specialized organizations he can be properly paid.

#### 5. Acknowledgements

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## SMEs and International Competition: Empirical Evidence for Romanian SMEs

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### Abstract

*One of the issues covered by the current debate concerns the future of the national economy in a world in an accelerated process of globalization. It is, in fact, the transition from national economy to the global economy as homogenous global space in which national economies are melting and whose background includes a variety of positions since the companies compete globally and not states, and structuring is determined by the dynamic global economy industries and firms efforts to create competitive advantages.*

*This paper has as main objective to understand and to approach the topic of the SMEs in the international competition, which, being considered a significant resource for those an organization is fundamental for the creation of the wealth since an appropriate administration takes place a series of benefits. Is it important to improve innovation potential, quality and operational excellence?.*

**Keywords:** competition, SMEs, internationalization, economy.

**J.E.L.:** F23, D22, O12

### 1. Introduction

Michael Porter argues, in turn, in his “Competitive advantage of nations”, the effort to assess the competitiveness of a nation must consider the standard of living result, because we can not talk about a competitive nation without that country's population has a level high standard of living. Definition, for example, strictly as part of market competitiveness, worldwide, which covers a country's exports bring limited and unproductive approach, because it takes into

account the economy's ability to create the nation's welfare.

Increasingly, we are witnessing changes in the business world does not resemble the past. This is why practitioners advocate for small and medium reinvention from that recognized principles have no relevance today. Competitiveness crisis facing the sector has not transient. Adam Smith's world and how it did business are a paradigm of yesterday. It turned out that a gradual transformation is illusory moment when radical transformation can not be postponed.

Recent theories and show new aspects related to the internationalization of business and, especially, the internationalization of SMEs, which raises a growing interest in academia and business in Europe and worldwide, while the transformations taking place in the economy beginning XXI century tend to bring small and medium enterprises at the forefront of economic development, giving them a new status.

As regards SME internationalization motivations, the literature associated to the two established categories of motivations for reactive and proactive type: The first category of motives which are reactive response to the pressures coming company in the business, such as: competitive pressure, lower domestic sales, excess capacity in relation to market opportunities at home, over-determined by off factors, the availability of foreign markets, etc.;

The second category of motivations underlying voluntary commitment to international business in order to capitalize on competitive advantages, among them including: access to material and financial resources abroad, reducing costs by harnessing the benefits of economic or trade policy or foreign countries increasing the production scale, technological advance capitalizing held in some areas, management of external market orientation, etc.

In our opinion internationalization and innovation besides Romanian SMEs lack the periodic review evaluation of their position in the market, according to the results of these tests, setting medium and long term strategies. This refers to how powerful the SME market position, if this position is expected to improve or contrary to deteriorate, which is the position stands firm against rivals from the market (usually the local market) and each important competitive variable, which is the company's capacity to defend its position opposite the probable changes in the field of trade and competition anticipated movements.

## 2. The Romanian SMEs in the International Competition: Stakes, Advantages and Limits

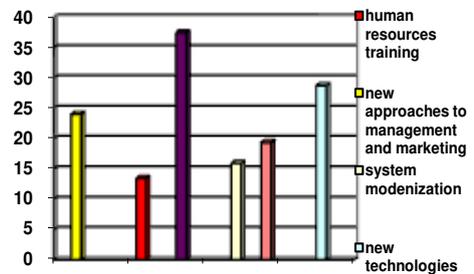
Increasing competition is the reality of sharp pressure on small and medium enterprises worldwide. To compete in niche markets for these companies bring unique balance resources, values and managerial capacities. The distinctive competencies they strive to build a competitive advantage relative to competitors and achieve superior financial performance, to ensure their access to some of the resources available to society. Capacity of larger firms to reduce costs through economies of scale effect, to support expensive research programs, SMEs oppose them greater flexibility and adaptation to market changes occur, greater mobility in the satisfaction of personal needs.

Innovation can be defined as new or innovative solutions in international competition. It provides small competitive advantage in that it provides, for a period of time, a monopoly to exploit unique trait obtained as a result of innovation. Furthermore, systematic innovation is probably the only indispensable lever for sustainable competitive advantage for small and medium enterprises.

To form an overview on SMEs in Romania, knowledge of nature in their innovation activities carried out are a starting point in analyzing the competitive advantage. Statistical data (Figure 1) for 2008 showed that innovation efforts of SMEs have focused mainly on new products (37,49%), new technology (28,75%), management and new marketing approaches (24,02%). These

figures illustrate how Romanian entrepreneurs are becoming more aware that, in the context of growing competition in all areas of activity, innovation is the most effective way to ensure competitiveness.

Figure 1. Nature of innovative SMEs



Given the size of firms on innovative efforts is found that the extent to which companies aimed at improving staff training system and amplification increase with size businesses. Activities to introduce new products and improved uptake of technologies are more common in small organizations and small for micro-enterprises. Medium enterprises recorded in greater managerial and marketing approaches us.

If small and medium enterprises in Romania, however, the emphasis is on motivation proactive type, and in particular on management involvement.

I also raised a number of essential changes in typology and structure of small and medium enterprise sector, which have a more pronounced international dimension - its leading companies in sectors of the economy, virtual enterprises; integrated enterprises value added chain of large enterprises, business networks or clusters that raises a growing interest in literature.

Internationalization of SMEs is achieved, in principle, gradually, by going through several stages, which define as many types of companies with international activity and expressed specific motivations to participate in the global market. Studies from the 90s of last century shows that some firms, namely SMEs, there is a gradual process, the stage of internationalization, they have international activities since its establishment right to enter the market under the large geographical

distance, to penetrate in several countries simultaneously, to form strategic alliances and joint ventures without the benefit of previous experience, etc. Therefore developed a new theory to explain the current process of internationalization, which is based on these developments and is centered on small and medium enterprises, which is currently in the process of consolidation. It is also generally agreed that none of these models alone can explain the dynamics of internationalization of SMEs, especially those leading sectors of the economy, whose main resource tends to be more represented by knowledge. It is often suggested a comprehensive approach that takes into account several models and theories to allow deepening phenomenon. However, most studies devoted to prioritize one of the models and the approach is still dominant stage. At the same time essentially notes and changes in typology and structure of small and medium enterprise sector, due to these new developments.

If the European Union special attention was given to the following types of SMEs: SMEs in the sectors of top technology and media have affinity with nature developed Internet business and new market developments, small and medium exploit the opportunities offered by electronic commerce, especially in services - sometimes called cyber-companies, small and medium-sized integrated value-added chains of large companies are forced to innovate under pressure from major customers.

An analysis by the European Commission to member countries in May 2009 showed that 33,3% of medium firms and 32,2% of small generating over 10% of their turnover from new or renewed during the last two years. These weights are close to that of large enterprises (35,8%), which prove that European SMEs are becoming increasingly innovative.

In the U.S., SMEs account for 86% of all exporting firms. In the last 10 years, the number of small and medium exporters tripled, contributing 31% of total exports.

Studies by the OECD show that the share of innovative SMEs in the total national companies varies between 30% and 60%, depending on the member country. On average, they perform research and development at a rate and a lower level of

large companies, but prove more innovative redesign of products or services to better meet market demand, the introduction of new organizational forms that increase productivity or in inventing new techniques to expand the market.

Worldwide, can be identified a small segment with an exceptional growth rate, which is positioned within the first 5-10% of companies in the world expanding. In many countries, the volume of jobs created by these SMEs is higher than that achieved large size firms. They are based on new technologies and developing impressive research activities. These SMEs are found in industries knowledge-based high-tech and in regions where there is an intense economic activity. They play a pioneering role in developing new products and markets, bringing an outstanding contribution to the creation of a new type of global economy, one based on quality, professionalism and creativity of the workforce.

So, in their haste to gain new markets or being forced to constantly reduce costs and increase quality, large corporations left uncovered important market niches that can be filled more effectively by small and medium enterprises. Therefore, intelligent strategies allow small businesses to grow despite increasing competition worldwide and marked the growing strength of large companies. SMEs can achieve this either independently, by promoting products / services differentiated from those of large companies, either by working with large companies as subcontractors, or by building alliances to multiply their potential.

Alliances of SMEs but is not limited only to those with big companies, they carried with companies of similar size. The sharing of infrastructure, technology and supply and distribution channels, allied SMEs manage productivity, competitiveness and ultimately profitability.

But, it is necessary to be taken into account that innovation is a prerequisite for survival in the market for both companies in countries with advanced economies and for those in process development, it can change quickly today rankings that seemed unshakable. Dynamics dizzying technical progress in the current era is that companies and economies that until recently have excelled in certain areas they could lose

global primacy over night the rate of introduction of innovation falls.

Relevant aspects of the table are evaluated in terms of implications for business strategies, supplemented or restricted and used under the terms of each company. This type of analysis allows the positioning of the SME in relation to the competition, highlighting both their strengths and those of rivals.

**Table 1 – Competitive position of SMEs**

<b>Pluses(+):</b>	<b>Minuses(-):</b>
<ul style="list-style-type: none"> <li>- Competitive advantages;</li> <li>- High customer loyalty;</li> <li>- Well defined market strategy;</li> <li>- Well differentiated product offer;</li> <li>- Increasing market share;</li> <li>- High flexibility to changes in demand;</li> <li>- Other.</li> </ul>	<ul style="list-style-type: none"> <li>- Poor competitive advantage;</li> <li>- Target of rival attacks;</li> <li>- Inadequate distribution system;</li> <li>- Poor response to changes in demand;</li> <li>- Bad reputation among customers;</li> <li>- Other.</li> </ul>

Once the mission enterprise, assess business potential and positioned against the competition, the next step is to transpose the general objectives of the mission, to measure company performance. These general objectives that are established for longer periods of time vary depending on the specific terms of reference, usually focuses on SMEs: profits, turnover, market share, etc.

A rigorous system for measuring their achievement, supposedly basic parts: expressing indicator (turnover, profit, market share, etc.) unit (lei, %, units, etc.) and the (actual size).

The general objectives of the Romanian SMEs can be ranked in relation to their scope of reference and hierarchical level to which they are established, the following sequence:

- Strategic overall objectives set out in the entrepreneurial SME, explicitly (usually in medium-sized companies) and implicitly (in the micro and small class), in relation to key areas of activity, they constitute the starting point objective in establishing the network of the company;

- Tactical objectives (derived) regarding the allocation of resources, they also usually set by the developer in micro and small and

mid-level managers respectively of medium-sized companies;

- Operational objectives (operational) that set the business in micro-firms respectively lower level managers in medium-sized companies, they relate to specific activities, current, which serve to achieve strategic and tactical objectives.

However, the objectives are the starting point in formulating strategies, providing the criteria against which, will be evaluating and measuring the results. These companies would be beneficial to gravitate as far as possible, around strategies difficult to imitate and / or offset, while starting from the premise that whenever one or more of the competing SMEs initiated by one nine “offensive” strategy, competitive pressures will be activated in November.

Basically, the behavior of each “actor” in the market, that market influences, and this in turn affects their behavior. An important role in this regard plays various rivalries between SMEs, which appear in different market sectors. Extrapolating observations made by A. Thomson and A. Strickland on Romanian SMEs can formulate the following conclusions:

- Rivalries between SMEs tend to increase as the number of competitors increases and firms are close in size and potential;

- Rivalries are usually stronger when the growth rate of demand for our products is slow;

- Rivalries become more volatile and unpredictable, the more diversity of SMEs according to priorities and resources, etc., is higher.

Design strategies will match the specific conditions under which each company operates. In this sense, scientists have developed various classification schemes; to better define the types of strategies. Experience has shown that the wide range of strategic options can be grouped according to the general objectives set out in a few basic types known: growth strategies, maintenance strategies, defensive strategies and combined strategies, most of themselves and making their own choices achievement.

In a highly competitive market as one that enables SMEs generally, each of which can become not only the subject, but also the object of attack rivals, be they companies or new entrants existing companies. Therefore,

the purpose of defensive strategies is to minimize the risk of SMEs to be attacked, or decrease the intensity of the attack.

Arsenal defensive strategies is vast, from those aimed at blocking access routes to competitors (which lends itself to a small extent but small and medium enterprises), to those designed to convince potential attacker, the effort is too high in relation to the effect (announcement intent to preserve market share, maintaining the profit share less attractive to outsiders, etc.). The benefits of successful defensive strategies are difficult to measure.

Design strategies are a necessary condition but not sufficient to ensure survival and even growth of SMEs. It is therefore important that the developer be able to translate strategic vision into practice. It should be noted, however, that in a small and medium enterprises, implementation is facilitated by its structural and functional flexibility, the concentration of power in the entrepreneur and the exercise by it of an active role authoritatively on his subordinates. The implementation of the various strategic options presented, concerns mainly the development of market strategies and financial strategy specific to each category of firms analyzed. Algorithm strategic management of SMEs can be developed on two vital directions listed: marketing and finance.

Attitude towards risk entrepreneur also has a considerable influence on strategy. Thus, those with reduced capacity to take risks will opt for so-called strategy mostly “safe”, which minimizes the impact of environmental threats; the profits are not spectacular, but acceptable. Often, the entrepreneur with risk aversion insists on addressing the financial perspective of the business, preferring financing from own resources or borrowed resources. He avoids as much as possible, significant financial commitments until the likely effects of the uncertainty is minimal. Moreover, innovations of any kind of business are interpreted as too risky, compared with the situation. Such places great value on entrepreneurial strategies “conservative” or defensive, designed to minimize risks.

A small entrepreneur with a high capacity to take risks, more proactive strategies “offensive”, with increased chances of profit,

more demanding, challenging but also risky. For him, innovation is better imitation and offensive defense is better. The Romanian economy is already operating in an open and competitive. There are a number of measures that can help maintain the competitiveness of SMEs continue to operate on the domestic market more competitive and increasingly important, although often neglected in unrealistic. It would be beneficial for Romania's economic development undertakings in the sector to succeed domestically and at the same time, turn to international markets through appropriate strategic approach to find niches, avoiding direct competition with large companies on field market segment that it dominates.

### 3. Conclusion

We believe that a more general level, the shift from internationalization to globalization of economic life - one of the defining characteristics of the evolution of global business in the second half of the twentieth century - has a strong influence on SMEs and their internationalization. The influence is mixed, both negative, the top competition, increased business turbulence, but positive, facilitating access to new markets, supply and sales, accelerate the transfer of know-how, access to new technologies, partnerships and strategic alliances at international level, etc. Literature and actual developments of SMEs shows that it lies rather in a position to counter the negative effects of economic internationalization and to capitalize on the positive, especially in the peak areas of the economy.

In conclusions, the competitiveness of SMEs is therefore interdependent national business environment developments and political environment, business clusters, and development of industrial zones and internationalization of economic processes of globalization. Moreover, the internationalization of SMEs internationalization evolves with the national business environment.

In the context of competitive markets XXI century, it becomes imperative need for strategic approaches to entrepreneurial survival and success of SMEs soliciting effective business strategies and actions.

Strategic entrepreneurship is applicable to new SMEs and existing firms in the market, thereby facilitating the positive impact of the efforts of companies to identify the most advantageous opportunities with profit potential of the highest, according to available resources.

According to Strategy 2020, Romania will harmonize legislation so as to enable promotion of the internationalization of SMEs and improve access to the single market. Entrepreneurship would need to be developed by concrete policy initiatives, including a simplification of company law (bankruptcy, the status of private companies, etc.) and initiatives to enable entrepreneurs to restart after bankruptcy. This gives in particular small means to participate fully in the Single Market.

After going through old and new concepts about the company and its competitiveness, conclusions can be drawn are very simple: from small and medium enterprises has been a competitive power market, whose springs are less predictable, but requires that any business that wants to survive to develop into a feature some form of uniqueness. Ultimately, the only sustainable competitive factor is innovation, which in turn depends on the quality of human resources and management.

It is difficult to place small and medium enterprises in domestic and foreign competition because they are less developed than in other transition countries. Their contribution to the growth performance of the Romanian economy is still needed. The influence is mixed, both negative, by the superior concurrence, the increase of the turbulence of the businesses environment, and positive, facilitating the access at new markets of provision and sale, the acceleration of the know-how transfer, the access at new technologies, partnerships and strategic alliances at international level, etc.

The full potential of the SME sector contributing to employment growth and competitiveness policy requires consistent and favorable development in general. In some moments, it is necessary for the state to intervene to offset the adverse consequences of market registered small businesses. A condition for the success of Romanian SMEs is that those who decide its fate to look into the future, not past.

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## A Critical Approach to Hofstede’s Model on Cultural Dimensions

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### Abstract

*Hofstede’s model on cultural dimensions to explain cultural difference has been widely used for exploring different aspects of culture, from management to educational settings. Based on his research from the beginning of 1970, Geert Hofstede created a new paradigm for the study of cultural differences, meaning a model of national culture on four dimensions, later expanded and updated on the basis of an analysis of other cross-cultural data and on the extrapolation of the model. Following the penetration of the model in the scientific community, it became a cornerstone for cross-cultural research, providing a popular method for the study of cultural differences in a wide range of disciplines. In the same time, as with any idea or paradigm shift, Hofstede doctrine has also generated controversies, being both undervalued and overused (Peterson, 2003). The purpose of our paper is to conduct an in-depth analysis on Hofstede model, revealing an objective reflection upon the work of Hofstede by tracking various subtleties and exploring some of its limitations, postulating that seeking commonalities among existing models of national culture represents the way in which cross-cultural research is offered the possibility to advance. As for the methodology applied, the goal of the paper is achieved by analyzing the pro and cons of Hofstede’s model and from the findings derived, by indentifying the keystones of a convergent widely accepted model.*

**Key Words:** Hofstede; Culture; cultural differences; cultural model; cross-culture.

**J.E.L. Classification:** A12, B40, P40

### 1. Introduction

The cultural dimensions developed by

Geert Hofstede to explain cultural differences have been widely used to explore different aspects of the concept of culture. Based on his research in the early 1970’s, Geert Hofstede attached a new paradigm to the studies on cultural differences, as a model of national culture, structured in four dimensions. Over the last decades, the model will undergo expansions and improvements, based on the analysis of the new data collected but also through the extrapolation of the model. It can be observed by analyzing the literature of the past thirty years, that through the introduction and the usage increase of Hofstede’s the model among the scientific community, it has become the basis of scientific research in the field of interculturalism, providing a popular way of studying the cultural differences of vast disciplinary areas as well as inter-and trans-disciplinary areas. At the same time, as with any new ideas or other change of paradigm, the doctrine developed and exposed by Hofstede has generated much controversy, being both under-valued as well as used excessively.<sup>[1]</sup>

The objective of this paper is to achieve a deeper analysis of the model put forth by Hofstede, constructed on the basis of objective reflections on the stated concept and following in this sense the various subtleties of the model, but also some of its limitations.

In terms of methodology, the objective of the research is achieved through pro-con analysis of the model and the derived results, by indentifying some basic principles of a widely acceptable convergent model, postulating that the identification of common anchors in existing models developed around the concept of national culture represents the path through which intercultural research could advance.

### 2. Hofstede’s cultural dimensions model

The empirical basis of Hofstede’s

multidimensional cultural model originates in the factor analysis of 116,000 questionnaires given to IBM employees in 72 countries in the early 1970's. Hofstede argues that most national differences in relation to values, beliefs, norms, self-characterization, as well as many other societal variables can be explained in terms of their statistical and conceptual association to four major dimensions of national culture. According to the theory developed, social interactions are culturally mediated and intercultural relations are inherently conflictual.<sup>[2]</sup> The four cultural dimensions identified are power distance, individualism, masculinity and uncertainty avoidance.<sup>[2]</sup>

In developing the model, Hofstede used constructed scaled indices to rank each nation within the dimension thereby achieving a „typology” of national cultural differences. This led him to argue that each dimension shaped behaviours in different social settings. Later, Hofstede added a fifth dimension – the short and long-term orientation towards time – in an attempt to „avoid cultural bias”.<sup>[3]</sup>

It should be mentioned that in addition to Hofstede's model, the scholarly literature allows us to state that there are at least five national culture models that continue to be quoted and widely used in management research. We refer here to the models proposed by Kluckhohn and Strodtbeck, Hall, Trompenaars, Schwartz and House (the latter one suggesting the model known as GLOBE).

In this context, a brief description of the five dimensions of Hofstede's model is required.

The power distance dimension presents the differences between countries, referring to vertical interpersonal relationships, i.e. between individuals with different levels of authority on a certain hierarchical scale (social, organizational etc.). Small power distance countries are presented as exhibiting social relations developed on the egalitarian principle and interaction is thought to be independent of the society members' authority statuses <sup>[2][5]</sup>. In large power distance countries one can observe marked privileges and behavior or communication differences depending on the status of the individuals interacting.

Hofstede's second dimension – individualist –  
collectivist dimension –

describes the power of the group over the individual. Hofstede defines collectivist nations as 'those where the group's interest prevails over an individual's interest'.<sup>[2]</sup> This leads to a high integration: the 'in-group' protects the individual, in exchange for this protection the individual offers loyalty. In individualistic nations, the subject is much more independent of the 'in-group' which he/she is a member of, so that individual interests prevail in social relations.

The third dimension, masculinity-femininity dimension, is used by Hofstede to describe the polarization between gender roles in a country. Male and female roles represent the two extremes of a continuum that covers a wide range of issues, from the importance given to values such as success and possession (masculine values by definition) to the social environment and mutual assistance (feminine values).

The uncertainty avoidance/acceptance dimension measures how people from different countries are likely to 'feel threatened towards situations they perceive as uncertain, unstructured or unknown' <sup>[2][5]</sup>. This dimension is expressed socially in the need for norms (formal and informal).

The recently added fifth dimension was labeled by Hofstede the long-term orientation versus short term orientation. Long-term orientation 'stands for fostering virtues oriented towards future rewards' whilst short-term orientation stands for 'fostering virtues related to the past and present – in particular, respect for tradition, [...] and fulfilling social obligations' <sup>[3]</sup>.

A comparative introspection allows us to observe within Hofstede's doctrine a series of conceptual features that confer a distinct identity and the status of paradigm shift in intercultural research <sup>[6]</sup>:

- Before the emergence of Hofstede's model, intercultural research often treated culture as a singular variable, the statistical differences identified between two nations or ethnical groups with no obvious cause were explained by using the cultural function. Empirically, it was considered that the cultural phenomenon is one sufficiently complex that its discussion as a whole would not represent the Solution of the decodification of statistical data. Hofstede's model is the first to highlight the need for an approach

on culture using distinct variables, through the use of the cultural dimension.

- The cultural dimensions of Hofstede’s model were constructed on a national level, being supported by correlating variables not on individual or organizational level, but on a national level. In fact, the dimensions discussed lose their meaning and content if they are used as individual descriptors or in relation with individual differences, because the variables they define do not relate to on an individual level, but on a level of national group. In consideration to these findings, Hofstede argues that the use of the culture notion in relation to the notion of nation or organization is faulty, a nation not being an organization and the two types of culture are different in nature <sup>[7]</sup>. The organizational culture consists primarily of organizational practices, being more superficial.
- Counter-arguing the critiques concerning the viability of the data collected and processed forty years back, Hofstede sustains that the dimensions of his model reflect stable national differences, thus defending the opinion according to which the cultures evolve, but in their evolution they tend to move together in the same cultural direction. To validate this hypothesis, the results of the study conducted by Inglehart in 2008 <sup>[8]</sup> can be presented. This study consists of an analysis of the empirical data gathered from countries in West Europe between 1970 and 2006. The results show the fact that while the cultures of the countries analyzed have evolved during the time period referenced and have shown a tendency to underline even an incomplete convergence, at least at the level of subjectively selected variables, the cultural pattern has not shown alterations during the 36 years of observation.

### 3. Critique of Hofstede’s notion of culture

Our analysis concerning the problematization of empirical identified inconsistencies of Hofstede’s model would not be thorough without approaching from the beginning Hofstede’s vision concerning the notion of “culture”.

Culture is conceptualized by Hofstede as

“the collective programming of the mind which distinguishes the members of one group or category of people from another” <sup>[5]</sup>. His definition outlines three inherent characteristics:

- By referring to culture as collective programming he is emphasizing its social nature whereby culture is a social product, formed, nurtured and shared by a group.
- By defining it as a ‘software’ of the mind, he underlines culture’s effect on our cognitive processes. One processes information and acts depending on our cultural software.
- Given the character of social product of culture, there will be as many cultures as there are social groups or systems. At an individual level, this implies that a person is likely to have different cultures, at least as many as the number of social groups to which they belong. This is referred to as ‘layers of culture’ <sup>[3]</sup>.

Hofstede appears to overlook the innate ‘fuzziness’ of culture. This is particularly evident in his notion of ‘cultural layers’, which postulates that an individual has clear and independent cultures or value sets, for each group he/she belongs to. Instead, we can not omit to evoke the complexity of one’s multicultural being by defining culture ‘as a fuzzy set of attitudes, beliefs, behavior and their interpretation of the meaning of other people’s behavior’ <sup>[9]</sup>. We understand this ‘culture haziness’ to be two-fold. First ‘group members are unlikely to share identical sets of attitudes, beliefs and so on but rather show family resemblance’ <sup>[9]</sup>. Second, we propose that there is some overlap between one’s different cultural sets, which allows us to act socially. This merger occurs at both micro level (individual) and at macro level (society). Hence, the concept of layers, which metaphorically can be represented as separate coats one wears and one takes off one by one, may not be adequate and instead one’s multicultural being is better symbolized as a single knitted coat with different types of thread.

Another ontological assumption in Hofstede’s definition of culture is its depiction as a relatively static concept, particularly regarding values. Hofstede describes culture through an onion metaphor

and states ‘culture change is slow for the onion’s core, labeled values’<sup>[3]</sup>. Contrary to this, Spencer-Oatey’s<sup>[10]</sup> emphasis is on the mutable nature of culture. Hofstede’s description emphasises a one-way relationship between values and social structures. Spencer-Oatey<sup>[10]</sup> in contrast argues for a systemic notion of culture, which stresses the interdependent relations between all elements of culture, for example, ‘the introduction of a single technological innovation may set off a whole series of related changes. In other words, culture changes beget other cultural changes’<sup>[10]</sup>.

Similarly, Neo-Vygotskian theorists stress the interrelationship between tools, the individual’s activity and other elements of culture emphasizing the two way process between individual/group activities and possible cultural changes. This bi-directional relationship between values and other components of culture challenges the capacity of Hofstede’s model to reflect contemporary values: particularly in those countries where radical political, social and educational structural reforms have occurred after he collected the data. More generally, globalization and technological revolutions such as the internet and mobile communication are having effects on nations, work forces and educational systems<sup>[11]</sup>.

Although Hofstede makes reference repeatedly to the concept of ‘in-groups’ to differentiate between the nations with collectivist character and individualistic nations, he fails to give a definition of these groups. While Hofstede describes the group dimensions as being either collectivist or individualist, Spencer-Oatey<sup>[9]</sup> makes reference to the notion of one’s responsibility towards the collective group, although the group’s nature may vary from a culture to another. For example, an argument can be made that a highly philanthropic and voluntary culture such as the American culture represents a manifestation of collectivist values. On the other hand, social security regulations in some of the so-called collectivist countries are significantly deficient; therefore one may argue that the respective collectivist behavior is not just an expression of one individual’s belief (value) that he/she depends on his/hers family, but a real necessity based on socio-economical factors.

These examples illustrate that individual interests are congruent to collective interests and vice-versa, making the classification of a society as being either individualist or collectivist difficult. Moreover, these examples reflect the complicated relationship between values and social structures. Finally, considering the case in which the collectivist character and one’s interest are expressed differently in each culture, a single measurement seems to be an impossible endeavor.

As highlighted before, Hofstede does not acknowledge particular organizational cultures within national organizations. To counter-argue, we can bring into focus the educational system and show that different schools, ranked differently according to prestige, regularly exhibit different student behaviors and it is accepted that understanding the school culture is important in understanding such differences<sup>[12][13]</sup>. Cambridge (2006) proposes that the lack of significant differences between teachers’ cultural values in sample of international schools could be a result of similar organizational cultures. Findings from Higher Education research show that the particular characteristics of the educational setting and the nature of the relationship between tutors and students, among other factors, are also influential in international students’ experience of British PhD courses<sup>[14]</sup>. Additionally, there are a range of studies that recognize the existence of specific Higher Education micro-cultures. (to see for example, Mayor&Swann, 2002).

Hofstede repeatedly emphasizes cultural differences and not commonalities. Nevertheless, there are many instances within his model where for example an Eastern country’s cultural dimension coincides with that of a Western country. In this context, we can suggest that an emphasis on commonalities can better explain how becoming bicultural is possible.

#### 4. Conclusion

We have argued that there are several problems with applying Hofstede’s model of culture:

- equating ‘culture’ to ‘nation’ is highly problematic;
- Hofstede’s model does not take into

account the flexible and changing nature of culture and his model is not able to reflect culture changes in the new global context;

- Hofstede's sets of information were used excessively in relation to time and space, ie Hofstede collected data in IBM offices in 1960 and 1970, and not in the evolutionary dynamics of human communities in the early 21st century.

Considering the identifiable shortcomings of Hofstede's model, we would like to suggest alternatives to his model, not as a substitute model, but as a set of suggestions for the assessment and research of cultural and intercultural learning in specific frames.

We argue that the notion of culture can not be reduced to such immutable concepts as nationality and other regional geopolitical constructs. Instead, support the opposite approach through the analytical approach of micro-cultures.

This approach would allow the development of models of reduced amplitude, which can be gradually extended to larger models revolving around cultural and intercultural relations. From this perspective, we consider culture a flexible and dynamic concept. In this respect, we take note to the need for a clear differentiation within the framework of scientific research on the concept of culture, and in intercultural, multicultural and cross-cultural research.

It is obvious that a critical approach to any other model mentioned at the beginning of our analysis would lead to the outlining of further inconsistencies. A study of convergent and divergent points of these models, conducted in 2006<sup>[4]</sup>, leads to the conclusion that the most widely used cultural models focus on different aspects of societal beliefs, norms and values, so that often convergence of these models is limited. The absence of this convergence is problematic for both researchers in their quest to study cultural differences and management practitioners in their quest to understand and adapt to new cultural environments.

The absence of convergence of the models brings us to suggest five main themes emerging of the six models set out, approach that allows the integration of the convergent aspects and thus to strengthen the utility (and possibly the validity) of the existing models. Thus we propose the following five themes:

- Relationship with the environment;
- The social organization;
- Distribution of power;
- Orientation in relation to rules;
- Orientation in relation to time.

At first glance, these five themes seem to replicate the five dimensions of Hofstede's model, but at closer scrutiny, one can observe that the other models are used to amplify, clarify and in some cases reposition the dimensions so that they have an increased relevance in a contemporary context.

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# Identity and Economics: Review of the Literature

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## Abstract

*Classical economic theory has evolved over the last fifty years in the way that economists have abandoned the exclusive consideration of the only two market structures (perfect competition and monopoly) and the assumptions that all participants from one market have the same information as the others. Today, the economists are addressing deviations from the perfect rationality of homo economicus, such as the preconception of the present moment, formation of the behavior and aversion to loss. Economists describe the motivation in that the individual has a "utility function", which is a numeric value attached to things important to the people. The economic theory of identity, formulated by George Akerlof and Rachel Kranton<sup>[1]</sup>, follows the progressive tradition in economics. In this paper are highlighted the theoretical foundation of the economic pillars of identity (the economics of identity) and the main areas of human activity where the theory could be observed.*

**Key Words:** economics; identity; norms, social categories.

**J.E.L. Classification:** A12, B40, P40

## 1. Introduction

Classical economic theory has evolved over the last fifty years in the way that economists have abandoned the exclusive consideration of the only two market structures (perfect competition and monopoly) and the assumptions that all participants from one market have the same information as the others. Today, the economists are addressing deviations from the perfect rationality of homo economicus, such as the preconception of the present moment, formation of the behavior and aversion to loss. Economists describe the

motivation in that the individual has a "utility function", which is a numeric value attached to things important to the people. The economic theory of identity, formulated by George Akerlof and Rachel Kranton<sup>[1]</sup>, follows the progressive tradition in economics. In this paper are highlighted the theoretical foundation of the economic pillars of identity (the economics of identity) and the main areas of human activity where the theory could be observed.

## 2. Review of the literature

Identity can account for many phenomena that current economics cannot well explain. The issue of identity of individuals has been a major difference between Continental European and British theories of economics in the 19th century. Many continental theorists have presupposed that there is a cultural and historical specificity of economic behavior.

The main argue between Marxian economics and other approaches referred to the question of endogeneity of identities. This question was conceptualized by the notion of "class" in Marxian economics. A class defines a "set of agents with similar behavioral patterns and structural roles in the economic systems"<sup>[4]</sup>. From this definition emerges the notion of "class consciousness" as a "peculiar expression of this identity, which might also enable those agents to collective action directed at changing the system"<sup>[4]</sup>. We could mention also the theory provided by Marx and Engels regarding the endogenous formation of the identity, taking into consideration that the evolution of technology engenders changes in the structural relations among classes which ultimately lead to changes of identities in the sense of their reflection in cultural and ideological frames (i.e. the claimed creation of the "new man" of the communist ideology).

The Marxian materialist position is just an

extreme side of the issue. On the other extreme side we find the works of Max Weber, whose approach elaborates on the issue of the cultural formation of economic systems and the process of “rationalization” of the Western European world is seen as being a change of identity of individuals, and the Calvinist entrepreneur represent the historical prototype of a new kind of individuals.<sup>[4]</sup>

The scientific approaches regarding the identity has been re-discovered in economics in two contributions by Akerlof and Kranton<sup>[1]</sup> and John Davis<sup>[3]</sup>. We will focus in this paper on Akerlof and Kranton approach which is basically about the social identity of individuals and the set up of a classical utility function, which just includes identity as a variable.

### 3. The definition of identity upon Akerlof and Kranton theory

The Akerlof and Kranton definition of identity is built on notions of taste and preferences as we can find them in the standard neoclassical view.

There are three notions that are used by Akerlof and Kranton in order to define identity: norms, situation and social category.

The first, meaning the *norms*, have been described by Vilfredo Pareto, “who noticed that much of utility depends not only on what economists normally think of as tastes, but also on norms as to how people think that they and others should behave”<sup>[2]</sup>. Following Akerlof and Kranton, the Pareto’s conception introduces very little change in economics until it is combined with another notion, meaning the situation: the way people should behave depends upon the particular *situation* – that is, when, where, how and between whom a transaction takes place.<sup>[2]</sup>

The third notion is the *social category*, which is used to describe types of people. Researchers argue that social categories matter to behavior because people often think of themselves in terms of social categories<sup>[2]</sup>.

Therefore, we can state that norms as to how an individual and the other individuals should behave vary with their social category and the situation.

Therefore, following Akerlof and Kranton<sup>[2]</sup>, we can use the term identity to describe:

- A person’s social category;

- A person’s self-image, capturing how people feel about themselves as well as how those feelings depend upon their actions;
- Gain and losses in utility from behavior that conforms or departs from the norms for particular social categories in particular situations.

In Akerlof and Kranton’s conception utility functions can change, because norms of appropriate and inappropriate behavior differ across space and time<sup>[2]</sup>. This approach seems to be a break with classic economics where utility functions are fixed. And this approach also seems to be validated by the psychologists, who consider that people can internalize norms.

The individual maximises the utility function, that specifies the social norms and preferences or tastes of the same individual.

The individual – in absence of the others – are gaining a benefit comparing to his utility of identity, when he adheres to the norms of the category he belongs to. This gain of which the identity utility benefits from may represent the pleasure of the people feel when they do something that helps them integrate into a group. This more vast perspective on the utility of identity corresponds to the interactionist perspective of identity, promoted by sociologists and anthropologists, by which identities and norms are deriving from the social interactions and power relations. The people that belong to groups or classes adopt different common signs to differ from the others from other groups or classes.<sup>[1]</sup>

The Akerlof and Kranton analysis could underline the dynamics between individuals and groups, presenting the way one activity can become the defining norm of the group.

### 4. Conclusion

Identity is useful to economists because it suggests a natural way in which behavior can vary within a population. And this is because identity corresponds to people’s own self-classifications and also to their classification of others.

Identity is also useful because the concept could lead us to conclusions on how behavior should vary across types. There is empirical evidence for the statement that particular norms for behavior are associated with the

notion of social categories. This behavior is often described in sociology by pointing to ideals, which are real or imagined characters who personify how someone in a given social category should behave <sup>[2]</sup>. Therefore, in terms of utility, we can observe the fact that an individual, that considers himself as a member of a given social category, could lose utility if his behavior differs from that of the ideal. We could also notice that the same person could lose utility even when he considers that he failed to live up to ideals.

The combination of identity, social category, norm and ideal allows parsimonious modeling of how utility functions change as people adopt different mental frames of themselves – that is, as they take on different possible identities<sup>[2]</sup>. Identity describes one special way in which people frame their situation.

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## Performance Indicators in Museum Institutions from the Three Es Perspective (Economy, Efficiency, Effectiveness)

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### Abstract

*For many organizations, such as museums, the lowest profit line, frequently used as a last performance test, does not exist.*

*In these cases, both the financial performance and the impact of the services are difficult to measure. Still, it is important to know if all the museum resources are properly assigned and if these are used in such a way, so as to offer the maximum effect.*

**Keywords:** management, museum, economy, efficiency, effectiveness.

**Classification J.E.L.:** M 16

### 1. Introduction

Museum managers request information about efficiency and effectiveness if they have to evaluate the performance of their organization. This information is insured by the performance indicators; without it, the managers risk assigning the resources “in the dark”. Museum managers will not know how to compare their performance with that of similar museums, or how their own performance will change in time. Without this information they won’t know when the diagnosis of their current management practices is necessary.

### 2. The evaluation of the performance

The evaluation of the performance contributes to a number of activities of the manager:

\* supports the information and implementation for the policies;

\* supports the planning and budget of the services and the supervision of the implementation of plan changes;

\* helps improve the standards of the service content and the efficiency of the organization;

\* helps approach an efficient use of the resources;

\* is used to increase the control and influence on the decision-making process.

Performance measurements improve the management practice, insure essential information so that the management can monitor the activities on some grounds, on certain levels of the organization. Performance measurements also insure information for the post-mortem strategies, when the policies, management practice and methods are evaluated.

Managers want the best features of the performance measurements to be [2]:

- a) The ability to make comparisons between the current performance, despite the targets, despite the performance of the prior period, or despite the performance of some departments or similar programs;
- b) Ability to underline the interest areas and relevant questions to make;
- c) Ability to insure a vast overview of a service;
- d) To identify trends over time;
- e) To develop the notes of local branches, norms and targets.

The use of performance measurements is thus, an essential management tool. The measurement of performance provides the information requested by the managers in order to improve the performance of their organization. Still, some see performance measurements as being exclusively in the context of improving managerial control. The

information is a means to exercise control; performance measurements can and should be used in such a way, but in order to focus on control aspects they must be confronted with the risk that the performances be seen with suspicion and unwanted answers be invoked at their introduction. There is a more positive aspect of using performance measurements, that allow the possibility of organisational learning. If the current performance drops below the preset targets, then the management may answer one question “Why has this drop occurred?”

A public organization, such a museum can be seen as a system that is depended on its resources, depending on its relationships with the external environment. The public sector museums are quite dependent on their relationship with central sponsorship and the local governmental departments. Private museums, and non-profit ones depend on their location, private sponsors and benefactors. It is certain that the system with mixed public and private financing that currently characterizes the museums in Great Britain, involves a complex knitting of resource-dependent relationships. This means that there is a large number of different constituents whose interests will, at some point or another come into conflict with one-another. The management has the task to chose which interest to serve at the expense of others, or to look for a reconciliation of interests. All the constituents will want to be satisfied receiving an added value for money. The performance is thus evaluated through money for value (VFM value for money).

Museums, like any other organizations, use their resources to purchase from suppliers (work and capital, buildings, materials) in order to produce or insure the services required by the clients/consumers. The value for money framework closely examines the performance of museums in terms of the relationship between the resources of suppliers and service production, and at the same time, tries to ascertain if the service production insures or not the values for the various constituents of the museum.

### **3. The 3 E: economy, efficiency and effectiveness**

There are 3 fundamental elements within the value for money framework that are

usually referred to as „The 3 Es”. These are economy, efficiency and effectiveness [4].

*Economy* deals with the lowering of the costs of the used or purchased resources, taking into consideration the quality of the suppliers as well. In short, economy refers to spending as little as possible.

*Efficiency* deals with the relationship between the production of goods, services and other results and the resources used for their production. How far can you go with a maximum production output for some given suppliers, or the minimum number of suppliers for a given production?

*Effectiveness* deals with the relationship between the results to be achieved and the actual results of programs and services. How successful is the production of goods, services and other results achieved through the objectives policy, the operational targets and other intended results? In short, effectiveness refers to spending wisely.

The examination of the value for money framework in museums may cover some or all of the following aspects:

1. Presentation, contract, control procedures plan used for the construction of the work capital; purchase of the procedures used for material purchases. This will offer the management information whether the purchase action is carried out for the best possible prices or not, in agreement with the wanted quality of the suppliers (economy).
2. The use of facilities, assignment of staff and mix, service integration; maintenance, management and system of resource assignment (efficiency)
3. Consumer satisfaction results, improved educational value; increased awareness of the national cultural inheritance (effectiveness).

Museum managers must also include the maximization of added value to their objective. The value for money framework proves if they are able to reach these objectives.

It is clear that some of them, who come from a non-managerial culture, will change the value included in the norms above, because the managerial objectives could be threatened by such an approach. A moment of reflection should tell us though, that the value of museum professionals can be in

agreement with managerial values. This is not a denial of the fact that the approach is not without flaws, that will be explored in detail in this paper.

The added value is just the difference between the value of the museum suppliers and the production.

The decrease of the suppliers' value is a relatively direct task for the managers who look for an increase of the added value. It is an exercise of minimizing the costs and restricting the budget. Still, both parts of the equation are not met. A very zealous attempt to contain the costs may turn into a reduction of the quality of the production (services) with the result that the value of that production will also decrease. More attention should have been paid to the evaluation of the services for the public.

There are two dimensions of the value for money framework. One that stresses the lowering of the costs for the suppliers: no matter the resulted service, it should be produced with minimum costs in agreement with the quality requirements. The other dimension, that is most often forgotten, requires that the produced service, be evaluated by its users. There is a rationalization in the production of thing with minimum costs, if nobody wants that given good. The value for money framework places the value of the consumers back in the managerial decision on the determination of the level of services, mix or quality. Obtaining information about consumer preferences and the evaluation of their service list does not exist as an independent task.

In case of museum services, many – perhaps most consumers- know nothing about that given service. A buyer-focused management will still try and find out what the buyers think about the delivered services. Instead of taking an attitude, a service focused on the consumer will approach a problem in more ways, paying attention to the need to train the public and evaluate aspects of their cultural inheritance; in order to find out what consumer think is attractive; to learn why some visitors come to museums while others don't. This requires performance indicators on using the service and is an example about how performance indicators can be used for organisational learning.

In an interesting paper, Ames [1] stresses that the performance measurements and the use of performance indicators is an area that is underdeveloped among museum people. He then starts to suggest a series of indicators that might be used. In Great Britain, the Audit Commission has also made an attempt to define the basic performance indicators for local museum authorities (1986). Some of the indicators suggested by these two publications are now present in the value-for-money context, along with suggested indicators.

Cost indicators (economy)

- \* Gross services' costs
- \* Gross costs for the visitors
- \* income to gross costs ratio
- \* preservation/custodial expenses
- \* operational costs per visitor
- \* level of resource

These indicators will include the index of income resources, capital resources, equipment and buildings. Examples of resource indicators may include:

- \* the number of staff on payroll
  - \* the ratio of the administrative staff reported to the operative staff
  - \* square meters of the buildings
  - \* ratio of the square meters assigned to specific activities and the total available area
- Fund sources indicators
- \* public ratio in total income
  - \* ratio of total income generated by the market in total income
  - \* ratio of the income generated by various sources in total income
  - \* volume of services

These indicators are a clear sign for the request of a service:

- \* number of visitors
- \* number of visitors per day
- \* visitors' trend – total number of visitors in the current year reported to the average number of visitors in the last 3 years
- \* number of exhibition days per day
- \* number of visit hours per day
- \* the use of collections; rate and total number of exhibited objects reported to the number of objects from the collection
- \* Productivity indicators (effectiveness)

The productivity indicators are available for the museum as a whole, or for the specific departments of activities in the museum:

- \* Energy efficiency – rate of costs with the energy for the total square meter area;

- \* Gross income per visitor (income from the entrance tax, shops, food, parking, etc);

- \* marketing efficiency – ratio of the changes of the marketing budget for the total changes for entrance or the total changes of the incomes from the entrance;

- \* Shops efficiency – ratio of sells per square meter or per buyer or visitor;

- \* Fund collection efficiency – rate of cost changes for the fund;

- \* percentage of documented collections;

- \* percentage of the budget assigned to preserving activities

Service availability (equity)

- \* low availability of income – ratio between the available hours per day from the total available hours during the week for a duration of minimum 3 years for the public sector;

- \* Minority visitors – rate of the annual presence of the minority, in the total presence;

- \* General availability – average of the number of ours during which the museum is opened: per week or per week, but in an interval other than from 09:00 to 17:00 from Monday to Friday;

- \* number of used lessees;

- \* Number of used lessees from the total number of users;

- \* number of users from the target groups, as percentage between the total number in the target group.

Quality

- \* Exhibit safekeeping – ratio between the number of ordered exhibits and total number of exhibits on the move;

- \* Number of complaints from the users;

- \* Staff expertise – rate of the expenses with the training of the staff to the total number of staff (equivalent to full-time jobs).

Production indicators (effectiveness)

- \* results of the polls regarding consumers’ perception, etc.

The list of performance indicators is nothing more than a suggestion. It is neither prescriptive, nor exhaustive. Given the statute of art of measuring the performance in museum-related services, any performance indicator needs to be tested in order to establish if there is sufficient data for it to be calculated; the usefulness of the information given by the management scopes; and the costs of the purchase of information, in relation to its usefulness.

The performance indicators are themselves less interesting or valuable. The content of the information in the in the indicators is useful only if it is used for a future comparison with something. This can be a set of indicators from different museums that offer a similar variety of services, or it can be the value of a single museum, the indicators from a previous year. The variation of the indicators between similar museums, or between different years can generate questions regarding the variation in itself.

Another way the indicators are used is setting some purposes and values for them. If the current execution is lower than the objective, then a diagnosis is necessary in order to find out why this has happened – could it be that an unexpected event that hasn’t been taken into consideration by the management control has caused this deviation?

Jackson [3] considered some criteria that can be used in order to judge the usefulness of the performance indicators.

*Consistency.* The definitions used to produce the indicators must be considered over years and units.

*Comparability.* Coming from the consistency requirement, it is the only reasonable for comparison.

*Clarity.* The performance of the indicators should be simple, well defined and easy to understand.

*Controllability.* The performance of the manager should be judged (measured) only in the areas where he/she has control.

*Contingence.* Performance is not independent from the environment where decisions are made: this includes the organisational structure and the adopted management style, as well as the complexity and uncertainty of the external environment.

*Coverage.* Do the indicators reflect those aspects of the behaviour that are important for the decision taking management?

*Limitation.* Focused on a limited number of key indexes of performance – that hat have the highest rate of amortization in terms of valuable management information.

*Relevance.* Many applications require specific performance indicators, relevant for their needs and conditions.

*Feasibility.* Are the purposes based on which predictions are made, realistic? Can

those targets be reached through reasonable actions?

It has already been discussed that performance measurements are managerial innovations in museum services. The exercise of initializing a performance revision needs a strong hand at the top of the organization. It needs a partnership between various constituents, between the senior manager and the manager, the cooperatives and in case of the museums from the public sector, between the management and the selected members. Without this unity of purpose, that is the basis for establishing a partnership, the efforts will be detoured towards debates on the usefulness of the performance and not on a revision of the business.

A strong management is needed to bring the “cultural change” in the organization. This is essential if we want the performance revision to have the desired effects. Cultural change means a change of the belief and value system that the top-management team of an organisation like a museum guides its activity. This usually involved a change from the ethos of one reactive administration (the administration of museum collections) to a more pro-active management of the organisation, that places the needs and interests of the consumers at the centre of the decision-making process and that judges the success and performance in terms of consumer service, through the value-for-money framework. Indeed, a part of the needed cultural change means accepting the new language of the value-for-money audit and the idea of some consumers who have preferences, instead of being passive users.

The message of the cultural change had to be transmitted in the entire organization, from the top to the bottom. It needs the setting of a total organisational dedication. From time to time it has been proven that individuals performed better, with regard to their contribution to the operations of the organisation, if they knew in which way their activities are connected to the work of the entire organisational team. A sense of attaining this, is that it insures that the objectives of each position are clarified and notified and translated specific results and performance predictions on all levels of the organisation.

Bringing cultural changes into an organisation is easily attained through an organisational development program, in which training plays an important role. This will divide the ethos of the high performance of the organisation, and at the same time, it will give the staff the needed skills and experience to reach these improvements. An increase of the performance needs, in most cases, a reorientation of the current practices, which in turn require a new set of expertise.

In many cases, the new information, and the value-for-money audit that will generate the data for the performance indications will require negotiations. Some managers will need buying and negotiation skills. A top-to-bottom approach, in which the above mentioned be introduced in the new system, is doomed to fail. In order to successfully operate within the value-for-money framework, data is necessary in order to build the performance indicators, and the organisation will issue data of the required quality if the organisational environment in which the new system is to be implemented, is in good order. If they introduce a threatening trend, that stresses their use as a managerial control instrument, then it is less likely that the cooperation will work properly. On the other hand, if they are presented as a type of organisational learning, then cooperation will probably be a success.

If sufficient resources are not assigned for the purchase of new abilities on all levels of the organisation, the improvement of the performances will be at risk. The new management informational systems involved in the value-for-money framework are needed, but are not sufficient to increase performance. These information systems will be of use only if the managers of the services will know how to use them efficiently.

The first stage in any performance revision exercise is the clarification of the strategic and corporative objectives for each organization. In these objectives, which in part define the effectiveness dimension- the effectiveness indicators prove the degree in which the organization has managed to reach its strategic objectives. If the corporatist objectives are not clearly denounced, there is a high risk that the organization be under-optimized. Even if the constituent elements of the organization meet their operational

objectives, if these are not clear regarding the way their actions will contribute to the corporatist objectives, there is no guarantee that these strategic objectives will be reached.

#### 4. Conclusions

While the more general level of the strategic objectives in any organisation is the increase of added value, the subject of constraining the quality of the process due to the fact that the added value is acceptable, becomes a statement too abstract to put into practice. Going further, some problems in defining the added value have already been presented. The strategic objectives need to be more concrete if they have to be translated into operational objectives.

Examples of corporatist objectives of the museum are included in the following list:

- \* to properly meet the request for its services;
- \* to insure services of the best quality;
- \* to develop services according to the request;
- \* to take care of all statutory debts;
- \* to maintain all taxes at tolerable levels;
- \* to look for new financing sources;
- \* to assist individuals and specific groups for potential development;
- \* to be a good and careful employer;
- \* to develop a performance-oriented management style;
- \* to encourage the concern for the general public of visual art and crafts and the local and national, cultural or scientific content;
- \* to make sure there are clear policies for the management of collections and targeting of users;
- \* to provide special events and exhibitions regarding the declared policies;
- \* to make sure that the background and quality of the presentations are attractive from visual point of view and of high standards;
- \* to make sure that the facilities are used within the limitations of the policies;
- \* to supervise the protection of the primary evidence of local and national history, natural history, as well as to increase the care regarding this subject.

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## The Economics of Inner Well-Being: Holistic Personal Development Between Lucrative Opportunity and Mass Human Awakening

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### Abstract

*This paper explores the recent trend of holistic ideas and self-development practices from two different angles: that of a very profitable business opportunity on one hand, and that of a large-scale, societal transformation at the spiritual level on the other. As our quest for happiness never ceases to amplify into a real social phenomenon, fuelled by inner desires as well as external pressures, a whole new market place for personal development products of all kinds emerges with it. The multi-media and publishing industries are flourishing on the accounts of billions of consumers worldwide, who give in to one seductive promise or the other in an everlasting race of becoming the best versions of themselves and who nowadays are so easily reachable through the internet. Is this a legitimate offer following the perfectly natural demand of our evolved society, whose primary need has become that of self-actualization? Or is it an opportunistic way of responding to this mass human awakening tendency, more and more noticeable in recent years? In a daring analysis at the borderline of business, psychology and sociology, this article aims at revealing interesting arguments from both sides of the story.*

**Key words:** holistic personal development, positive psychology, happiness industry

**J.E.L. classification:** Z10

### 1. Introduction

Departing from the general idea of inner, holistic well-being, but from the strict point of view of the individual, we can honestly state that our modern society has become very loyal to the cult of happiness. After all, this mysterious condition is what everyone is looking for, the universal dream we all want to transform into reality. Personal quest for some, genuine dictatorship imposed by social norms for others, people are ready to make any effort enabling them to foresee the light of happiness. As anything worth having, this state is not an easily attainable one, there is no recipe for success because we are all so different and there surely isn't a clear pathway towards it.

For this reason, maybe, we are able to talk nowadays about happiness taking the leap from a very intimate concept to a selling product, largely exploited by our consumerist society. It seems like we are bombarded from all sides with a plethora of offers and solutions meant as an answer to any sort of personal problem or inner longing, from how to lose weight, stop smoking, improve your brain's capacities up to, for example, getting initiated into the art of meditation. And so on and so forth, the list could go on forever. We are to choose from a multitude of personal development therapies and methods usually wrapped up into books, seminars, conferences, work-shops, articles or all sorts of multi-media products, nicely pushed forward especially by the power of advertising, celebrity endorsement and personal branding of experts.

Nevertheless, all these things did not appear out of nowhere. There is an important demand for personal development products in general, which accentuated tremendously over the past couple of decades. In order to achieve a complete understanding of this entire phenomenon, we will first look into the socio-psychological aspects causing this increasing obsession for holistic personal

development among the individuals of the 21<sup>st</sup> century. In this sense, positive psychology – a fairly young science and the newest branch of this field - seems to clarify many interesting things by simply studying the psychological conditions necessary for us to reach a state of fulfillment.

Further on we shall expand on how this inner impulse towards personal betterment of the majority among us has led to the emergence of a new lucrative sector. A myriad of business opportunities gathered together under what we could call a “happiness industry” have found a fertile soil especially in western, developed economies, within culturally individualistic societies. Holistic personal development refers to a whole life, where continuous improvement is sought after in all three main dimensions of our existence: body, mind and spirit. This way, the happiness industry has become a sub-part of different other traditional industries like multi-media, publishing, beauty or medical industry. Nothing wrong in all that, except when there are people trying to take advantage of this trend, ending up in harming the innocent, naïve consumer. There are many voices attacking some of the personal development products in the market place today as, without a clear framework and proper legislation for this sector, everyone is potentially at risk.

After analyzing the causes and manifestations of this phenomenon, our goal is to closely look at the criticism brought to the happiness industry at large and see what conclusions can be drawn out of that. Last but not least, we are asking the question if, in spite of all the criticism, the existence of all these personal development products out there can lead to more good than bad in the end, as maybe for the first time in history humanity is truly preoccupied with continuous, conscious betterment from within. Are there serious arguments in this sense or is it just a vain hope that all the resources coming into play when talking about happiness industry are not simply wasted in a money-making exercise?

This article is set to find complete, researched answers to all these questions. But first things first - let’s understand the real premises of holistic personal development.

## **2. The need for personal development: psychological and socio-cultural factors**

There are many factors influencing our insatiable appetite for self-improvement. In a very thorough analysis of what she calls the rise of “mind-body-spirit” or MBS publishing, Elisabeth Puttick (former editorial director of Thorsons at HarperCollins, the largest MBS imprint in the UK) admits to the complex causes of why the market for MBS products has known such a rapid growth. Extrapolating the MBS market to the holistic personal development market, we cite what we believe to be the most relevant factors outlined by Puttick (2005) as leading up to such considerable growth:

- “growth of holistic thinking and approach throughout culture, e.g. in religion, science, medicine, computers, education, psychology, business, gender relations;
- post-scientific, post-secular search for meaning and purpose;
- globalization bringing increased interest in non-Christian spiritualities, particularly Buddhism and shamanism; it also increases the sense of personal smallness, helplessness and alienation, shifting the emphasis from the political to the personal – from changing the world to changing oneself;
- shift from organized religion towards organized spirituality;
- influence of US trends (therapy culture, individualism that encourages self-development, greater interest in religion and spirituality)”.

To all this we could also add an argument derived from Maslow’s hierarchy of needs (1943), implying that, in a modern society whose material and safety needs are largely satisfied, it is only normal we start exploring higher needs, such as the need for self-actualization. Sticking with Maslow, we also remember his ideas regarding what he called people with “B-Cognitions”, where the B stood for “being” as opposed to “having”. It may just be that all the time we spent chasing success (and all the pragmatic things it implies) have led us to a long-awaited realization that inner values nourishing our

souls are worth much more than any worldly or imagined possessions.

Moreover, in addition to all this, what we believe to have played a crucial role in the growing interest for holistic personal development practices is the increasing scientific evidence that our connected attitudes and beliefs come from our very fabric as human beings. In this sense, one of the newest sciences out there – positive psychology – has gained incredible momentum and success, starting in the US with the research efforts of Martin Seligman and being disseminated worldwide in a matter of years. Together with his colleague Mihaly Csikszentmihalyi, he was expressing his conviction that “a psychology of positive human functioning will arise, which achieves a scientific understanding and effective interventions to build thriving individuals, families and communities” (Seligman & Csikszentmihalyi, 2000). This field is founded on the belief that people want to lead meaningful and fulfilling lives, to cultivate what is best within them, and to enhance their experiences of love, work and play. Its merits lay primarily in the fact that it brought our pursuit of happiness under the scientists’ magnifier, taking theoretic psychology from studying and treating psycho-pathological illnesses to also studying and understanding “normal” persons and what determines their happiness.

With its three central concerns: positive emotions (contentment with the past, happiness in the present and hope for the future), positive individual traits (the study of personal strengths and virtues) and positive institutions (the study of general strengths that foster better communities), positive psychology makes it very easy for everyone to relate to it, hence its tsunami-like ascension. In his book “*Authentic Happiness: Using the New Positive Psychology to Realize Your Potential for Lasting Fulfillment*”, Seligman (2002) explains how happiness encompasses many different emotional and mental phenomena, delimited in three overlapping areas of research:

- The Pleasant Life = “life of enjoyment”, or how we savor positive things and emotions that are part of normal and healthy living;

- The Good Life = “life of engagement”, or the benefits of experiencing states of *flow* and *mindfulness*;
- The Meaningful Life = “life of affiliation”, or how contribution determines a positive sense of well-being, belonging, meaning and purpose.

Looking at this theoretical conceptualization we understand why everyone relates to positive psychology. It encompasses the study of ancestral emotions and values generally valid for our species, that we care for and pursue beyond any social, cultural, political or economical segregation criteria invented by the human mind. Therefore it all seems like a forgotten language that everyone knows how to speak only in their hearts. So when it was finally revealed in an organized, palpable form and enjoying the legitimacy brought by its rise to the rank of science, the human soul rejoiced in finally being offered an accredited map towards fulfillment. This may very well be the missing puzzle piece explaining why we are all so drawn towards self-improvement and personal development products in general, and even more so in recent years. After all, these are just practical applications of positive psychology and, following our natural tendency of gravitating towards a holistic state of well-being, we have begun to explore and create an ever richer arsenal of such applications.

### **3. Happiness - a thriving but controversial business**

For reasons briefly exposed so far, we can say happiness is more than ever taken very seriously. As Puttlick (2005) puts it in the case of holistic personal development books, the success of the first mind-body-soul bestsellers from the mid ‘90s “demonstrated the demand – the market – for these types of books, which in turn stimulated the supply. The key players were now hungry for ‘product’, and began to pump it through”. This showed an incredible opportunity that needed to be seized immediately, that of feeding a new-born demand for a specialty niche and turning it into the fastest-growing non-fiction genre of the global publishing and multi-media industry. As a result, all the

methods and practices for holistic personal development that have been perfected over the past years and fed to the avid public, firstly as books and then taking advantage of any possibly existent channel, each with its own supreme promise of initiation into a world of abundant happiness.

It is difficult to estimate the real value of this ultra-competitive market, still in full boom. The most recent study we found on the market for self-improvement products and services is the 8<sup>th</sup> edition of the only available analysis of this market, elaborated by Market Data Enterprises in 2010 and concentrating primarily on US-originated products and services[1]. Going through this study we realize the actual extent of this \$ 10.5 billion market for motivational self-improvement programs, products or services that seek to improve us from a holistic point of view. It encompasses books, CDs/DVDs, videos, audio-books, infomercials, motivational speakers, multi-media packages, public seminars, workshops, retreats, webinars, holistic institutes, personal coaching, online education, websites, training organizations and more, covering major topic categories such as weight loss / exercise, business / sales skills, business opportunities / investing, improving relationships, general motivational and stress management.

Thus we realize that what may initially seem to be a nebula-like market place, it is actually a very segmented one, with every specialty showing different major characteristics, different past and provisional developments and most importantly different experts and champions.

The motivational speakers market is characterized by live events and an amplifying shift in product mix to webinars/online courses. It comprises also the corporate training market and it is dominated by self-improvement gurus / celebrities, who developed astonishing careers via personal branding and transformed it into a way of life. These are people like Anthony Robbins, Richard Bandler, Deepak Chopra, Stephen Covey, Dale Carnegie, Louise Hay, Napoleon Hill, to name only a few of the past and present giants in this industry.

The self-improvement books market, comprising also the so-called “New Age” bookstores, has its own stars as well. From

classics like Scot Peck’s *The Road Less Travelled* (1978) and Louise Hay’s *You Can Heal Your Life* (1984) to a perpetual bestseller like Paulo Coelho’s *The Alchemist* (1988), to titles consolidating this genre such as James Redfield’s *Celestine Prophecy* (1993), Daniel Goleman’s *Emotional Intelligence* (1996) or Eckhart Tolle’s *The Power of Now* (1997) and making room for major book phenomena that boosted the market: *Chicken Soup for the Soul* and *The Secret* (also a movie) again, to name only a few.

These two main segments may seem to take care only of the mind & spirit aspects of our personal development, but there is an entire offer out there leading us on the way to a healthy, faultless body. The biggest chunk of it is occupied by the weight loss market, responding to our fixation for fitting into this generation’s highly debatable norm of a perfect body image. The diet industry is like an enormous octopus expanding its tentacles into sub-segments such as: diet soft drinks, artificial sweeteners, health clubs / gyms, commercial and medical programs, diet drugs / pills, surgeries, fasting plans, low-cal foods, meal replacements, diet books etc.

And then there are products specifically designed to serve our body, mind and spirit simultaneously, directly answering the needs of our exigent, fast-paced lifestyle, like the very popular practices of yoga and meditation or the stress management programs relying mainly on relaxation techniques, biofeedback and massage therapy.

Absolutely everything that we mentioned so far is also available or marketed online, where the long tail of self-improvement products and services seems indeed infinite. Technological development made the internet an ever more democratized universe, opening the gates of online commerce and advertizing to established market players and those of independence and free-lance careers to the newbie’s of the industry. Moreover, the social media phenomenon sends traditional “word-of-mouth” on new heights and this is what truly makes or breaks a personal development product, even more so than in other industries.

Nevertheless, it becomes more and more difficult to navigate through the online ocean of offers, through all the promises of life

coaches, auto-proclaimed psychotherapists or spiritual gurus. And the vigilance of our collective wisdom is usually inefficient, as there are split opinions on most subjects. This market place is in soaring need for regulations, frameworks and standards meant to protect the consumer from fake experts and made up self-improvement methods with a purely deceiving, lucrative purpose.

In an apparently soft marketing exercise, based on the supposed intention of sharing and empathizing with the client, every coach says that his / her method has changed his / her life. Many of them are assumed to be normal people with no special skills or abilities (just like the clients upon whose credulity they are trying to build a business), who at some point in their lives had a breakthrough moment applying one self-improvement method or the other and who consequently decided they could teach that method further on for a living. Some skeptical voices assume these people to simply reiterate the concepts or methods of previously acknowledged experts, renaming and reorganizing content in an attempt to make it their own. Thus, all of a sudden, a new self-made expert in personal development is fabricated.

The certification problem is a serious one. Consumer protection authorities have no legal reference point when it comes to those willing to exploit this flourishing industry. You don't have to be certified in order to become a personal coach and in some countries it is absolutely possible to auto-proclaim yourself a psychotherapist. No wonder the general discontent with untrained people preaching diverse methods when it comes to holistic personal development.

Previously mentioned aspects, extremely accentuated by the chaotic hyper-online-market, built up a shady reputation of an otherwise very interesting and dynamic business area. It all makes up for a bazaar-like marketplace out of control, an economic jungle in which the consumer of self-improvement products finds it more and more difficult to make the right choices or to separate the best, the real professionals, from the fakes.

Even more so, it has led to a fierce debate on whether or not any of these practices are actually working, if they are worth their money or not, going as far as rising

allegations of similarities with sectist behaviors and methods. This is especially the case when it comes to practices for the mind and spirit, where scientifically proven evidence of their efficiency is mostly lacking. All that is defending them is the wave of positive testimonials coming from satisfied clients. But skeptics do not accept this as a valid argument; they attack it with the conviction that self-suggestion and the placebo effect can be powerful enough to create the illusion of a real, positive influence, even more so if the practice / method in question is supported by the skills and technique of a versed, charismatic so-called expert, with a witty, persuasive discourse.

#### **4. The road to a possible mass human awakening**

All of this criticism brought to the ways in which the marketplace for self-improvement products and services continues to expand is not illegitimate at all. In fact, some would go so much further than this, saying “these trends can be interpreted negatively as symptomatic of the general dumbing down and decadence” of modern society and culture (Puttick, 2005). After all, how else could we be so blind in our search for happiness, so ready to accept and pay for any method promising us the world, no matter how wacky, without any further inquiry? How else would such important things, playing with our very well-being, could be left unregulated? Looking at the veritable explosion of practices we can only assume things go on exactly like this. We are willing to “swallow” anything, any book, course or webinar liable of bringing us closer to our ideal state of existence.

However, mainstream acceptance might not be such a negative thing after all. The multitude of body-mind-soul products and services available on both the online and offline market, together with the increasing recognition of name-brand authors are indicators of the integration of holism into popular culture and lifestyle as a perennial, omnipresent spirituality. This is no fling, no superficial or ephemeral tendency of trying out the new trend. To once again cite Elizabeth Puttick (2005), “on the bigger scale, holistic spirituality needs business, to

get its message to the market as well as its goods and services. And mainstream society needs holism”. It needs holism because we should never cease dreaming and trying to change the world for the better, to transform it into a more pleasant life arena for us and generations to come. But if we want to change the world we have to start with ourselves, each and every individual. Or as Gandhi said: “Be the change you want to see in the world”. This deep, sustained interest for holistic personal development will give birth to paradigm shifts and will help us break free from outdated thinking patterns, allowing us to become real change agents.

Positive psychology helps us understand how this actually happens in practice. Practical applications of positive psychology include helping individuals and organizations identify their strengths and use them to increase and sustain their respective levels of well-being. Through many of the holistic personal development products and services we learn exactly this – to identify and accentuate our strengths and become happier, better functioning individuals in every area of our lives, from our educative years to the time invested in the workplace, to pursuing and sustaining beautiful and meaningful relationships with other people around us. And as it has been scientifically proven, it is exactly this factor that makes us most happy in live, that gives us the feeling of fulfillment and of “successful living” – that of having healthy and strong relationships (Shenk, 2009).

## 5. Conclusions

This paper reflects the socio-economic reality of our modern society in its continuous access towards happiness-bringing self-improvement. Scientists have proven that what predisposes us to happiness are mainly the genetic inheritance (50%), external conditions / environment (10%) and most importantly, what constitutes our intervention, investment and control margin, our daily way of thinking (Davidson & Begley, 2012) and taking action (40%). As if we intuitively knew that beforehand, we embarked on a journey of self-discovery and continuous improvement. This, in turn, engaged copious business opportunities, a whole new industry and an overabundance of

holistic personal development products and services, but not without side-effects.

The majority of negative comments addressed to this high-paced emerging happiness industry are very justified. The two forces creating this fascinating market place – a curious demand following its quest for fulfillment and the responding offer trying to capitalize on each and every one of our personal development areas – are already too big to self-regulate. Like any other industry, this too should be taken more seriously and offered the attention it deserves. It is hoped that this paper will help to the better understanding of the “happiness industry”, the discovery of innovative measures for addressing this stringent problem and the identification of new and productive areas of research, based on empirical data.

Last but not least, we feel the need to express a general concern regarding the pursuit of happiness with all costs. More often than not an imperative, a self-imposed goal, this sort of happiness becomes harmful, bringing anxiety and not liberation. As noble a goal to reach true happiness and as elevating as this mass movement towards holistic spirituality might be, we must remember they are not a destination but the journey itself.

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## Economic Discourse in Globalization

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### Abstract

*Discourse has been referred to as in many ways and a great importance has been attached to its context (be it cultural, political or economical). In other words, it has been viewed as integral part of a social, cultural or economical practice. Among many other important factors in the process of globalization, language occupies the first places. To put it differently, globalization has been and should be approached with a focus on language.*

**Key Words:** discourse, text, economical discourse, globalization.

**J. E. L. Classification:** Z 19

Communication within or across languages implies interpretation of discourse. Understanding how elements of a discourse concur to produce a given meaning involves comprehension skills and competence. The cultural, political or economical are paramount as well.

### 1.1. Discourse or text

In linguistics, the syntagm “discourse analysis” is used to refer to the analysis of both spoken and written texts. Discourse analysis has been defined as “The attempt by various linguists to extend the methods of analysis developed for the description of words and sentences to the study of larger structures in, or involved in the production of, connected discourse. Term first used in the 1950s by Zellig Harris [...]”. [13] In both cases, the emphasis is on the analysis of the way texts go across the limits of single sentences in order to form whole stretches of language.

Like many other theorists, Bruce considers that text and discourse are interconnected. [1]

He asserts that “discourse is embodied in texts and texts make up discourse.” Kress refers to this interrelation as to one of ‘emergence’. [8]

As he puts it, “discourse emerges in and through texts.” Therefore, text and discourse are not similar notions, but interrelated and independent ones.

The basic meaning of the term discourse in habitual usage is “talk”. It has been employed in many ways for infinite purposes. Historically, the term “discourse” has been applied to more rehearsed forms of spoken language (i.e. speeches) than to spontaneous speech. It has also been used to make reference to the topics and types of language used in particular contexts (i.e. the legal discourse, the medical discourse, the religious discourse). The W.N.E.E.D. provides us with meanings of the entry “discourse” such as:

“noun (Middle English *discours*, from Medieval Latin & Late Latin *discursus*; Medieval Latin, argument, from Late Latin, conversation, from Latin, act of running about, from *discurrere* to run about, from *dis-* + *currere* to run-more at CAR) (14<sup>th</sup> century)”

- archaic: the capacity of orderly thought or procedure: rationality
- verbal interchange of ideas; especially: conversation
- a: formal and orderly and usually extended expression of thought on a subject b: connected speech or writing c: a linguistic unit (as a conversation or a story) larger than a sentence
- obsolete: social familiarity.” [15]

Moreover, according to the O.C.D.O.L. the entry “discourse” is defined as “Any coherent succession of sentences, spoken or (in most usage) written. Thus this entry in the dictionary is an example of discourse; likewise a novel; likewise a speech by a politician or a lecture to students; likewise an

interview or any other series of speech events in which successive sentences or utterances hang together. Often equivalent to text. The term in French (“discours”) is often restricted, following Benveniste, to speech directed by a specific speaker (an ‘I’) to a specific audience or addressee (a ‘you’). Distinguished by Benveniste from a narration (e.g. an historical narrative) or ‘récit’.” [13]

Some linguists use discourse to separate speech from writing. In their opinion, discourse is employed when talking about speech whereas text is used when discussing writing.

Viewed from a different angle, discourse is viewed as process and text as product. In a more general perspective, the term “discourse” makes reference to any naturally occurring stretch of language, spoken or written.

As Kress (qtd. in Hatim 2001: 28) puts it, discourse represents “institutionalised modes of speaking and writing which give expression to particular attitudes towards areas of socio-cultural activity.” [6]

Hence, discourse represents a “part of socio-textual practices” (ibidem: 193). On the same line of thinking, Fairclough itemizes discourse as language use viewed as an integral part of social practice. [4]

For the purpose of our research, Hatim’s (2001: 187) definition is relevant. In his opinion, discourse is “a vehicle for the expression of cultural values and belief systems (racism, cultural hegemony, etc.) within and across languages.” [6]

The modern meaning of the term “discourse” as encompassing all forms of talk has developed since conversations also progress. This assertion makes us think that speakers make efforts in giving their interactions coherence and meaning. In other words, discourse becomes a “crafted medium” in the modern world. [2]

In addition, Carter metaphorically links the term “talk” as discourse to the term “text” since that they both allude to the act of weaving (from the Latin *texere*, *textum*-to weave). As a rule, people use the metaphor of “losing the thread of the conversation” when they are engaged in a dialogue. On the other hand, he considers discourse in written texts to be the focus on the way written texts are constructed that is to the texture of texts.

This analysis includes semantic and grammatical rules at the level of words, sentences, paragraphs of different genres within a cultural context.

On the same line of thinking, Kramsch believes that there is a natural linkage between text and discourse. [7] In fact, a text is to be viewed as a discourse so that the whole meaning can be communicated. In addition, she emphasizes the fact that text explication (grasping the author’s intended meaning) and text deconstruction (associations within the text under scrutiny) are specific both to texts and discourse.

We totally share Ulrych’s opinion that both discourse and text call attention to any stretch of language that has unity. Seen in this light, Ulrych considers that it is the co-text or the knowledge of the world outside language that gives rise to the unity of discourse or text. [10]

Moreover, she lays emphasis on the fact that the text represents the uttered intention as understood by the speaker who then rebuilds this unity in another culture.

A totally different view is supported by Laclau and Mouffe who view discourse as a totality which encompass both the linguistic and non-linguistic. From their angle, discourse is not a mixture of speech and writing but they are two different internal constituents of the discursive totalities. [9]

Their ideas are weaved around Wittgenstein’s example of building of a wall. They start from the supposition that one asks his/her workmate to pass a brick and add it to the wall. Both the act of asking for the brick which is linguistic and the act of adding the brick to the wall which is extralinguistic are integral part of a total operation that is the building of a wall or communication, in our case.

Laclau and Mouffe also use the term “discourse” to lay emphasis on the fact that every social formation is meaningful and symbolic. This idea is reinforced by the parallel between two acts such as kicking a spherical object in the street and kicking a ball in a football match. We may say that both of the physical facts are similar but the meaning is totally different. They argue that the object is a football as far as it creates a system of interrelations with other objects which are socially built. They label this systematic set of relations as discourse.

On the other hand, integrating a football within a system of socially constructed rules does not involve that it stops being a physical object. Their proposition is additionally sustained by the example of a stone which exists independent of any system of social relations but it may be, for instance, an object of aesthetic contemplation within a particular discursive format.

Therefore, Laclau and Mouffe consider it necessary to point out the fact that the existence of objects is independent of their discursive articulation only to the extent that one could use that mere existence as a point of departure of a social analysis such as behaviourism which is in opposition with their *modus operandi*.

## 1.2. Discourse as a moment of the social process

Both agencies and agents use alternative strategies, especially in times of instability or crisis. They are used for structural change. These strategies, as we call them, are always “elaborated in and through discourses” (Fairclough 2006: 21). [4]

Discourses have non-discursive effects. They simplify economic and political relation and have also the capacity to mobilize people. Since the economy is viewed as “an imaginatively narrated system” and the state system as “an imagined political entity”, discourses are meant to have “a key role in the always tendential constitution and consolidation of the economic, political and other systems, shaping the forms of their institutional separation and subsequent articulation” (ibidem).

Discourses are constitutive. As Williams puts it:

“We find then not a reified ‘language’ or ‘society’ but an active social language. Nor is this language simply a ‘reflection’ or ‘expression’ of ‘material reality’. What we have rather is a grasping of this reality through language, which as practical consciousness is saturated by and saturates all social activity, including productive activity”. [11]

Many linguists and economists consider discourse to be a moment of social events which is dialectically interrelated with other moments. Some use the term ‘text’ for the discursive moment of social events. This

does not only mean written texts but also speech as a moment of events.

Discourses are part of social changes. Social change implies change in the behaviour of social events, in social practices and the networking of social practices. Therefore, it includes change in the character of texts, discourse and languages.

As an example, when a particular state is subsumed to globalization processes, we can expect change in its institutions and organizations, change in discourses and so forth. In the case of discourses, we may say that new discourses are constantly emerging. In other words, they condense other moments of the social process as people experience them in their interaction with the world.

By way of illustration, new public management implies a shift in relations between social fields: government and private business. Government organizations are more like private business organizations in particular ways. In part, these will be changes in orders of discourse: relations between new market discourses and existing discourses, new market genres and old ones, new market styles and old ones.

New institutions, organizations, practices or discourse will emerge within what is basically a change in relations between social fields, institutions, organizations, orders of discourse, discourses, genres and styles.

## 1.3. Economical discourse in the globalized world

The idea that the economical discourse (or ‘jargon’ as some people would describe it) is very popular both in the West and in Romania is widely shared. As far as Romania is concerned, it is true that it had a socialist economy and a one-party state until 1989 but is now functioning economically in the capitalist ‘global economy’. This shift also implies a change in the Romanian language as well.

As an example, the Romanian language comprises direct borrowings from the English language such as *marketing* (meaning marketing); *marketability* (meaning “vandabilitate; grad de tranzacționare”); *marketing mix* (meaning “mix de marketing; elementele de bază ale unui plan de marketing: produs, preț, piață, promovare”); *carrying market* (meaning “piață portantă”);

*crossed-market* (meaning “piață intersectată, situație în care prețul oferit de un broker este mai mare decât prețul de ofertă cel mai scăzut al celui alt broker și viceversa”); *either-way market* (meaning “piață în care cotațiile la ofertă și la cerere sunt aceleași”); *accounting* (meaning “contabilitate; evidență contabilă; gestiune; clacul; explicare; justificare”); *cash budgeting* (meaning “planificare a intrărilor și ieșirilor de numerar”); *company* (meaning “companie, firmă, societate comercială”); *crossing* (meaning “încrucișare”) or *monetary asset* (meaning “activ monetar”). [14]

On the other hand, there are some words which previously existed in the Romanian language “and are historically the same as words familiar to us in English (with differences in spelling, pronunciation and morphology due to the difference between the languages), but are used here in the ways and with the meanings of contemporary business English, which is new in Romania” (Fairclough 2006: 2). These words are *global*, *strategie* or *success*. [4]

For the purpose of our paper, we also consider the following terms relevant: *capital* (“în sens larg) stoc de valori sau de active care, intrate în circuitul economic, pot genera venituri posesorilor lor. (2) Ca factor de producție, capitalul cuprinde bunurile rezultate din producție și care sunt folosite pentru producerea altor bunuri economice [...]” (D.D.E. 2001: 80)) and *corporație* (“formă specifică de organizare a activității economice. Inițial, corporația a apărut sub forma unor organizații ce uneau meșteșugarii din aceeași meserie sau de meserii înrudite. Se mai numea breaslă și era constituită în scopul de a promova interesele și drepturile profesionale ale membrilor ei” (D.D.E. 2001: 129)). [12]

Some of the literature on globalization puts forward the issue of discourse as a feature of globalization. A relevant theory on discourse in the process of globalization is put forward by Harvey [5] and Fairclough [4]. They both view discourse as an integral part of the social system. Harvey describes discourse as being one of the six dialectically interrelated instants of the social activity such as power, values and beliefs, social connections, rituals and institutions and material practices. By dialectal relationship, Fairclough means that although these

instances are distinct from one another, they intermingle. It is also true that a change in discourse brings about new identities or realities.

As a conclusion, the new economical discourse in Romania is widely influenced by the English language.

Moreover, the change in discourse has triggered the economic change as well. In other words, economic change occurred when the discourse was operationalized and put into practice.

The general conclusion is that the word or the discourse has a major impact on the social, cultural or economical environment. The word has the power to change realities and also to build new identities, cultures and economies.

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## The Clash of Identity and Economic Behavior

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### Abstract

*This paper is a response to the recent implications of the economic crisis on social identity and social choice. We aim to explore the emerging forms of protest and their liaison with group identity, according to the current mutations of state's economic policies. Firstly, our task is to examine what happens to group identity when faced with anxieties about the economic welfare in the circumstances of the prolonged economic crisis.*

*Secondly, the following concepts are to be discussed: the interminglements between the economic difficulties encountered by individuals and their mobilization around the need for social security, the social identity thus constructed, and the protest seen as collective grievance. We will emphasize that the negative outcomes of the economic crisis and the recession that followed caused a complex configuration of social constructs, leading to social cohesion despite the existing differences, due to the perception of facing the same inequalities.*

**Keywords:** protest, group identity, economic behavior, mobilization

**J.E.L classification:** D63

### 1. Introduction

The contemporary financial and economic crisis, that after more than two years is still casting its negative consequences not only on the European but also on the world economy, has left behind many negative outcomes. The long terms consequences can easily be seen in all the spheres of social life. In this paper, we have limited the material to relate strictly to the interminglements of social identity in the wider context of economic behavior. The

arguments and conclusions presented here are in accordance with those of well known authors like Appadurai Arjun, Mathieu Deflem and Michael Chibnik. One of the main consequences of the economic crisis was that it announced the death of the neoliberal ideology. [1] Thus, the same system that created the liberal paradigm became the harbor for unleashing violent reactions, exacerbating social inequalities and creating a cycle of protests. The perception and illusion of economic inequality was promoted by the same actors that globalization has created, therefore the new medias were crowned in the role of the freedom fighter, organizing the protesters and stimulating their demands for accountability. Human beings were also transformed by risk and uncertainty as propagated by the media and denounced by decisions makers. [2]

### 2. Social mobilization: A Janus faced concept

The anthropological perspective in the analysis of the financial and economic effects on social identity must first look at the correlation between economic inequality and individual mobilization for the sake of social rights.

Firstly, we must underpin the idea that the crisis is primarily a matter of the global market, and the main point of analysis for scholars is the economic and financial one. Nevertheless, even for a non expert, the crisis has also sociologic points of view.

Secondly, since the financial meltdown, propelled by the increase of unemployment, the social identity has suffered significant transformations, manifested especially as the unanticipated collective grievances and protests that made the future appear even more unpredictable than ever. During the past

year, hundreds of thousands of people have demonstrated on the streets against the austerity measures of European governments to overcome unemployment and poverty. They imply that the government failed in protecting their interests in guarantying the needed social security. [3]

In order to understand these issues, it is extremely important to make a thorough analysis of the concept of social choice and protest. Equally important in our approach are the reasons for the collective protest as a part of constructing a group identity, and the ways in which mobilization is considered a solution. We will start by talking about an interesting concept in our point of view in this matter, namely the representation of social identity as a protest against the state's economic policies. [4] We will frame the discussion between two essential problems that arise in connection with the cause for which social identity can be expressed in relationship with the economic behavior, namely the *collective* fear of economic insecurity and the way in which it defined a new material identity. [5]

For scholars, the mobilization of the unemployed has for long been considered by the specialists in the field of collective action as a highly improbable phenomenon due to the fact that they have no strong organizations, leaders and ideologies. The events following “the crisis” have debunked this theory by proving that marginalization and individual values are equally important in fueling the cohesion of individuals.

Today's society promotes individualistic values, like self esteem, wealth and material accomplishments and, due to this representation, unemployment is considered to be the consequence of personal failure.[6] This observation became invalid when a large part of the population became aware that they are becoming a majority that opposes the financial decisions taken by a selected minority.[7] “We are the 99%” became one of the mottos for those that were powerless against decisions makers in the United States market regulation. Their apparent diversity was structured around the reality of sharing a public conscience that valued the concept of social justice and social choice. In the large context of social unrest and resistance against the austerity measures, „we are the 99%” became a metaphor of

what comes to be interpreted as political activism in the core of capitalism (i.e. Wall Street). As a paradox, the same accumulation of capital, known as the flexible accumulation that has led to a dispersal and fragmentation of social groups and classes, has now created the ground for marshaling against this old order.

Conflict can arise if the agent recognizes that the moral values of his or her society are harmed and if he or she is aggrieved in what he or she can consider his or her personal interests. [8]

Identity, as Nobel laureate Amartya Sen said, is a double edge sword, and the sense of security, given by the appartenance to group, is similar to an instinctive force and a weapon of choice. [9] Going beyond the level of person and role identities, the different aspects of the economic crisis pushed the individual to demand accountability and engage in active measures. Identity is not only a source of pride, but also a source of power, and can create conflicts between those that assume social values and those who can be regarded as disconsidering them. Within a group, the inside solidarity can lead to group discord on the outside. [10]

The first problem that arises, and which can be considered the most delicate one, is represented by the motivation of economic behavior in the spontaneous actions made by protesters against anti-recession. As a result of social comparison, those individuals who are similar to the group characteristic are categorized as being part of the eponymous group and are labeled in as members of the group. Correspondingly, those individuals having different values are categorized as the outsiders of this group, as outcasts. In a way, the fact that one has a particular social identity means being similar to others in the group and that he perceives things from the group's perspective, ergo having internalized their values. It is assumed that individuals, as group members, think alike and act alike, as group identity is their higher moral conscience. Thus, there can be a certain level of uniformity in the acts and ideas of group members.

Sociologist Peter J. Burke and sociological psychologist Jan E. Stets, both Professors at the University of California, Riverside, in their *Identity Theory*, define the term of identity taking into account the existence of

three main elements: role, group and individual particular characteristics: “An identity is the set of meanings that define who one is when one is an occupant of a particular role in society, a member of a particular group, or claims particular characteristics that identify him or her as a unique person” [10]. Thus, by means of this definition, the two identity theorists underline that there are three bases of identities (role, social group and person) and, accordingly, they make the distinction between role identity, social identity and person identity. Role identities are based on the various social structural positions individuals hold, social identities are related to individuals’ memberships in certain groups and are based on group categorization and group evaluation and person identities are based on the perspective according to which each person is a unique entity, distinct from other individuals (in this case the focus being on the features individuals internalize as their own, like social security, welfare and financial stability).

This theory assumes that individuals do not have to interact with other group members in order to think and act alike. The simple act of identifying with the group is enough to activate the adoption of similar perceptions (e.g. competence, character) and behavior among group members. In the instance that individuals consider themselves as the embodiment of a group prototype, social psychologists state that a *depersonalization process* has taken place. [11]

In that instance, instead of having a *unique existence as individuals*, they see themselves in terms of the full-scale attributes that other group members have, or in terms of their ideal representations of the group values.

Arne Johan Vetlesen identifies thus how they perceive the individual rights like “certain given, irremovable, and hence non optional conditions of human being-in-the-world, namely, dependency, vulnerability, mortality, the frailty of interpersonal relationships, and existential loneliness” [12] In our situation the fact that no individual or community is entirely sufficient unto itself is crucial to understand the cooperation of individuals that are strangers one to the other against decision makers. The conflict of what is the public good is an agent for

mobilization and social cohesion. More precisely, Vetlesen identifies a series of mandatory conditions, in order to emphasize the way social ideologies are constructed, perpetuated and propagated;

“We (as individuals and groups) are limited in our actions by our *interdependency* with others; we are *vulnerable* because our existential and even physical well-being is dependent upon others over whom we only have a limited control at best (hence the social centrality of the problem of the management of the action of others, and the concern to render their action predictable); we are *mortal* because we are embodied; our interpersonal relationships are *frail* because they are always to some degree contingent, and not least they are rendered more or less doubtful because of the mortality of the other; and we are existentially *alone* since our dependency upon others means that we possess no self-knowledge without them, and yet upon them ultimately we cannot depend(...) the form of a *protest against such givens*; recognizing their realness for others . . . but denying their realness for oneself”[12].

The social identity’s ability to arise powerful emotions by invoking solidarity between citizens, on the basis of group identities, is a result of cultural capital. In creating the “*cultural habitus*”, the use of symbolic practices can ground solidarity between the group members. Like gender, the economic status is the symbolic association of difference with class that creates the instance of being unlike. The economic status, like unemployment, remains one of the most potent symbolic categories of political unlikeness. [13] Social psychologists, like Stets and Burke, state that identity is defined in a social context and that people have a personal identity, which is unique to them, as well as a social identity, which is based on their membership in social groups (e.g. member of a political party, or trade union).

The concept of identity is seen as a corollary to the problem of conflict, as a mechanism for disturbing the presumption of a stateless social structure where the group seeks to act as a state agent. [14]

In his book *Fear of Small Numbers- An essay on the geography of anger*, Arjun Appadurai develops the theory that globalization can produce violence, exclusion

and inequalities. As seen in the worldwide protest against post-crisis austerity measures, the individuals that now have the same economic status (i.e. unemployed or indebted to banks) tend to develop a peculiar form of strong self-identity. This economic identity is often seen and employed as a form of counter-identity, a way to oppose the risk of being socially excluded. Mixed with media representations and political hate speeches, they develop the conscience of “we” or “they”, as opposed to “us”, the “99%” and “others”, “the 1%”. [15]

A clear discrepancy between self-situation significance and identity-standard significance can be established if we chose to analyze the use of collective pronouns like “we” and “they” in the Occupy Wall Street Movement and the social uprising against austerity measures all around Europe.

Globalization can be defined as many things, as a process or as a product of our knowledge society. Some authors consider globalization the pillar of recent events. [16] This is an interesting attempt at explaining how mobility and dynamics, as basic features of globalization can generate insecurity or even fear, thus becoming the source for intensive campaigns that call into action the resort to group violence. An analysis of “this social productivity of violence” shows that it can now be considered as an important element in generating both social cohesion and political activism. This process is explained as the result of the clash of identities and the driving forces of social change. Thus, globalization can exacerbate social, economic and political uncertainties by producing in the same time new encouragements for protests. [17]. Thus, globalization, as a way to promote a universal cultural identity, can fuel riots, exacerbating the large scale grieves and the existing tensions between a majority group and a minority, because both groups fear the reversal process that globalization can achieve.

The clustering of economic protests, however, remains to a large extent a driving force in search of an explanation. Saying that they occur in proximate states is not interesting in itself. We know that riots, like violence, often spread across national boundaries, but what are the exact causal mechanisms behind the international

diffusion of economic protests? Previous studies of conflict diffusion have established several possible explanations. The mobilization against the economic policies may be spatially clustered because the issues and actors engaged in them span national boundaries due to the same process of globalisation. Furthermore, through a “demonstration effect,” the protest against a state’s monetary policy in one country can lead actors in other states to update their beliefs about the efficacy and desirability of challenging their own governments or reshaping their demands. Most of the scholarly literature and public discussion about violent acts (i.e. uprising or rebellion) can have important security consequences, which suggests that the groups in seek of expressing their identity can spur the spread of conflicts both between and within other groups, or even at a larger scale, between them and state agents. [18]

Rebellion and insurgency are forms and specific types of political violence. Political violence refers to all collective attacks within a political community against the political regime, its actors-including competing political parties. The concept, according to Gurr “subsumes revolution, guerrilla wars, coup d’état, rebellions and riots”. [19] The social uprising that engulfed the world financial market, increased under the “force” and the threat of using a violent reactions Participants in political violence may value it as a means of expressing political demands or opposing undesirable policies.

The major challenge for the sociology of protest is which form of political mobilization could be described or considered as an isolate rebellion due to economical difficulties, and which could be defined as a conflict, i.e. the manifestation of group identity? To determine which political acts are rebellious, international law specialists distinguish between two types of non-institutionalized collective actions by citizens: social protests aimed at limited issues, such as changing the policies of authorities or particular personnel; and the rebellion dealing with fundamental issues, such as who governs and what is the structure of authority, when this authority is not the expression of the majority group identity. As argued by Gurr, the former are generally violent and may include mass violence,

because they challenge directly the authorities, are disruptive and entail violence. [20]

When analyzing the problem of the recent mobilizations against the crisis's effects, a concept that is circulated is *social movement*. In “*Violence and New Social Movements*” Rucht defines it as “an action system, formed for a certain period of time and based on collective identity, of mobilized networks of groups and organizations which aim to bring about, prevent, or reverse social change by means of protest—if necessary, violent protest”[21]. Social movements in their many forms can include formal organizations, like trade unions, but are not themselves organizations. A distinctive feature between formal and informal movements is that the latter doesn't include a clearly defined membership, like a charter or statutes, binding agendas, and hierarchical structures. The boundaries between social and political movements in modern societies are blurred, like the conflicts between the individual pursuit of self-interest and the decision maker's interest.

The unemployed classes and those impoverished by tax policies were strongly involved in collective protest actions in early 2010 and 2011. They have had a considerable impact on public debates and mainstream culture, as symbols of resistance. Their mobilization depended on a series of factors, which help to explain protest differences across time and space, like the financial crises in Spain, Greece and Italy and the market regulation and the need of scapegoats in the USA postmarked meltdown.

These peculiarities have to do, first, with grievances, given the fact that financial deprivations were much more pronounced in countries that have a higher unemployment rates and lower wages. In the wider context of the financial and economic crisis, people around the world fund themselves close to full employment and poverty, while the state failed in protecting their interests and social rights. In 2010 and 2011, the persons who were unemployed and disappointed with social policies were occupying the “headlines” of social and political news for demanding an increase in the minimum social payments and economic measures against inflation and low income.

The emergence of acts that unified trade unions and anarchic groups can be “evoked” as an unprecedented movement in their quest of economic security and social justice. Moreover, the precarity of daily life has provided a funded and reasonable action against the government's lack of interest for their grievances. The general state of frustration and anxiety can also be correlated with their perceived political, social and economic marginalization. As outcasts, they could not establish a reciprocal relation with the local political landscape due to the fact that they were treated by the public authorities as illegitimate actors, and not as social and political partners. [22]

This climate has created a well founded fear of those “powerless” for regaining a position as a social partner interested in economic welfare. As we stated before, the exceptional and prolonged episode of social insecurity emphasized the need for social action. Even if the social and economic outcasts came from different backgrounds, the fear of marginalization and poverty rose above other social differences like age, religion and culture. Acting collectively has changed the economic and political behavior of these individuals, fueling their need for association and thus, act in a unitary form. As Ted Robert Gurr stated in *Why Men Rebel*, the generalization of the fear of being unemployed and socially excluded threatened the social identity in itself and generated feelings of frustration and anger, all the more vivid when expectations have been failed [23]

These movements assert their ideology and identity by using symbols, language and clothing and through the collective practice of protest (i.e. violent or non-violent). Culturally, how individuals understand and relate to wealth, poverty and social inequality is crucially influenced by social group membership and personal history.

### 3. Conclusions

Through this paper we have tried to demonstrate that there are many forms in which the complex and the context-dependent term “group identity and social mobilization“ can be defined. A “social group” can be thus attracted in this widening gyre of the political and economic struggle

and can perceive their activism and resistance as its only resort to conserve its social welfare. The negative outcome of the economic struggle and recession harbored the clashes between group members and political actors hence they were only exacerbated by the process of globalization.

In this alarming chain of events, a unique process of cohesion and ideological homogeneity took place. The endemic financial crisis is a reflection of a society in which laws have regained their role as means of preserving privilege, as well as the best instruments for repression against the public interest. It is a global society in which differences are the exchange currency for inequalities and unconformity, seen as a menace. If classes ceased to exist long time ago, the economic crisis transformed their lingering remains into inequalities and, consequently, into latent conflicts. In a Europe where citizenship, qualification and income divide the population in nationals and foreigners, into workers and socially helped, there is no surprise that the struggle for a new economic model and implicit behavior is occurring.

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## Approximation of Bayesian Networks for Modeling Data

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### Abstract

*In this paper we want to achieve an approximation algorithm for Bayesian networks using data. At first we want to make a description of Bayesian networks and then talk about their modeling of the data using approximation algorithm PNM.*

**Keywords:** Bayesian networks, data approximation, modeling.

**Clasificare J.E.L.:** L8-Industry Studies:Services (L86-Information and Internet Services)

### INTRODUCTION

Bayesian approach is an alternative to traditional methods of assessment which provides a convenient way of incorporating the information set.

One of the disadvantages of the method is unable to make estimates without knowing the prior distribution of parameters.

Techniques used in Bayesian networks have been widely usage for proving extremely effective in data analysis. Bayesian networks are known and trusted networks as probabilistic graphical models belong to the family. Graphical models are graphs in which nodes are random variables and arcs are the propagation conditions is used to represent uncertain knowledge of a domain. In particular, each node represents a

random variable while the lines between nodes is dependent probability between corresponding variables. These addicts are generally estimated using statistical methods of calculation. So Bayesian network combines the principles of graph theory, probability theory, computer science and statistics. In this paper we want to approach the optimization problem for a Bayesian network so first we want to introduce some knowledge about Bayesian modeling will talk about methods for approximating the Bayesian network.

Feature of a Bayesian network is that we allow uncertainty modeling and reasoning. BN is a directed graph where each node contine a probability information. Full specifications are as follows:

- set of random variables make up the Bayesian network nodes. Variables can be discrete or continuous.
- A set of directed links (arcs) connecting pairs of nodes. If an arc from node X to node Y, X is called the father of Y.
- Each node  $X_i$  has a conditional probability distribution  $P(X_i | \text{Parents}(X_i))$  which cuantizeaza effect that I have parents on that node.
- The graph has no directed cycles, therefore directed acyclic graph is called (DAG - Directed Acyclic Graph)

There are specialized software for processing of RB, such AgenaRisk. When RB is compiled, it can be done

dynamically and have the following characteristics:

1. The effects of observations entered in one or more nodes can be propagated in all Bayesian networks, in any direction, and the marginal distributions of all nodes are updated.
2. Only relevant inferences can be made in Bayesian networks (using conditional dependency structure and current knowledge to identify those inferences that are valid).

### Bayesian network modeling

To build a Bayesian network must specify two things to describe: topology (structure) and nodes. Numerous methods have been proposed for inference of probabilities in Bayesian networks including accurate prediction methods or approximate prediction methods. For example, Monte Carlo methods provide approximate solutions by selecting random samples from the distribution of variables. In theory though, so exact inference methods and the approximation method can be an NP problem (Dagum and Luby, 1993).

Fortunately, in practice, approximate methods to demonstart to be extremely useful in many cases.

If there are k random variables on the model, the spring k (k-1) / 2 non-oriented network can move on, that amount of space network will be  $2^{k(k-1)/2}$ . Thus, the researchers used search algorithms, EM algorithm, Monte Carlo method, etc..

Suppose we have a network known S and all known variables. We denote by  $S^h =$  probability and can be taken jointly depending on the set of variables S, V and  $\Delta C =$  standard specified

Step 1: Choose  $S^h$  and evaluate  $\Delta C$  for all arcs  $S^h$ , we change the arc in two steps, for any maximum  $\Delta C$ .

Step 2: Repeat step 1 until there are changes to the arcs (for any  $\Delta C > 0$ )

An important measure for learning Bayesian network model selection is on the fringe of its connection  $P(D | S^h v_s)$

Where  $v_s$  is a probability vector and  $S^h$  is a probability network and D is a set of data.

If we assume D independent parameters unlimited distribution and no lack of data, each vector  $v_{ij}$  is updated independently.

For all i and j is given by the product likelihood probability for each pair i and j

$$p(c|\xi) = \frac{\Gamma(\alpha)}{\Gamma(\alpha + N)} \prod_{k=1}^r \frac{\Gamma(\alpha_k + N_k)}{\Gamma(\alpha_k)}$$

$$p(D|S^h) = \prod_{i=1}^n \prod_{j=1}^{q_i} \frac{\Gamma(\alpha_{ij})}{\Gamma(\alpha_{ij} + N_{ij})} * \prod_{k=1}^{r_i} \frac{\Gamma(\alpha_{ijk} + N_{ijk})}{\Gamma(\alpha_{ijk})}$$

and Bayesian network approach for a maximum is:

$$\underset{v^h}{Max}(p(D|S^h))$$

For individual variables approximation problem, the procedure can be described as:

Let  $X = A_1, A_2, \dots, A_p$  be an initial partition and  $\lambda$  a known distribution, we apply a model f(x) the initial partition, we have an optimal distribution model  $\lambda_c$  with under  $X_c = B_1, B_2, \dots, B_c$  with  $c \leq p$ .

Probability PNM

For a variable. Let dataset  $D = \{X_1, X_2, \dots, X_n\}$  for each variable  $X_i$  of D define the norm for the approximation error.

$$\|U_i\|^2 = \int_{-\infty}^{+\infty} (p(x_i)f(x_i))^2 - (p(x_i)x_i)^2 dx_i$$

and the sum of differences for all variables in D, where  $\|D\|^2$  is the identifier of the approximation error.

$$\|U\|^2 = \sum_{i=1}^n \|U_i\|^2, \text{ where } \sum_{i=1}^n p(x_i) = 1$$

Seeking approximation for D is:

$$\text{Min} : \int_{-\infty}^{+\infty} (p(x_i) f(x_i))^2 - (p(x_i) x_i)^2 dx_i$$

, where  $i=1, \dots, n$

For n-variable. Based on the above case we can expand the variables n

$$\|U_{ij}\|^2 = \int_{-\infty}^{+\infty} \int_{-\infty}^{+\infty} (p(x_i|x_j) f(x_i))^2 - (p(x_j|x_i))^2 dx_i dx_j$$

$$\|U\|^2 = \sum_{i=1}^n \sum_{j=1}^n \|U_{ij}\|^2$$

PNM data approximation algorithm (for one variable)

Inputs: proxy variables (x), where kernel iterations (steps), minimum norm ( $\xi$ )

Output data: number of variables procedure

the variables (X, L, kernel,  $\xi$ )

statically int C out\_c[];

L=level; C=1;

Calculating  $f_c(x, L)$  of

$$f(x, n) = \frac{1}{n} \sum_{i=1}^n Kh(x - X_i)$$

Calculating approximate  $\|U_0\|^2$  of

$$\|U_i\|^2 = \int_{-\infty}^{+\infty} (p(x_i) f(x_i))^2 - (p(x_i) x_i)^2 dx_i$$

While (  $c \leq \text{length}(x) \ || \ \|Uc\|^2 < \xi \|U_0\|^2$  )

```
{ i=1;
  while (x(C+1) ≤ x(C) i++;
    C = C + 1;
```

Update  $f_c(x, L)$

Update PNM aproximam  $\|Uc\|^2$

If (  $\|Uc\|^2 < \xi \|Uc-1\|^2$  ) {

$\|Uc\|^2 = \|Uc-1\|^2$  ;

locate C; }

}

L = L-1;

If (L!=0) {

$X_{\text{front}} = x(1), \dots, x(C)$

$X_{\text{behind}} = x(C+1), \dots, x(\text{Length}$

(x))

If (length (  $X_{\text{front}}$  ) !=0) intra  
variabile ( $X_{\text{front}}$ , L, kernel,  $\xi$ )

If (length (  $X_{\text{behind}}$  ) !=0) intra  
variabile ( $X_{\text{behind}}$ , L, kernel,  $\xi$ )

L = L-1;

Return Null; }

Else return out\_c;

## CONCLUSIONS

In this paper we analyzed the Bayesian networks and their modeling algorithm using PNM.

In conclusion, the advantages of Bayesian networks are:

- are more compact than core systems run
- use past information to predict what will happen
- provide a valid analysis even when information is uncertain
- allows prediction or diagnosis, according to the analysis required
- is made with a lower cost than building systems or expert systems decision
- is easy to explain how a system reaches a certain decision, action
- offers diagnostic problems

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## Analysis Algorithms to Search the Web Links

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### Abstract

In this paper we want to achieve an algorithm for carrying out searches on the web. We speak of the two algorithms, namely Kleinberg and Page Rank, search algorithms.

**Keywords:** Algorithm, web topology, link, information.

**Clasificare JEL:** L8-Industry Studies: Services (L86-Information and Internet Services)

### INTRODUCTION

Increasing volume of information caused by the emergence of electronic commerce, electronic education and the site made it difficult for search engines work. Many pages contain irrelevant links are used only for its internal navigation between pages. Data Mining manages to find the partial or total solutions and can be divided into:

- Web Content Mining, is used to search information in a document
- Web Structure Mining is based on the topology of links
- Web usage mining controlling user behavior.

Next we address the algorithm "Page rank" (for assigning measures to pages) and "Hubs and Authorities" (for detailed evaluation of the importance of web pages)

#### *Kleinberg algorithm*

1. Creates a lot of pages page
2. Identify candidate sites

3. Realize your page ranking sites authorized and hubs

Step 1. This step is a great text-based search, which are selected from hundreds of pages to be used for startup process, pages often contain information not expected the authorized user, because it may be that these sources not use common topic. Following the searches made in the first phase, based on a text search, there are pages containing that text.

Step 2. At this step set of root pages is extended by pages that include links to any page in the root, root saudin the pages that have property that there is a link from the root set of pages to them. This set is called extended candidate set.

Step 3. In this step the extended set is ordered according to the degree of authority on topical sought, and depending on the links to other sites authorized therein.

Note: Kleinberg's algorithm based on the pages returned by search words are then processed to find a larger collection of pages of authorized sites are selected.

PageRank was developed at Stanford University by Larry Page (from which derives its name and then and Sergey Brin as part of a research project about a new kind of search engine. Project started in 1995 and led, in 1998, a working prototype named Google. shortly thereafter, Page and Brin founded Google Inc. company., the company

behind the Google search engine. Although only one of the factors leading position Google search results, PageRank continues to provide all devices based search engine Google. PageRank is based on citation analysis, theory developed in the 1950s by Eugene Garfield at Pennsylvania State University, Google's founders cite Garfield's work in their original work. analysis was developed web links first Jon Kleinberg and his team in the CLEVER project at the Almaden Research Center IBM.

**Page Rank** algorithm was created in 1997-1998. The most successful Internet search engine, Google works based on this algorithm. Page Rank is rooted in social network analysis and is basically providing a ranking of each web page depending on how many links from other Web pages lead to that page.

Assume that we have  $n$  Web pages, each page  $I$  containing a number of  $O_i$  links to other websites. Note  $A$  the adjacency matrix associated with the website seen as a directed graph  $G = (V, E)$  where pages are vertices and links between pages are arcs of the graph. Associated graph adjacency matrix will have elements

$$A_{ij} = \begin{cases} \frac{1}{O_i}, & \text{if } (i, j) \in E \\ 0, & \text{if } (i, j) \notin E \end{cases} \quad (1)$$

Starting with an initial vector of probabilities, using a stochastic irreducible and aperiodic matrix, according to Ergodic Theorem of Markov chains, we obtain a range of vectors of probabilities converges to a unique state of equilibrium

$$P_1 = A^T P_0 \quad (2)$$

$$P_k = A^T P_{k-1} \quad (3)$$

$$\lim_{k \rightarrow \infty} P_k = P \quad (4)$$

Vector of probabilities obtained will give us web pages rank. To apply Ergodic Theorem adjacency matrix is transformed to meet conditions of irreducibility and aperiodicity. The next formula

$$P(i) = (1-d) + d \sum_{(j,i) \in E} \frac{P(j)}{O_j} \quad (5)$$

gives the rank of page  $i$ ,  $P(i)$ , and  $d$  is a mitigating factor that takes values between 0 and 1.

The pseudocode algorithm for calculating the ranking of web pages is:

Page Rank

```

P0 ←  $\frac{e}{n}$ 
k ← 1
repeat
    Pk ← (1-d)e + dATPk-1
    k ← k+1
until  $\|P_k - P_{k-1}\| < \varepsilon$ 
display Pk
    
```

Where  $e$  is a vector with all elements 1,  $\varepsilon$  is called the threshold of accuracy and 1-norm of a vector is given by the sum of constituents.

Algorithm

Label the edges in  $G_{Q,p}$  with an index ranging from 1 to  $R_{Q,p}$

Set  $\eta_e = \eta_{ij}$

Set  $\delta_e = \delta_{ij}$

Set  $\tau_e = \eta_{ij} / \delta_{ij}$

Mark all the edges in  $G_{Q,p}$  as not visited

Allocate weight vector  $W$  of size  $|C_{Q,p}|-1$

Allocate vector  $\Sigma$  of size  $|C_{Q,p}|-1$

Initialize  $W$  and  $\Sigma$  to zero

for  $e = 1, e \leq |R_{Q,p}|, e = e + 1$

mark edge  $e$  as visited

visit  $(e, e, 1, \tau_e)$

$W[1] = W[1] + \tau_e$

$\Sigma[1] = \Sigma[1] + 1$

Function visit  $(o, e, 1, s)$

$a = e + 1$

while  $a \leq |R_{Q,p}|$  și  $l \leq |C_{Q,p}|-1$

if  $a$  is not visited and  $a$  is safe

mark edge  $a$  as visited

```

visit (o,a,l+1,s*τ)
W[l+1] = W[l+1]+s
Σ [l+1] = Σ [l+1] + 1
Set edge a as not visited
Else
a=a+1

```

The pages are most important, the other pages tend to have greater links with it. In a web page, some links are more important than others and its importance can not be distributed evenly to all its connected pages and the problem is solved by Weighted PageRank algorithm. The algorithm calculates the importance of pages called "outlink". Each page receives an importance commensurate with its links.

Importance inlink sites will be denoted by  $W_{(w,u)}^{in}$

Importance outlink sites will be denoted by  $W_{(w,u)}^{out}$ .

Denote by  $I_u$  number  $u$  inlink pages sites, sites  $I_p$  number inlink pages  $p$  and  $R(v)$  the set of pages that have links to you, we have:

$$W_{(v,u)}^{in} = \frac{I_u}{\sum_{p \in R(v)} I_p}$$

If we note with  $O_u$  the egg-sized pages outlink number  $u$ , with  $O_p$  sized pages outlink number  $p$  and  $R(v)$  the set of pages that have links to you, we have:

$$W_{(v,u)}^{out} = \frac{O_u}{\sum_{p \in R(v)} O_p}$$

Given the importance of Page Rank and outlink sites  $u$  get a page's importance:

$$PR(u) = (1-d) + d \sum_{v \in B(u)} PR(v) * W_{(v,u)}^{in} * W_{(v,u)}^{out}$$

Where  $d$  is the "tax" used by Google to combat the effects of "dead ends" and "spider trap".

Authorized pages are pages that can provide information about a given subject.

To define the degree of authority and degree of connection, assign each site a matrix like matrix used to define the importance of the site pages.

Let  $A$  be the matrix associated to a site where:

$$A = \begin{cases} a_{ij}, & \text{if the page has successors or predecessors} \\ 0, & \text{altfel} \end{cases}$$

We note with its transpose  $A_t$ , is the vector that measures the degree of authority and  $h$  is the vector that measures the degree of connection. The vector  $h$  can be calculated:  $h = \mu_1 * A * a$ , formula shows that the degree of connection of a page is given by the sum of all degrees of authority pages link to it by  $\mu_1$ .

The degree of authority can be calculated:  $a = \mu_2 * A_t * h$ , the formula shows that the degree of authority of a page is given by the sum of all degrees of related pages that link it with  $\mu_2$ .

## CONCLUSIONS

The Internet and e-commerce is an important key to future success of any organization, offering huge opportunities and market outlets worldwide. E-commerce projects are doomed to failure because of misunderstanding the new rules of e-economy environment, thus failing to step into the competition.

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## The New Kondratieff Cycle and Greentech Innovation

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### Abstract

*One of the themes that have been approached more and more within the specialised literature is being represented by economic cycles. The analysis of these is very useful in the long term predictions, in finding solutions for the economic raise and for solving the economic crisis. The concept of the green economy has gained currency to a large extent because it provides a response to the multiple crises that the world has been facing in recent years – the climate, food and economic crises, so the importance of greentech innovation. In this paper we intend to bring contributions to the study of the Kondratieff cycles in terms of new techno-economic paradigm.*

**Key words:** Kondratieff Cycle, techno-economic paradigm, green economy, greentech innovation

**J.E.L. Classification:** E32, E6, Q55

### 1. Introduction

One of the themes that have been approached more and more within the specialised literature is being represented by economic cycles. The analysis of these is very useful in the long term predictions, in finding solutions for the economic raise and for solving the economic crisis. General development of the economy (based on data relating to advanced countries) shows that the country's productive forces take place in the form of "waves" (cycles) long by 40-60 years. This period is dominated by a technical way of production of certain technology. Some experts identify the big "waves" with the history time of the

outbreak, maturation and exhaustion values of an industrial revolution. In these terms, where is "the place" of global economy nowadays?

### 2. The New Kondratieff cycle

In the development of each economy, two main phases are distinguished: an upswing phase and a downswing phase, each with a duration of 20-30 years.

In the upswing phase the implementation and technical operation of the new way of production occurs, business activities - based on new technologies - take place at this stage, with increased efficiency. Within the period of 20-30 years there are being observed: the dominance of years of prosperity, relatively high rates of economic growth, rising living standards, high employment level, etc.. The period of transition from the old way to the new production techniques is marked by a structural crisis, a period which is extended during downward phase. In this phase of long economic cycles, initially, some showing signs of exhaustion values of favorable growth factors occur. There is a tendency of decreased efficiency and rate of profit. It is the sustained period of scientific research to find solutions to streamline the production process. It also marks a transition to new production techniques.

The effects of a particular techno-economic paradigm most faithfully represent Schumpeter's idea of "creative destruction", capable of sustaining a lengthy growth cycle resulting from the emergence, disappearance and reconfiguration of the various sectors. Each techno-economic paradigm requires a new infrastructure allowing the new technologies to be diffused throughout the economic system, while the dominant characteristics of the production system are

restructured to incorporate processes that allow new products to be created and distributed. We try to characterize the five technological revolutions that occurred between 1770 and 2010 and their corresponding techno-economic paradigms, as well as the characteristics of the industries and infrastructure underlying them (Freeman and Pérez, 1988; Pérez, 2002) and the new Kondratieff cycle – the sixth.

❖ **First Kondratieff cycle:** From 1790 till 1844- 1851

- **Technological revolution** : The “Industrial revolution” - Britain;
- **New or redefined infrastructures** : Canals and waterways Turnpike roads, Water power (highly improved water wheels);
- **New technologies and new or redefined industries** : Mechanized cotton industry, Wrought iron, Machinery

❖ **Second Kondratieff cycle:** From 1844-1851 till 1890-1896

- **Technological revolution** : Age of steam and railways , In Britain and spreading to Continent and United States ;
- **New or redefined infrastructures:** Railways (use of steam engine) Universal postal service, Telegraph (mainly nationally along railway lines) , Great ports, great depots and worldwide sailing ships, City gas;
- **New technologies and new or redefined industries:** Steam engines and machinery (made of iron, fuelled by coal), Iron and coal mining (now playing a central role in growth), Railway construction, Rolling stock production Steam power for many industries (including textiles)

❖ **Third Kondratieff cycle:** From 1890-1896 till 1939-1950

- **Technological revolution:** Age of steel, electricity and heavy engineering - United States and Germany overtaking Britain ;
- **New or redefined infrastructures:** Worldwide shipping in rapid steel steamships (use of Suez Canal) Worldwide railways , Great bridges and tunnels Worldwide telegraph Telephone (mainly nationally),

Electrical networks (for illumination and industrial use);

- **New technologies and new or redefined industries:** Cheap steel (especially Bessemer), Full development of steam engine for steel ships, Heavy chemicals and civil engineering, Electrical equipment industry, Copper and cables, Canned and bottled food, Paper and packaging

❖ **Fourth Kondratieff cycle:** From 1939-1950 till 1984-1990

- **Technological revolution:** Age of oil, the automobile and mass production, In United States and spreading to Europe;
- **New or redefined infrastructures:** Networks of roads, highways, ports and airports, Networks of oil ducts, Universal electricity (industry and homes), Worldwide analog telecommunications (telephone, telex and cablegram) wire and wireless;
- **New technologies and new or redefined industries:** Mass-produced automobiles, Cheap oil and oil fuels, Petrochemicals (synthetics), Internal combustion engine for automobiles, transport, tractors, airplanes, war tanks and electricity, Home electrical appliances, Refrigerated and frozen foods

❖ **Fifth Kondratieff cycle:** From the 1980s till 2030(?)

- **Technological revolution:** Age of information and telecommunications, In United States, spreading to Europe and Asia and then becoming globalized;
- **New or redefined infrastructures:** World digital telecommunications (cable, fibre optics, radio and satellite) Internet/electronic mail and other e- services, Multiple-source, flexible-use electricity networks, High-speed physical transport links (by land, air and water);
- **New technologies and new or redefined industries:** The information revolution Cheap microelectronics Computers, software, Telecommunications, Control instruments, Computer-aided biotechnology and new

materials

❖ **Sixth Kondratieff cycle**

- **Technological revolution:** Green New –Deal, Eco-bio-economy;
- **New or redefined infrastructures:** Bioinformatics - Computation applications for the analysis and storage of biological data (genomes, protein sequences, modelling of complex processes, etc.), Nanobiotechnology;
- **New technologies and new or redefined industries :** Greentechnology , Application of nanotechnology/ micromanufacturing tools and processes to construct various biotechnology devices and applications (studies of biosystems, diagnostics, etc.)

The fifth upswing began in the 1980s and ended with the current crisis. On past durations, we are now in a downswing phase with the dates of beginning: 2008-2010.

However, there is also quite a bit of evidence to suggest that the current financial crisis does indeed mark the start of the downswing. Given that this is not a normal recession, but a downturn caused by an all-embracing banking crisis, 2008-2010 seems the more likely inflection point.

### 3. The Green Economy – a new paradigm?

The concept of the green economy has gained currency to a large extent because it provides a response to the multiple crises that the world has been facing in recent years – the climate, food and economic crises – with an alternative paradigm that offers the promise of growth while protecting the earth’s ecosystems and, in turn, contributing to poverty alleviation. In this sense, the transition to a green economy will entail moving away from the system that allowed, and at times generated, these crises to a system that proactively addresses and prevents them.

The concept of green economy should be seen as consistent with the broader and older concept of sustainable development. The specificities of the broader concept are its *holistic* character, as it encompasses the three pillars of development – economic, social and

environmental – and its particular focus on *inter-generational* equity. This is reflected in UNEP’s definition of a green economy as “one that results in improved human well-being and social equity, while significantly reducing environmental risks and ecological scarcities”.

Ocampo highlights four different macroeconomic issues that must be taken into account in the analysis of the green economy.

1. The first one relates to issues of inter-temporal welfare: how the welfare of future generations is taken into account in current economic decisions, an issue that is relevant for savings and investment decisions today, but has broader implications, as the social discount rate chosen should be used in cost-benefit analysis at the microeconomic and sectoral levels.
2. The second refers to the effects that the degradation of the environment has on aggregate supply, as well as the effects of environmental spending and protection policies on both aggregate supply and demand.
3. The third is the fact that economic growth is always a process of structural change, a fact that is highlighted by the significant changes in the patterns of production and consumption that must be put in place in the transition to the green economy, which in this regard can be characterized as no less than a new technological or industrial revolution, and will have deep impacts on production structures as well as on consumption patterns.
4. The final one relates to how global initiatives in this area are going to be financed.

A broader analysis of the macroeconomic implications of environmental protection is that provided by UNEP’s recent Green Economy Report (UNEP, 2011, chapter 13). According to the simulations provided, investing in the green economy \$1.3 trillion, equivalent to 2% of world GDP or one-tenth of global investment, may lead to slower growth for a few years (relative to the scenario in which those resources are invested according to past patterns), as renewable natural resources are replenished, but will result in faster growth after 5-10 years. Aside from the fact that the green economy can deliver in the long-term more

growth, it also reduces downside risks associated with climate change, energy shocks, water scarcity and loss of ecosystem services, increases employment (as green investments are generally more employment intensive) and have direct benefits in terms of poverty reduction (particularly through improvements of agricultural productivity of rural smallholders). Relative to business-as-usual, this scenario reduces energy demand by 40% by 2050 (largely through reduced power, and transport efficiency), which is increasing supplied by renewables production, and also decreases water demand by 22% and the ecological footprint by 48%.

### **The Green Economy – some challenges and dilemmas**

- ❖ **One dimensional approach** - The first risk is that the “green economy” is defined or operationalised in a one-dimensional manner, taken out of its being embedded in the sustainable development framework, and promoted in a purely “environmental” manner and without consideration of the international dimension, especially its negative effects on developing countries (Khor, 2011).
- ❖ **”One size fits all” approach** - all countries – without considering the levels and stages of development - are treated in the same manner. This would lead to failures either for environment, development or both.
- ❖ **Use of environment for trade protection** - There is a risk that the environment, and by implication the “green economy”, can be inappropriately made use of by countries for trade protectionist purposes, and that in particular developed countries may use this as a principle or concept to justify unilateral trade measures against the products of developing countries.
- ❖ **Attempting to gain market access through the guise of environment** - Another risk is that the environment is misused as a disguised method by countries to promote the access of their goods and services into markets of other countries. There is a fear that the Green Economy concept could be used as a front for mercantilist interests.
- ❖ **The treatment of subsidies** - Another concern of many developing countries is that some developed countries have been providing their companies with major subsidies for the research and development (R&D) of environmentally sound technologies. This puts developing countries at a disadvantage, especially since they lack the financial resources to match the developed countries' subsidies. Given this unfair imbalance in subsidies, the developing countries and their firms would be in an even worse competitive situation if they have to lower their tariffs on environmental products.
- ❖ **Environmental standards** - Another potential problem is the adoption of environmental standards for products; developing countries that are unable to meet the standards face the prospect of losing their exports. The approach towards developing countries should be to provide resources and technology for upgrading their environmental technology and standards, and not to penalise them.
- ❖ **New conditionality** - Another risk is that the “green economy” may be used as new conditionality on developing countries for aid, loans, and debt rescheduling or debt relief. This may pressurise affected developing countries to take on one-dimensional environmental measures rather than sustainable development policies that take economic and social development and equity goals into account.
- ❖ **Intellectual property rights** - One of the basic tensions is this: the willingness to invest in innovation depends to some degree on the products of that innovation being protected from low-cost imitation. This is particularly true for technologies where the costs of research and development are high and the cost of imitation is low.
- ❖ **Government support** - is critical to creating national systems of innovation, among other things though investment in education, support of research and development.

## The Greentech Innovation

Investment is fundamental for the green economy, and for sustainable development more broadly. It is the vehicle by which old infrastructure and productive capacity are transformed into new and greener stock. A number of developing country firms have already gained significant market share in new technologies. China in 2009 exported over \$10 billion worth of solar panels and cells, more than twice as much as the second biggest exporter and almost 80 times the value exported only ten years earlier, when it was not even among the top 5 world exporters. India’s Suzlon Energy is now a global power in supplying wind turbines, with a 6.4% share of the global market. Three Chinese companies now rank in the top ten for market share in wind power as well, though they are almost exclusively focused on meeting domestic demand.

The Green or Clean Revolution is a swift and massive scaling-up of clean energy technologies and infrastructure. It will satisfy the increasing energy requirements of emerging economies which are determined to develop unhindered, while continuing to provide the high quality energy services the developed world has come to expect.

Policymakers have also begun to see the opportunity for growth in low carbon markets. China has developed from non-player to world-leader in creating economic value from green technology. Chinese investments of \$912 billion in clean energy and environmental protection will create 10.6 million jobs, boost GDP by \$1.3 trillion and drive an additional \$220 billion in energy savings.

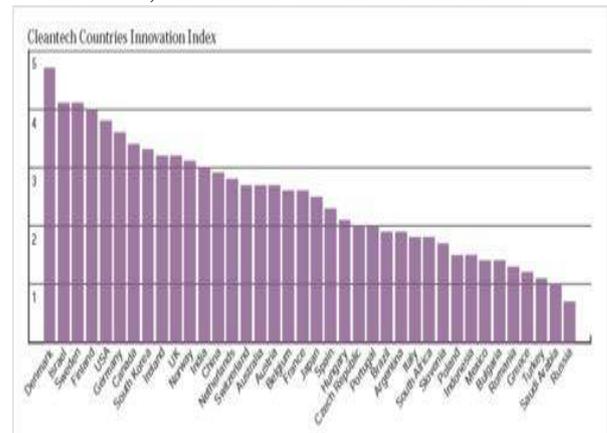
Clean technology innovation is a global phenomenon. The Cleantech innovation study: “Coming Clean: The Cleantech Global Innovation Index 2012” study ranked 38 countries across 15 indicators that relate “to the creation and commercialisation of cleantech start-ups, ...measuring each [country] relative potential to produce entrepreneurial start-up companies and commercialise technology innovations over the next 10 years.

Top-line results:

- Denmark leads the global rankings, “with its unique combination of a supportive environment for innovative cleantech start-ups, evidence of those start-ups gaining momentum, as well as a strong

track-record of companies commercialising their cleantech innovations and scaling them up to widespread market adoption, particularly in wind.”

- Scandinavian (or Nordic countries more broadly) “performed notably well, as Sweden and Finland also placed third and fourth respectively. These countries ... are behind [Denmark and Israel] on their ability to scale-up entrepreneurial cleantech companies to wider commercial success. (A pattern shared by fifth place country the United States.)”
- “China and India placed 13th and 12th respectively, but stand out as having a strong potential to rise through the ranks in the coming years. While not currently creating innovative cleantech companies in great numbers relative to the size of their economies, they are already strong centres for cleantech production, and have increasingly supportive governments, large sums of private money ready to be invested, and massive domestic markets.”



is that running economies the way we've always done, doing business as usual, is clearly not an option. The new Green Economy is therefore a proposal for an alternative and far more sustainable way of doing business.

- A green economy is described as one that results in improved human well-being and social equity, while significantly reducing environmental risks and ecological scarcities. In other words, we can think of a green economy as an economic environment that achieves low carbon emissions, resource efficiency and at the same time is socially inclusive.
- There is no unique definition of the green economy, but the term itself underscores the *economic* dimensions of sustainability or, in terms of the recent UNEP report on the Green Economy, it responds to the “growing recognition that achieving sustainability rests almost entirely on getting the economy right”. It also emphasizes the crucial point that economic growth and environmental stewardship can be complementary strategies, challenging the still common view that there are significant tradeoffs between these two objectives – in other words, that the synergies prevail over the tradeoffs.
- The Clean Revolution is a swift and massive scaling-up of clean energy technologies and infrastructure. It will satisfy the increasing energy requirements of emerging economies which are determined to develop unhindered, while continuing to provide the high quality energy services the developed world has come to expect.

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## The Concept of Empirical Economic Statement

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### Abstract

*The issue of establishing various categories of statements within scientific research is not new and does not represent a niche subject, only debated within certain sciences or during different time spans. We could say, more than that, that the proposed subject is, at this time, and was in the past, an attraction point for researchers in all scientific fields, regardless of the more permissive or strict manner of delimitation. Logicians, philosophers, sociologists, linguists, and last, but not least, economists, have dedicated ample spaces within their researches in order to establish the different role of various statements within the scientific research. Through this paper we will present our own vision concerning content and the role of empirical statements in the scientific researches in general and within economic science, in particular.*

**Keywords:** empirical statements, empirical economic statement, the sufficient attributes of the concept of empirical economic statement.

**J.E.L. Classification:** B40, B41

### 1. Introduction

In order to achieve our purpose, we have established the following objectives for our study:

- The inventory of sufficient predicates which a statement must fulfil in order to be included within the category of empirical statements;
- Establishing the various types of statements which are included in the empirical ones, of another sort of statements which exist outside the

empirical ones and their role within the scaffolding of scientific research activities;

- Establishing the sufficient attributes which an economic statement must fulfil in order to be included in the category of empirical statements;

The method of research that we will apply in reaching the proposed objectives will consist of a critical analysis, realized from a logical perspective, of the main points of view expressed throughout time in connection with the proposed subject and expressing one's own point of view. The result of this approach will be, we hope, the creation of a new personal approach in connection with the role of empirical statements within the research methods used within the case of scientific research within the economic field.

### 2. A methodological principle of scientific research – appearance

As we already said in our previous study [5], Kant [2] does not deny the existence of an objective reality, quite the opposite, he supports it, but he states at the same time that it is outside of our possibilities of rational knowledge. We know, from a rational point of view, through our senses, thus objective reality is filtered [3] and subjectivised. What we come to know about reality refers to those perceivable forms of manifestation of reality, so, to appearance, to a phenomenon [1] and thus not to the reality per se, to its essence, which remains unknown. Any primary observation created as a result of the study of the world around us implies our perception on this world. For this reason, we believe that any empirical statement must be tested by its confrontation with the primary observations which fundament it. The supported idea,

however, generates the appearance of the issue presented in the following paragraphs. Because these primary observations are at the core of statements concerning the surrounding world, they should meet, at the same time, the following prerequisites: to be synthetic sentences about the world we live in and to be non-debatable. A consequence of the principle of appearance is however the logical impossibility of meeting both conditions at the same time. Either the primary observation talks about what we believe about the world and *not the world as it is*, but then it does not meet the first condition, being, in fact, a statement about the watcher and not the watched object, or it presents a part of the external world and involves our perception about *belonging to this world*, being, in this situation, debatable. To put it differently, any primary synthetic observation about the world is debatable because it surprises its appearance, while any personal perception is undebatable, but it is not included within the synthetic affirmations about the surrounding world.

The principle of appearance become, we claim, within the presented context, a methodological premise of all researchers. In the following part of this paper, we will remember the solutions which have been taken into account by the specific literature when dealing with overcoming the methodological deadlock mentioned before, already presented in our aforementioned study [5].

### **3. The critical analysis of sufficient attributes of empirical statements**

In order to limit the sphere of inclusion of the “empirical statement” category, we will try, in the following, to establish the adequate criteria which an statement must meet in order to be considered empirical, or, to put it in another way, the sufficient attributes of empirical statements.

Watkins [6] creates a synthesis of the criteria which have been used throughout time to delineate the category of factual understandable statements from other categories of statements. He presents the following categories of criteria:

- Translational;
- Verifiable;
- Verifiable or falsifiable;

- Falsifiable.

Watkins [6] realizes, within his study, an analysis of the criteria mentioned above, but judged not from the perspective of factual understandability, but from the perspective of their ability to reveal the difference between empirical statements and non-empirical statements. In the author’s opinion, the sufficient adequacy criteria (the attributes which we will also use until establishing our own criteria, in the second part of the paper) to set the bounds for an empirical statement are:

1. The possibility to universally generalize all the elements of the statement which refer to testable properties;
2. The lack of tautologies within the statement;
3. The lack of statements of a theological nature within a statement whose acceptance cannot be affected by observations.

The first adequacy criterion which Watkins [6] mentions is not one which cannot be challenged, and, for this reason, we will make a series of assumptions concerning its use. Through the “possibility of universal generalization of all the attributes of an assumption which make reference to testable properties” we understand the submission of all such attributes to the test of falsifiability (and not the one of verifiability), thus eliminating the false statements from the category of empirical statements.

The second criterion which Watkins [6] mentions, namely the lack of tautologies within the empirical statement takes into account the fact that it represents statements obtained by replacing several known terms of a statement with synonymous terms and this is why it is not tautology, which represents a logical truth and is empirically testable, but the initial statement that was the foundation for its construction.

The third criterion of adequacy mentioned by the author, namely, the lack from within the statement, of several tautological statements whose acceptance cannot be affected by observations, is cited, as no such statement is not testable.

Coming back to the boundary criteria whose usage has been considered throughout time to be possible with the purpose of creating demarcation line. The first category

of criteria on which we shall pause, from the chronological perspective of their occurrence, represents the translational criteria.

### 3.1. Translational criteria

According to Wittgenstein [7], any original sentence results from the logical processing of the elementary sentences, true or false according to performed observations, so the sentences which are not testable are meaningless. The world, he says, is completely described by the specifications of all the elementary sentences and the mentioning of these specifications being true or false. To make a difference between the empirical statements, a solution is thus, to build an empirical language which would be used as a “bed of Procrustes” for the statements which are subject to being tested. Those who cannot be expressed by the usage of the created language will not pass the test to which they were subjects.

The supporters of the translational criteria are the partisans of such an empirical language whose foundation is given by connected primary observations, through various logical connections. In our opinion, however, such a translational criterion would not be adequate for the third criterion for empirical statements which Watkins [6] identified. As Popper [4] proved, by building a counter-example, such a criterion would allow for the issuing of theological statements whose acceptance cannot be affected by observations, within the statement. As long as such a language includes, within its logical operations, an universally existential quantifier, negation, and primary noticeable elements, the statement “there is an X which was not born, will not die, is not divisible, is not limited and is not material; and there is no Y of which X does not know about or cannot influence or a Y which can influence X” is, according to the translational criteria, empirical [6].

Also, we believe that, considering all the presented aspects for the support of philosophical grounds of the appearance principle, an elementary statement bound to the surrounding world cannot be true or false, only apparently true or apparently false according to this principle. In this context, a universal generalization of all the elements of

the statement to which it refers is not possible.

As a result, a translational criterion cannot be used as a means for demarcation for the delimitation of empirical statements because it allows for the inclusion of theological statements within them and does not lead to the universal generalization of all the elements of the statement which refers to testable properties, which is in contradiction with the adequacy criteria defined before.

### 3.2. Verifiable criteria

Another solution to the problem which Wittgenstein [7] issued, proposed in an attempt to eliminate the lackings of the translational criteria, is that of using statement verification criteria, which, if confirmed via primary observations, validate the verified statements, confirming their empirical character.

The partisans of these verifiable criteria consider that the probability of an empirical statement to be true is greater and greater as the number of singular particular verified cases which confirm the statement in cause is greater.

The application of the checkable approach comes in contradiction with the first criterion which Watkins [6] established for empirical statements, because it does not allow for the universal generalization of all the elements of the statement which refers to testable properties. The probability that a universal law is true cannot be “pushed” towards zero most of the times by applying verifiable criteria, because most universal laws are statements which make reference to a number of situations which is invariably greater than the number of verified cases. The practice to determine the probability that an empirical statement is true by establishing a relation between the number of verified cases which confirm the statement to the total of verified cases most often generates the occurrence of a paradox, meaning that the statement which was empirically proven false has a high possibility of being true. This probability differs from zero, but only appears because the denominator has the number of possible cases (infinite) is replaced with the number of observed cases (finite).

Still, such a paradox cannot exist when the verifiable criteria are being used to confirm

empirical statements which regard a finite number of terms, completely observed. Considering all these factors, we believe that verifiable approaches cannot be used in these situations, in order to validate an empirical statement because the first adequacy criterion stated by Watkins [6] is not accomplished. According to the principle of appearance which we issued, an elementary sentence linked to the surrounding world cannot be true or false, but only apparently true or apparently false. In this context of universal generalization of all the elements of the statement which refers to testable properties is not possible and because appearance always allows for the apparition of new manifestations of the real which would transform elementary verified statements and considered to a certain point both true and universally valid, in challengeable statements. Testable properties which result after the primary observations are not logically unchallengeable, considering the appearance.

### **3.3. Verifiable and falsifiability criteria**

Using this group of criteria appeared as a reaction of logical empiricists to the critics of Popper’s verifiability. Using this disjunctive criterion does not succeed in the delimitation of empirical statements because it breaks the second adequacy criterion which Watkins [6] issued, allowing the existence of tautologies within the statement. So, a statement like “Romanians are blonds or non-blonds” through “non-blonds” meaning “which are not blonds”, would be included within the verifiable half of the used criterion within the category of empirical statements.

And within the situation of using such a type of demarcation criteria, the testable properties which result from primary observations are not logically unchallengeable. Considering the appearance and using the same arguments as with the verifiable criteria, we have as a result the impossibility of their universal generalization, ergo the rejection of the first adequacy criterion used.

### **3.4. Falsifiability criteria**

Popper [4] tries to solve one of the issues signalled within the first pages of this article, meaning that the synthetic primary observations on the world are challengeable because they also include their appearance, introducing a new criterion in the debate. He says that we can include them within the sphere of primary synthetic observations which we can test as long as we consider necessary. In other words, the author creates a relaxation of the defining characteristics of the primary observations on the world, considering that they must be synthetic statements about the world outside us which can be tested as long as we consider necessary. By introducing the testable criterion, Popper [4] accepts challengeable statements within the category of primary synthetic observations, with the condition that they can be tested (thus proven false). Statements with a theological content are however eliminated from this category, because they can neither be tested, nor unchallenged.

By introducing this new condition with a large affordability, Popper does not solve, we believe, the issue raised by the first adequacy criterion used by Watkins [6]. The possibility to universally generalize all the elements of the statement which refer to the testable properties is not logically possible as long as falsifiability does not solve the issue of primary sentences, true or false according to made observations.

Popper [4] states that we can accept within the category of empirical statements only those who contradict at least one of the primary observations, as true or false, considered “a potential falsifiability”. But the existence of potential falsifiability is impossible within the acceptance of appearance as a methodological principle. A “true” primary observation now can prove “false” in the future which involves the impossibility of a universal generalization of statements which refers to possible false properties. If within the situation of verifiability the observation of does not allow for the generalization, as showed before, neither in the case of falsifiability, an (apparently) unfalsified statement until the present moment, cannot be universally generalized, from a logical perspective, because:

- a) It could become false in the future or

- b) It was false in the past, but the appearance did not allow noticing its falsehood.

In the context of sufficient given attributes, the relaxation of defining characteristics of primary observations of the world which Popper [4] realized does not solve the problem of belonging which we raised because the second situation allows for the universal generalization of sentences which refer to properties which were already false. So, falsifiability cannot be used as a criterion of demarcation within the situation when we use the sufficient attributes of the empirical statements which Watkins [6] used in his article.

#### **4. New sufficient attributes of empirical statements**

Within the presented context, there are two possible ways to solve the stalemate of delimiting empirical statements from non-empirical statements. The first consists of redefining sufficient attributes of empirical statements, whereas the second consists of finding a new demarcation criterion.

Considering the vulnerabilities noticed as a result of the analysis of the first of the sufficient attributes of the concept of empirical statement, meaning the possibility of universal generalization of all the elements of the statement which refers to testable properties, we will choose the first of the options chosen above and we will try to adjust it. Considering the fact that using this criterion in conjunction with the principle of appearance makes it logically impossible to find a demarcation line among the reasons already mentioned, our purpose is, thus, to replace it in order to obtain a set of sufficient attributes through which the usage of an empirical statement will gain consistence. In our opinion, such a set is formed from the following three components:

1. The universal interpersonal acceptance of all the elements of the statement which makes reference through possibly false properties;
2. The lack of existence of tautologies within the statement;
3. The lack of theological affirmations within the field whose acceptance cannot be affected by observations.

One can notice that we left unchanged the two sufficient attributes which Watkins used and we modified the first. From this reason, we shall make several considerations bound by the use of delimitation of the concept of empirical statement.

As we showed before, neither verifiability nor falsifiability cannot allow for a universal generalization of all the elements of a statement which refers to testable properties. The situation changes, however, if we use as a first sufficient attribute the universal interpersonal acceptance of all the elements of the statement which refers to falsehood properties. The principle of appearance, mentioned within the first part of this study, does not allow for the fulfilment of primary observations, in a cumulative fashion, the following conditions: to be synthetic statements on the world we live in, undebatable. They are either personal perceptions of the world we live in, undebatable, or they are synthetic statements of the world around us, but then they can be contested. The issue which follows is determined by the way in which the passage from subjective statements (apparent) is made, to undebatable synthetic statements. The only solution which we see to solve this issue is the universal interpersonal acceptance of these statements.

So, in the situation in which falsifiability is used as a demarcation criterion, a true statement (apparently) can be, from a logical perspective, accepted in a universal and interpersonal fashion, even if:

- a) Can become false in the future or,
- b) Was false in the past, but the appearance did not allow for the observation of its falsehood.

#### **5. The concept of empirical economic statement**

If, within the most important part of our study, so far, we have tried to create the foundation for the concept of empirical scientific statement, in general, in this last part we try to establish the sufficient predicates which an empirical economic statement must fulfil. To fulfil this desideratum we will create a short recall of the way in which we define „economics”, in one of our papers. Economics, we said, is that kind of human action which is held in the expectancy of an immediate or subsequent

intervention in nature in order to change material changes with it. As the arguments which are at the basis of this definition were presented in another paper, we will not present them again, considering them known. As a result, we will use the given definition in order to found, from a logical perspective, the sufficient attributes of the concept of empirical economic statement. In our opinion, such attributes are:

1. The universal interpersonal acceptance of all the elements of the statement which make reference to falsehood properties;
2. The lack of existence of tautologies within the statement;
3. The lack of theological affirmations within the statement whose acceptance cannot be affected by observations;
4. The explicit or implicit inclusion of the realization purpose of the material and natural exchanges.

While the first three predicates characterize the proximal genre of scientific empirical statements, the fourth represents the specific difference for the class of economic empirical statements. To put it differently, through an empirical economic statement we understand that statement which does not include tautologies and theological affirmations, whose properties can be proven false, are accepted in a universal and interpersonal manner and which imply the purpose of the material and natural exchange. Any other formulas which do not account for the sufficient attributes mentioned above are not economic empirical statements, but statements with a metaphysical character. In our opinion, such statements cannot be included, due to this reason, within the category of scientific statements and cannot be the object of study for research within economics. A debate on

such statements is thus meaningless for scientific growth, and for this reason in particular, it cannot be included within the category of scientific ones.

## 6. Acknowledgments

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## The Performance Analysis

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### Abstract

*The notion of performance has multiple meanings and sometimes it is paradoxical as each company must define performance for its internal and external communication. As we are trying to find a definition of performance based upon the features that a company should have, we find that every day companies invent new ways to compete in a competitive environment. One thing is certain: performance is achieved over time and can be seen.*

*We will test the model on the analysis of credit risk indicators of multitude of existing indicators, we considered representative performance.*

**Key words:** performance, credit risk, indicators.

**Jel clasification:** M40, M41, G32

Performance does not exist if it can not be measured (if it can be described by a set of measures or indicators, more or less complex). Performance assessment cannot be limited to a plain result.

Performance is a state of competitiveness of the company that ensures sustainable market presence. Performance is a potential indicator of future results that is due to meet strategic objectives. We can say that performance was not only a present or a

temporary situation; it also refers to the future.

We believe that the performing company is one that brings together the expectations of all partners: to comply with its contractual obligations and create value for shareholders, employees and customers.

The notion of performance is evidently associated to Profitability, Efficiency and Effectiveness. However, we believe that performance should not be confused with the indicators which describe it. Efficiency expresses mainly the quality of the economic activity of rationally using the production factors within the company. It is a fundamental requirement for the economy and it should always guide business actions and decisions. Efficiency is seen as an assessment term, a value concept, which is measured by the ratio between the value of the production obtained and the value of input resources. Efficiency applies within all socio-economic activities and it can be defined as the quantity of the useful effect retained in the effort unit. Efficiency reflects both economic and social effects. It expresses the maximum increase in results with minimum effort and time costs, this, of course, taking into account the specificities which vary from one branch to another.

*Profitability* is an issue that concerns any company because its activity is oriented towards profit, towards running a profitable activity.

The pursuit of an economic activity in

order to obtain a higher profit should be based on a coherent economic theory which has to guide the material, financial and human efforts of the company in a competitive environment. An increasing profit can be ensured by reducing uncertainty, the risk assumed in the economic activity. If there were no uncertainty, then we would know all the elements necessary to obtain profits; the companies would have the certainty that revenues are higher than expenses and there would be registered an increase in supply over demand, leading to a balance between revenues and expenses and the profits would be zero. However, in reality, uncertainty and risk lead to the existence of profits, without being reduced to zero by competition. Since, in a world without uncertainty, there would be no profits or losses, we might consider the profit or loss as a consequence of uncertainty.

“Therefore, the profit is not a payment to be made in order to obtain a resource, it is a remnant; it is what remains of the revenue after the total costs are covered, it is the result of forecasting the future more accurately than other competitors. It is a random income, and not a flat-rate income, which determines each economic agent to better anticipate the circumstances of his/her activities.” (Ciucur D., Gavrila I., Popescu C., 2007)

According to the neoclassical theory of risk, whose theses were drafted by A. Marshall and developed by A.C. Pigou, a company operating under uncertainty and whose profit is a random variable takes into account the following issues:

- the amount of the expected profit;
- the size of possible profit fluctuations.

Starting from the theory of the marginal unit, Marshall and Pigou tried to underlie the entrepreneur’s behavior. Thus, if there are two possible options which give the same expected profit, the entrepreneur chooses that option where the expected profit fluctuation is less. A decision involves choosing the alternative which allows the achievement of the same profit, but in terms of minimum fluctuations.

The fundamental thesis of the neoclassical theory of risk is that “for a higher expected profit, the entrepreneur is ready to accept a higher risk.” The concept of risk is financial, hence the need to capture and predict its size. The expected profitability is the one which, for a future period, has the greatest opportunity to achieve.

*Performance* may be defined as “a state of competitiveness of the company reached by a level of *efficiency* and *productivity*, which ensures its sustainable market presence.” (Niculescu Maria, Lavalette G., 1999)

Thus, taking into account the above definition, performance requires the simultaneous and complementary presence of the two “ingredients” which, separately, represent the necessary conditions of, but not enough for, performance. This is important because a holistic view of performance is possible only by correlating the dynamics of the two indicators.

Bogdan Andronic, in his work *Firm performance (Performanța firmei)*, brings into discussion a metaphor that expresses the above relationship, namely: “... we can compare the company with a car engine, the efficiency with the accelerator and the productivity with the clutch pedal...”

Therefore, a performing enterprise is also effective and productive, these being its effects (results). At the same time, efficiency and productivity are the causes that determine performance.

Professor M. Ristea believes that “we can associate the following three concepts to performance: efficiency, economy and effectiveness.” (Ristea M.,2000)

In conclusion, the enterprise *performance* requires knowledge of:

- a) current objectives, strategies and company policies;
- b) the achievement degree of economic objectives set for a period of time in order to be met by a company, i.e. the degree of the achieved economic efficiency;
- c) the productivity level of production factors, especially labor productivity;
- d) the performances reflected in the key

economic and financial indicators: profitability, liquidity, solvency, profit/share, return on investment, market share.

We focus on profitability as a measure of the company's capacity to obtain profit, making a comparison between the results obtained and the means used in order to achieve it. *The profit* may not represent the company goal, but it is necessary in order to achieve its objectives. In general, the strongest competitors:

- create value;
- obtain competitive advantages and optimally distribute the created value;
- improve the ratio effect / efforts.

Achieving high performance requires meeting all the three conditions mentioned above, as it is possible for a company to perform work efficiently but without obtaining a competitive advantage, or certain products / services can have a competitive advantage even if they belong to, and are produced by, inefficient enterprises. In other words, it results that a business can be effective but not competitive on the market, in which case we can not talk about performance globally or we can talk about competitiveness at the company level but not about efficiency, which leads again to a lack of performance.

Return On Assets – ROA will be determined having in sight the average of fixed assets (between the beginning and the end of the period) because there is the probability of a false improvement of this rate by selling fixed assets towards the end of the considered period. At the same time, we will underline also the ROA's assessment prospectively determined by using the balance sheet and profit-and-loss account foreseen by the customer for the next period; the same procedure will be used for the ROE too.

If shareholders have invested during the period by their own resources into business, we recommend ROE formula as formula of the financial return calculation {ROE = Profit / (capital at beginning of period + new capital investment - capital repayments during the period)}. Also, we may consider in calculating financial profitability the

credits given to the company by the shareholders; it's preferred to consider loans directly subordinated loans to the bank because the bank ensures the stability of this resource in the company.

Return shareholder rate( *Jianu, I.,2007*) is obtained for a single period and it is determined based upon the formula:

$$\text{Return shareholder value ratio} = \frac{\text{Return} + \text{plus or minus obtained shareholder value}}{V_0} = \frac{d}{V_0} + \frac{V_1 - V_0}{V_0}$$

Where

d - dividend received by shareholders for the period taken into account

$V_0$  - value of shares at beginning of a period

$V_1$  - value of shares at end of a period

We can start from the amount of profit shown by the company forecasts or we can calculate this expected rate, as it concerns stock exchange listed companies taking into account the shares' value. We can say however that, although derived in this way, the rate of return received by shareholders is not useful to the forecast.

To capture this aspect, we propose a different rate, shareholders' required rate of return:

$$\text{Shareholders' required rate of return} = R_d + \beta_i * (R_p - R_d)$$

$R_d$  - Interest rate

$\beta_i$  - Coefficient  $\beta$  of  $i$  share

$R_p$  - Rate of market return

$R_p - R_d$  - market risk premium

If the company is not listed to the stock market, we can calculate this indicator, by asking the company manager on what are the prospects for pay equity for the current year and we will compare the prospected value to the shareholders' required rate of return.

The difference between the two rates is that the first one represents the company expectations to reward shareholders and the

second considers the claims of shareholders to have financed their capital invested.

By making comparison between the two we can anticipate the shareholders' decision to retire, to sell their share package or to accept corporate takeovers or mergers.

It's about performance only if :

**Shareholder's required rate of return < Shareholder's earned rate of return**

Both return rates become useful by comparing their dynamics too, from a period to another (at credit reanalysis or at the extension of lines of credit).

In addition, we recommend the analysis of the dynamics of earning per share - IFRS considers it as the main indicator as it concerns the analysis of business performance

➤ **Earning per share:**

$$EPS = \frac{\text{Net Income}}{\text{Total Shares}}$$

➤ **Dividends per share:**

$$DPS = \frac{\text{Dividends}}{\text{Total Shares}}$$

➤ **Dividend payout ratio:**

$$DPR = \frac{\text{Paid Dividends}}{\text{Net Income}}$$

This is how we can understand whether shareholders have been accustomed to a certain remuneration of capital in prior periods, if they chose to reinvest the company's profits or to keep their due dividends. Therefore, creating value is synonymous to profitability, in the spirit of "win - win" partnership; it seems unfair the banking practice to prohibit the withdrawal of dividends during the financing period.

Not ultimately completed and ongoing ROI should be considered. As tools for measuring their performance, a project is highly efficient if the return period is the smallest, the net current value is above zero, and the internal rate of return is higher than the average market interest rate or weighted average cost of capital. It therefore requires an analysis of previous investment status if they meet their return period and whether the projections set at the time of the investment are met. The analysis of ongoing investment projects efficiency plays a primary role in the estimation of credit risk. It must be identified the extent to which they are not hiding losses and they are well forecasted by the company.

We believe that in order to achieve performance, the company must engage itself into innovative strategies and not just focus on the efficiency of current research.

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# The Present and Future of Investment and Saving Across The European Union and The Euro Area

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## Abstract

*Much attention has been devoted in recent years to the sustainability and adjustment of global imbalances. This has put the spotlight on saving-investment balances across the world. This paper investigates the factors behind developments in private saving and investment across Member States with a view to explaining trends and projecting the adjustment of saving-investment balances in the near term. While neither the EU nor the euro area is characterised by any apparent major imbalance at the aggregate level, this masks a considerable diversity across countries. Divergences across Member States have come under particular scrutiny in the course of the financial and economic crises.*

**Key words:** private saving, private investment, prospects, euro area Member States, outside the euro area.

**Clasificare J.E.L.:** O16.

## 1. Introduction

Gaps between gross national saving and investment are not problematic per se. Indeed, such gaps may be interpreted as reconciling the independent decisions of savers and investors and promoting the efficient allocation of savings towards productive investment across countries, which has in turn been facilitated by financial market liberalization and financial deepening among EU countries. In the initial stages of transition of Eastern and Central European countries, it appears that capital flows were channelled towards investment in productive capital stock. However, against a background of robust growth and contained inflationary pressures, the search for higher returns directed capital towards a wider range of opportunities, including less productive uses

in both the emerging countries of the EU and the catching-up countries of the euro area.

## 2. Aggregate and sectoral patterns in saving and investment

Over the long run, there was a strong downward trend in both investment and saving ratios in the EU between the early 1970s and the mid-1980s. From a cyclical perspective, the sharp drops incurred in the course of the recessions of the early and late 1970s were never recouped, leading to an overall contraction in savings and investment of about 5 pps. of GDP. This was followed by a relatively more stable period (1995-2000), characterised by average saving and investment ratios of around 21-23%. In the run-up to the financial crisis, both ratios recorded significant, albeit temporary, increases, while remaining below the previous peaks of the early 1990s. The crisis saw concurrent sharp drops in both ratios, which fell to all-time lows in 2009-2010. Overall, the saving-investment gap has remained very small over the past two decades for both the EU and the euro area.

*Aggregate saving and investment patterns across the Member States prior to the crisis: stylised fact.* The strong co-movement in saving and investment observed at the aggregate EU and euro-area levels was also the predominant pattern across countries in the period from the second half of the nineties to the mid 2000s. However, important divergences in movements of savings and investment were visible across the Member States in the period preceding the crisis. Typically, many countries experiencing stronger growth in investment were catching-up economies, with lower per capita income levels compared with the EU average, which benefited from large inflows

of foreign direct investment. Nonetheless, even for catching-up and post-transformation countries of Central and Eastern Europe – which have typically enjoyed relatively high investment ratios – investment growth was unusually strong compared with non-European emerging market economies with similar per capita income levels: e.g., the almost 20-pps.rise in the share of investment in GDP in Bulgaria and Latvia. In several countries, the investment boom was also linked to a strong expansion in house-building activity (e.g. the Baltics, Ireland and Spain). On the other hand, declines in investment-to-GDP ratios were recorded by several euro-area countries - Germany, Netherlands, Austria, Portugal and Slovakia - and some non-euro-area Member States - the Czech Republic, Hungary and Poland. In the latter group of countries, the increases in residential housing investment were muted in comparison with their regional peers. On the saving side, strong upswings were evident in the run-up to the crisis in a number of countries, namely Denmark, Germany, Ireland, Latvia, Lithuania, Austria, Slovenia, Finland and Sweden. Conversely, some Member States saw a noticeable deterioration in their saving ratios – particularly those suffering from long-lasting fiscal imbalances (Greece, Portugal and Hungary).

*Adjustment during the crisis.* Measures of dispersion broadly point to a reduction of cross-country divergences in investment and saving behaviour in the course of the crisis, although the dispersion of saving ratios broadly stabilised for the euro-area Member States. As a general pattern, both saving and investment ratios decreased noticeably as a direct consequence of the crisis. The Baltic countries (together with Ireland and Luxembourg) experienced the most significant downward adjustments. The reversal in investment activity, in particular, was sizeable in countries with buoyant investment in the pre-crisis period. These mostly catching-up countries – typically Member States with housing booms before the crisis – saw a significant downward correction in investment ratios (Estonia, Ireland, Latvia, Lithuania and Luxembourg). Saving ratios also fell sharply in most Member States. However, despite the economic slump, saving ratios rose in Bulgaria, Estonia, Latvia, Hungary and

Romania. All Member States with a marked increase in the saving ratio in the pre-crisis period experienced a drop during the crisis (Finland, the Netherlands and Denmark). Conversely, saving ratios continued to fall in most countries that had already witnessed noticeable reductions ahead of the crisis (Greece and Portugal).

*Sectoral patterns underlying saving and investment across Member States ahead of the crisis: stylised facts.* The various patterns in aggregate saving-investment dynamics across countries hide an even greater variation in sectoral trends. The private sector accounts for the major share (around 90%) of both gross national saving and investment. Within the private sector, the corporate sector predominates in most countries in terms of both source of saving and instrument of investment. In the pre-crisis period, gross national saving was driven up largely by higher general government saving across the Member States. This reflected—to varying degrees - successful fiscal consolidation efforts and boom-related windfall fiscal revenues. The corporate sector also contributed to higher savings. In particular, higher corporate saving was recorded in the non-euro-area countries and in some euro-area Member States (Germany, Estonia, Ireland and the Netherlands). In most Member States, the saving ratio was depressed primarily by lower saving in the household sector (Estonia, Greece, Italy, Romania and the United Kingdom). Nonetheless, the household sector made a neutral or slightly positive contribution to the change in overall saving in some Member States (Germany, Austria and Sweden). Rising investment by the household sector was typical in countries experiencing a housing boom (Denmark, Estonia, Ireland, Spain, Latvia, Lithuania and the UK) and was partly driven by considerable foreign capital inflows in some countries. The corporate sector also contributed to higher investment (Estonia, Latvia, Romania and Slovenia) – linked in most cases to large inflows of foreign direct investment. At the same time, among the older Member States, Spain, France and Italy also recorded a marked increase in corporate investment rates. On the other hand, lower corporate-sector investment weighed on aggregate investment ratios in some Member

States (Germany, the Netherlands, Slovakia and the Czech Republic). The general government sector had a mostly neutral or positive impact on the overall investment ratio (generally in the non-euro-area Member States), although some countries recorded a deterioration in the government investment ratio ahead of the crisis (Germany, Austria, Portugal and Slovakia).

*Sectoral developments during the crisis.* The decline in saving ratio was largely driven by a sharp drop in general-government saving during the crisis. This reflected, inter alia, the impact of the crisis on general-government revenues and expenditures via automatic stabilisers and stimulus measures. Only Hungary recorded an increase in general-government saving – the result of limited fiscal room for manoeuvre against the background of a balance-of-payments crisis. Moreover, in most euro-area Member States, where corporate saving had increased before the crisis, corporate saving also came under pressure (Estonia, Ireland, Greece and the Netherlands). Nonetheless, an increase in household saving in most Member States – along with a continuous rise in saving in the non-euro-area corporate sector – acted to partly offset this general trend. The pre-crisis investment boom was abruptly reversed during the 2008-2010 period. Most Member States experienced falling investment ratios largely due to a sharp drop in investment activity in the corporate sector (particularly in Ireland, Latvia, Lithuania and Estonia). The household sector also contributed significantly to a decline in the investment-to-GDP ratio – in particular in Member States with unwinding housing booms (Spain, Ireland, Estonia and Greece). However, in some Member States, higher public investment partly contained the drop in investment ratios in the private sector (Poland, the United Kingdom).

### **3. An assessment of potential driving forces behind developments in saving and investment**

*Drivers of national saving.* National saving is important from both the micro and the macro perspectives. At the micro level, households save to fund retirement, purchase expenditures. Corporations save to fund their

own investments or to strengthen their balance sheets. At the macro level, depending on the current-account position of the country, saving can fund domestic investment either partially or completely and accumulate net claims against foreigners. Movements in the saving ratio (both public and private) have an important influence on domestic demand, helping to determine both domestic capacity utilisation and, through the saving-investment balance, the country's current-account position. This sub-section examines the factors which drive saving ratios in the government and private sector.

*Drivers of government saving.* The factors which lead governments to run deficits or surpluses are numerous, complex and much-studied. The most important time series determinant is usually the cyclical position of the economy, as higher transfer payments and lower tax receipts worsen the fiscal balance during cyclical downturns. At the EU and euro-area levels, this relationship appears to hold remarkably well. However, at the individual country level, the picture is more varied. For the ten years up to 2007, the correlation between the deficit and the output gap is significant at the 5% level in only ten Member States. This increases to 21 Member States when the end-date is moved to 2009 to include two years of the financial crisis which brought a relatively uniform worsening of fiscal balances and widening of output gaps across the EU. The remaining six Member States are Romania. Of these Member States, four had average deficits over the period of at least double the EU average. Persistent deficits could be linked to a weak cyclical response of the fiscal balance, for example if a less-than-reliable tax base caused revenues to respond to factors other than the cycle.

*Drivers of private saving.* The drivers of private saving are more complex. An important issue is the distinction between the household and corporate sectors. However, data on the sectoral breakdown are not always reliable enough to draw strong inferences on the distinct behaviour of the two sectors. For households, the theoretical starting point for this section is a life-cycle consumption model although there are widely-acknowledged deviations from this model in practice, particularly due to considerations of uncertainty and constrained

liquidity. The corporate sector is fundamentally an intermediate one, owned finally by the household sector and foreigners. The preferences and rights of shareholders therefore play a role in determining saving. If it can be assumed that shareholders generally prefer to have cash over and above that needed for the operation of the business paid to them as dividends and that company management has incentives to hoard cash and therefore maximise their range of strategic options, it would be reasonable to expect countries with more developed shareholder rights to have lower rates of corporate savings. More concentrated ownership of firms should have the same effect, because larger shareholders have greater incentives and opportunities to influence company managers. Because of such factors, interest rates may not have the same impact on corporate saving as in other sectors, since high interest rates could just as well be expected to increase shareholder demands for dividends, reflecting the higher opportunity cost to shareholders of leaving the money within the company. It is also possible that some households vary their saving behaviour according to the behaviour of the firms which they own, saving less when the firms they own save more, in anticipation of bigger dividends in the future. Household and corporate savings in the EU are not strongly correlated and trended in opposite directions during the pre-crisis decade, suggesting that the drivers of saving behaviour in each sector are different.

The role of interest rates in influencing saving behaviour is complex. It is clear that higher interest rates increase the incentive to save but they may also reduce disposable income, and therefore the opportunity for saving by net-debtor households and firms, meaning that the overall effect varies with the relative marginal propensities to save of net creditors and net debtors. The market-clearing interest rate also responds to developments in demand for financing and, in an open economy, foreign capital supply and demand. EU real interest rates and savings followed a markedly similar downward path in the mid-and late nineties. But their paths have diverged in the more recent past. A common influence on private-sector saving, of particular current importance, is public sector saving. Both

households and corporations may save more in anticipation of future tax rises if the government has a large deficit. The causality could also run the other way, with governments increasing their borrowing at times of high private-sector saving in order to make up for shortfalls in aggregate demand which such higher saving could create in the absence of strong export demand or domestic investment. It is also likely that common factors will act in opposite directions on the private sector and government balances. For example, higher cyclical unemployment increases the government deficit and is also likely to increase household precautionary savings. The relationship between government and private saving is therefore also connected to the economic cycle and the output gap. This negative correlation between government and private-sector saving does appear to hold for the EU as a whole. A final potential influence is that of demographics. The greater the proportion of life a worker plans to spend in retirement, the more he should save during his working life. With a constant retirement age, this would translate into a positive relationship between saving and longevity. However, it would not be surprising if such phenomena did not show through in the data. In reality, few individuals make specific calculations about the exact level of saving needed to retire comfortably at a given age.

*Determinants of investment.* Investment is a crucial element of economic performance. It determines the size and structure of the capital stock and enables the penetration of new technologies, thereby influencing employment and growth prospects in the medium-and longer-term. Moreover, as one of the most volatile components of aggregate demand, investment is a key driving force of the business cycle. This section begins with a description of cyclical fluctuations in investment before turning to the drivers of investment. Over the period 1996-2010, real investment in the EU grew on average at about the same rate as real GDP, i.e. slightly below 2% per year. As a result, the share of investment to GDP (in constant prices) remained broadly unchanged for the period as a whole, at around 20%. This is in line with the standard growth literature which suggests a constant investment-to-GDP ratio over the long run. In spite of this long-run stability,

the investment- to-GDP ratio has fluctuated over the business cycle. This is because investment displays a clear pro-cyclical pattern, accelerating more than overall economic activity at the beginning of recoveries and decelerating more during slowdowns. Over the period 1996-2010, two cycles can be identified: the first in the late 1990s and the second towards the end of the last decade. During the second cycle, the investment-to-GDP ratio experienced a wider fluctuation: 2½ pps. in terms of annual figures between peak (2007) and trough (2010) against 1½ pps. in the previous cycle.

*Drivers of private investment.* The most straightforward model of investment –the "accelerator model" – in its simplest form postulates a linear relationship between investment and changes in output. As the microeconomic foundations of this relationship are rather poor, other models have been developed which emphasise the role of costs. Modern economic theory focuses on three main macroeconomic determinants of investment: aggregate demand, cost of capital and profitability. In turn, the key components of the user cost of capital are financing costs, the purchase price of new capital relative to the output price, and the depreciation rate of the capital stock. The remainder of this section explores the potential explanatory power of these investment drivers for the various investment trajectories of capital formation in the EU countries over the last 15 years. Where aggregate demand is concerned, several Member States fared much better than the EU average in the years preceding the financial crisis. Between 1996 and 2007, the average growth rate of GDP exceeded 5% in Estonia, Ireland, Latvia, Lithuania and Slovakia compared to 2½% in the EU as a whole. Although demand growth may account for part of the difference in investment growth rates, it cannot provide an explanation for the diverging trends in the share of investment-to- GDP compared to the EU. For the user cost of capital, long-term real interest rates are commonly used as indicators of borrowing costs. The latter decreased significantly in several EU countries in the ten years preceding the financial crisis. On average, their level in the EU in 2007 was about 2½ pps.lower than in 1996. Focusing only on long-term real

interest rates as a measure of the user cost of capital may be too restrictive. A better measure of the overall cost of financing could be a composite indicator, which would take into account the composition of the source of financing, e.g. loans, debt securities and equities. However, while the various measures of the cost of capital may exhibit different developments and volatilities in the short run, the underlying trends tend to co-move in the long run. The equipment-construction breakdown of investment shows that this negative correlation between the investment price deflator and the investment to GDP ratio holds and largely stems from equipment rather than construction investment. This is hardly surprising. As the real-estate booms of the past decade in several EU countries have shown, it is the expected rather than the actual relative, price of output which spurs capital spending in the construction sector. Observed patterns of construction investment in Ireland and Spain seem to confirm this. In both countries, expectations of rising real estate prices boosted construction investment well above normal levels. For instance, the recently-acceded EU Member States have traditionally enjoyed a lower wage share (higher profit share) than core euro-area countries. The evidence is not categorical, however. Germany and Spain experienced very different investment patterns, particularly in the construction sector during most of the past decade, despite similar developments in the wage share. All in all, the examination of traditional macroeconomic variables suggests that they are unlikely to be able to fully explain the different investment patterns observed in several EU countries since 1996. Divergent expectations about future profitability across countries, possibly related to underlying structural differences in labour and product markets, have also probably played a role. But there is reason to believe that financial conditions play a role in corporate investment decisions.

#### **4. Near-term adjustment prospects for saving and investment**

On one hand, the ongoing fiscal consolidation is set to improve government savings by around 1¾ pps.and 1½ pps. of

GDP, respectively, in the EU and the euro area. On the other hand, saving ratios in the private sector are set to decline as, in line with the empirical results, they react negatively to the increase in government savings and possibly the worsened terms of trade related to higher prices of imported commodities. As a result, over 2011-2012, the overall increase in the saving ratios of the economy as a whole is expected to be relatively limited in both the EU and the euro area – in the order of 1pp.of GDP. These developments at aggregate level reflect similar patterns projected for most Member States. However, the size and sectoral composition of the adjustment vary widely. Some euro-area Member States, which are characterised by large imbalances and relatively low savings ratios, are expected to increase their saving by more than the average. This is particularly evident for Greece, where both the government and the household sectors are engaged in balance-sheet adjustments, while the large adjustments anticipated in the government sector in Ireland and Portugal are set to be only partly offset by lower savings in the private sector. Outside the euro area, saving ratios are set to rise significantly in Lithuania and the UK between 2010 and 2012. In the former, private saving is expected to increase marginally in parallel with a large improvement in government saving.

The expected overall moderate increase is driven by the rise in the private (especially corporate) investment ratio, while some decline is anticipated in government investment ratios, in line with the results of the previous empirical analysis. Corporate investment is set to benefit from improving demand prospects, still low real interest rates and moderate wage increases. At the country level, the decline in the investment ratio is set to continue over the forecast horizon in those euro-area Member States where large balance-sheet adjustments in both private (particularly household) and government sectors are still warranted, namely Ireland, Greece, Spain, Cyprus and Portugal. On the other hand, investment ratios in Estonia, Malta, Latvia and Lithuania are expected to benefit from renewed inflows of FDI.

The above projections for changes in saving and investment ratios imply broadly stable current-account balances in both the

EU and the euro area over the forecast horizon. Where imbalances within the euro area are concerned, sizeable improvements in the current-account balance over the forecast horizon are anticipated, in particular in Greece and Portugal, due to higher saving but also lower investment ratios. The still-sizeable external imbalances in these countries would suggest that further adjustment in sectoral balance sheets and improvements in competitiveness are to be expected beyond 2012. Some further adjustment also seems likely in those euro-area Member States where the anticipated increase in domestic demand is not sufficient to shrink the large current-account surpluses by 2012. On the saving side, progress on consolidation of public finances is likely to have a crucial impact on private saving ratios, which will differ depending on the fiscal space available. In Member States with the greatest need for fiscal restraint, reductions in the private saving ratio might partially compensate for this. As regards private investment, an important boost is likely to come from the closing of the output gap and gradual improvements in GDP growth. The restoration of profits in the corporate sector could also support investment.

## 5. Conclusions

As regards private investment, an important boost is likely to come from the closing of the output gap and gradual improvements in GDP growth. The restoration of profits in the corporate sector could also support investment. The impact of other determinants are likely to vary considerably across Member States: differences in real interest rates as well as relative cost of capital (partially reflecting falling prices in the construction sector of many EU countries), should have a differentiated effect on investment levels across Member States.

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## Study on Sustainable Development Policies

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### Abstract

*Concerns for sustainable development at the level of every country and at international level are the result of a group of problems that are worrying: poverty in the middle of welfare, environmental degradation, losing trust in institutions, uncontrolled extension of urbanization, unemployment and other economic-financial or geopolitical crises.*

*Sustainable development policies start from the understanding of the fact that the economy of a country and of all countries means more than the sum of its parts, the alterations occurred within a subsystem cause changes by virtue of the dynamic interdependencies existing between the parts.*

**Cuvinte cheie:** environment and environmental policy, social cohesion, development policy, sustainable economic development

**Clasificare J.E.L.:** E61, H12, O16, O20, R11;

### 1. Introduction

Sustainable development is considered that type of development that answers the needs of the presents, without compromising the abilities of future generations to fulfill theirs. Present generations cover their needs accordingly.

Sustainable development policies start from the understanding of the fact that the economy of a country and of all countries means more than the sum of its parts, the alterations occurred within a subsystem cause changes by virtue of the

dynamic interdependencies existing between the parts.

### 2. Sustainable development - multidimensional concept

Sustainable development is a multidimensional concept to the extent in which[1]:

1) It has a powerful moral weight. On the inheritance that every generation inherits, it builds its future; it is the duty of the current generation to give at least the same chances that it has inherited.

2) It is established as a worldwide concept to the extent in which we admit that there are no economic or ideological borders for pollution, poverty, waste and human degradation.

3) It supposes a different treatment depending on time and especially space and for space, meaningful distinction is between the rich and the poor. If in rich countries, the problem of de-pollution, improvement, living quality is a transformation one, for poorly developed countries the matter is not one of living quality, but rather of survival.

4) The notion of sustainable refers to duration, to a long time, the concept refers to the increase of quality to the disadvantage of quantitative economic growth. The process of sustainable development wants to be sustainable human development mainly oriented towards living and environmental quality.

5) The approach of the phenomenon is made on predominant economic positions. Economic philosophy is guilty of ecologic degradation and social, moral and political mutations, depending on the

growth type and post-war consumption way to which sustainable development proposes to answer.

6) The environment and environmental policy have a privileged place. Ecosphere degradation degree provides explanations in this matter.

7) Theoretical approach of the phenomenon of sustainable development has had a political weight more and more because political involvement in the economic and social life has been a doubtless fact.

Sustainable economic development involves intensive economic growth, environmental quality, creation of a favourable framework for solving social problems that the individual and communities are facing within the spirit of social justice, of democratization.

The pattern of sustainable economic development is centred on man and on fulfilling its needs, on human development, evolution by means of three indicators: living hope, valorization level and national income per inhabitant/wealth.

The pattern of sustainable development specific to the economic and social systems supposes compatibility of economic efficiency criteria with social, human and ecologic efficiency ones in order to provide equality of chances to the generations that coexist and succeed on earth.

Sustainable development is not a philosophy but it rather inspires economic and social policy on multiple directions. At the level of principles, sustainable development policy means[1]:

1) Increasing the concern for values economy directly requiring the decrease of specific consumers, raw materials and energy, with the preservation of goods quality;

2) Promoting a new technical production method based on:

a) Trivalent enterprise, regular company “to operate within a

network” taking from upstream and providing in downstream

b) “clean productions” with as less polluters as possible and less waste as possible

c) Biologic agriculture

3) Promoting a new way of consumption which refers to: reconsideration of the notion of need, the philosophy of reason instead of profit logics, removal of consumption from the effect of advertising

4) The solution of market by establishing competition mechanisms in allocating all the resources; application of the principle according to which the polluter pays by clearly defining and strictly complying with ownership rights; direct negotiation between economic agents, internationalization, guarantee-collection systems.

5) State solution which is materialized in the application of regulation and control standards and other measures; direct implication of the state in the economic and social policy and resources consumption regulation.

6) Promoting a new type of economic growth characterized[5] by:

a) A severe campaign against waste

b) A cult for product durability

c) Reconsideration of the importance of recycling

d) Permanent search of substituents and alternative technologies

e) Consistent effort for saving

f) Collaboration between generations

g) Distribution of results that bring social progress.

Sustainable economic growth is understood as a growth capable to support economic stability and human progress on long-term, to harmonize ecologic requirements with economic and human development.

This opinion connects the increase of sizes and change of structure. It excludes the assimilation of growth with progress.

This concept comprises four groups of phenomena[6]:

1) Increase of size which is revealed by size indicators especially by GGP (gross global product) of the national economy;

2) Objective structure alterations revealed by several structural indicators and coefficients: industrial product (IP)/ total product (TP)/ total profit (TP) etc.

3) Systems or groups of institutions alterations which control the fulfilment of fundamental economic functions within their mutual relations;

4) Progresses which are the result of an economy or of one of its parts towards a purpose being revealed by quality indicators, average, structure indicators, groups of several simple indicators.

Following the general trend of economics evolution towards an increased level of efficacy and pragmatism, the theory of economic growth develops towards a theory of economic growth process forecast that have the role of analysis and macroeconomic decisions substantiation regarding the growth process[7].

Sustainable development wants to be an alternative to post-war economic growth that because of the economic and social progress has caused negative effects. From this point of view, the supporting arguments of sustainable development are critics made to the weak functions of the type of economic growth. We can show that the type of post-war economic growth polluted the environment and affected human health, caused and encouraged waste by finishing the known reserves, frustrated the third world and increased the differences from that of the rich, created the illusion of welfare through lying statistics, corrupted well-known values and reduced the individual to one dimension that of homo oeconomicus[1].

These minuses underlined by literature on the theme of sustainable development show that the pattern of post-war economic growth has turned out to be a universal remedy and that the philosophy of the dominating man that owns the nature and acts as he pleases has to be changed.

Economic growth is the sustainable size of an economic, simple or complex unit, made by changes of structure and possible systems and accompanied by economic progresses.

Concerns for sustainable development at the level of every country and at international level are the result of a group of problems that are worrying: poverty in the middle of welfare, environmental degradation, losing trust in institutions, uncontrolled extension of urbanization, unemployment and other economic-financial or geopolitical crises.

Sustainable development policies start from the understanding of the fact that the economy of a country and of all countries means more than the sum of its parts, the alterations occurred within a subsystem cause changes by virtue of the dynamic interdependencies existing between the parts.

Starting from factors that influence one another in the process of development – population, natural resources and environment, agricultural production, industrial production and pollution – the policy of sustainable development wants to find the most adequate optimization criteria of the needs-resources ration, objectives to be reached, means necessary based on their mutual compatibilities in time and space. Such an economic environment has to be designed and developed which by means of its inputs, transformations, outputs, to be able to enter in direct dynamic compatibility with the natural environment and with the present and future needs and interests of the generations.

The concept of sustainable development as well as its achievement policy cause the problem of man purpose-means and human community in general from the points of view of time and space[8].

Such perspectives that have to be integrated in sustainable development depend on man's culture, on its past existence, on the actuality and difficulty of its problems at every level, on the development and incorporation level of scientific and technical discoveries, on national and international development strategies. Mutual compatibility in time and space of the four extents (natural dimension exists only as long as the environment created by man is compatible with the natural environment, economic dimension based on competitiveness, social-human dimension, all outputs from the environment created by man have to directly answer the present and future needs and interests of coexisting generations, national state, regional, and world dimension within the meaning of optimization criteria compatibility at national, regional or international level) give the development criterion a durable character.

Through the answer that has to be given to the existing trends – fast increase of the population, accelerated industrialization, malnutrition, disappearance of resources and a deteriorated natural environment, the policy of sustainable development proposes to create the conditions for passing over the limits of progress in time and space both quantitatively and qualitatively from the position of the social man, of the compatibility of the environment created by him with the natural environment, of generations in time and space.

### 3. Vision of sustainable development

The vision of sustainable development integrates the following major requirements at the level of all national economies and at the level of the global system of world economy[7]:

1) An essentially revised fundamental behaviour as a direct way of fighting against objective and subjective restrictions of development and cohabitation with the natural environment;

2) Substantial improvement in real, absolute and relative terms of development in developing countries in relation to developed countries of the world;

3) Strategic planning with specific and common elements in direct compatibility both at national and international level;

4) Reaching a rational and durable state within the conditions of educational traditions and current activities, of immediate interests will slow down transformation, the success being provided the real understanding of human condition in the context of radical change.

5) By passing to sustainable development, one hopes to achieve a safer and safer present within a future through this complex and long lasting process;

6) Within this fundamental process, it is essential that science helps man investigate itself under its aspects and objectives as well as investigate the world it wants to change;

7) Within this complex process, the key of sustainable development is not only the survival of the human species, but rather whether it can survive without falling in a state of existence lacking any value.

Sustainable development is defined by the following important elements:

1) Permanent and safe compatibility of the environment created by man with the natural environment;

2) Equality of chances of the generations coexisting and succeeding in time and space;

3) Interpretation of the present through the future under the form of introducing the purpose of sustainable development the natural and human safety instead of money profit maximization;

4) Introducing the compatibility of national development strategies as a result of powerful interdependencies within geo-economic and ecologic plan;

5) Moving the weight centre in providing general welfare from the quantity and intensity of economic growth to its quality;

6) Ecologic capital is interdependence and organically integrates with the capital created by man within a global category that redefines the economic and social objectives and extends its horizon in time and space.

7) Passing to a new natural-human strategy in which the objectives of economic and social development have to be subordinated to human and environmental curing in time and space.

#### 4. Conclusion

Starting from the need to achieve these components, the policy of sustainable development wants to detect the change of economic growth type, pollution control, creation of an institutional and legislative framework, educational system able to anticipate and deepen the knowledge, the system of economic instruments, able to prevent, protect and provide rare resources, the system of specific indicators based on which one can appreciate the quality of development and human life, ecologic balance.

Sustainable development needs short-term and medium-term policies and long-

term for 20-25 years. Policies are therefore necessary at regional, international and planetary level and at the level of the company with compatible objectives in time and space based on criteria that result from the improvement of living conditions. At the same time with the substantiation of these policies, it is essential that every level operates as a sum of economic, judicial, substation and information regulating means that provide the fulfilment of objectives.

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## Financial Risks Insurance

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### Abstract

*The credit insurance protects the dealers and the producers from the risk of non-payment by the consumers who buy or rent goods or benefit from similar credit facilities. It appeared as a necessity coming from the fact the most of the trade contracts are concluded when the payment is made partially or totally after the delivery of the goods or the performance of the services making the contract object, so with a late payments, respectively "a credit sale".*

**Keywords:** risk, insurance, credit insurance, decentralized economy

**J.E.L. Classification:** E20, E22, E24

### 1. Introduction

Financial insurances represent a relatively new form of insurance appeared as a consequence of the process of narrowing the distinction between financial institutions and insurance ones. It is a new concept by means of which the insured one removes the risks of financial losses that may appear in its activity, transferring them to an insurer.

Commercial credit represents both the value transferred to the buyer by a seller based on trust, and the lapse of time before the reimbursement by the buyer of the value, as payment[1].

The financial insurances are different from the bank guarantees. By the financial insurances, the risks are taken over only in certain conditions, while the bank guarantees involve the unconditioned assuming of all the obligations.

The commercial guarantees coming from the need of the persons responsible for offering guarantees against the non-payment, have started to be used thousands of years again. Such a guarantee was offered by means of one or several private guarantees

that assumed their responsibility for the non-payment risk. Such a system was considered as inadequate and even condemnable for the guarantor.

The guarantees offered by the companies acting as a bail have multiple advantages. The first company of England that practiced this system was Guarantee Society, in 1849. Subsequently, others insurers started to practice or were even constituted in different forms of association for practicing this type of insurances, by using different types of bills, either individually, or in group.

In 1934, based on the Swiss Civil Code, the International Association of the Credits and Investments Insurances was constituted and called the Bern Union, having as a purpose the acceleration of the free exchange of information regarding the country risk and the establishment of certain healthy principles and rules and of the discipline in international trade and in the field of insuring the export credits and the foreign investments[8].

### 2. The role of the credit insurance in the modern economy

The credit insurance is a special insurance because its object is much different than the other types of general insurances. The credit insurances certainly represent a feature of the contemporary business world.

The credit insurance protects the dealers and the producers from the risk of non-payment by the consumers who buy or rent goods or benefit from similar credit facilities. It appeared as a necessity coming from the fact the most of the trade contracts are concluded when the payment is made partially or totally after the delivery of the goods or the performance of the services making the contract object, so with a late payments, respectively "a credit sale". Thus, the credit insurance comes to remove the seller's fear regarding the non-payment by

the buyer of the amounts he deserves, offering protection for the non-payment risk. The reason may be represented by the buyer's financial situation or, if the sale occurs in another country than the one where the seller is, the causes related to the situation of the importer's country. The credit insurance appears as a direct protection of the sellers from the risk of non-cashing and, at the same time, as a guarantee in front of the bank, also constituting a possibility to access the financing[6].

The insurance may be made on only one credit or on the business number.

The purpose of the credit insurances is to protect from the financial losses resulted from the non-payment, the payment incapacity or the insolvability of the buyers who purchased goods on credit or the insolvability of the credit beneficiaries. The bills of credit insurances protect the collections from the commercial activity in conditions of transferring the non-collection risks on the insurer and, as a consequence, the business number may increase.

The credit insurance is considered as a luxurious insurance, as it is specific and it works in optimal conditions in the framework of the market economies, with a stable and well developed credit system. Globally, most of the credit insurances are practiced in developed countries.

The credit insurers usually offer a large scale of services, next to the insurance ones, such as; market studies, consultancy, technical assistance, feasibility studies, credit investigation and surveillance. Among the insured risks, we may also meet some that are more rarely accepted on the market, such as: exchange risk, expropriation risk, restrictions for the fund transfer, etc.

Even if the insurances against these risks are available on the national and international insurance markets, only a relatively reduced number of dealers call them in the entire world.

It is important to notice that, no matter the size of the risks, 3 demands for the insured ones are distinguished[9]:

1. Prevention, by collecting, processing and interpreting the information on clients, in order to minimize the non-payment risk;
2. Collection of the debts, respectively the ability to recover the debts anywhere

in the world, no matter the differences regarding the language, the culture or the legislative system;

3. Insurance, respectively the payment of the compensation in case of non-payment by the debtor to the insured one.

The insurable risks may be grouped in two categories:

1. Commercial risks, that are related to the buyer's financial situation and refer to:
  - a) The non-payment due to the buyer's insolvability.

Insolvability may be determined by different causes, such as: bankruptcy; any measure of forced execution on the property of the debtor who did not lead to the integral payment in favour of the insured one of the invoiced amounts; the execution of a judicial decision of homologating the agreement contracted between the debtor and its creditors; an agreement with no judicial procedure with all the creditors or with most of them; suspension or the official moratorium on the payments due by the debtor or any similar measures according to the legislation of the debtor's country.

- b) The temporary or permanent impossibility of the buyer to pay the purchased goods or the performed services.
  - c) The buyer's refuse to accept the contracted merchandises for reasons that do not depend on the seller.

2. Political risk, that represents a special category, very important for the correct evaluation of the possibility to return the credit and, implicitly of the non-payment risk. This risk interferes only when insuring the export credits. It may be mainly determined by the "subjective elements existing in the importer's country. By producing one of the risks afferent to the respective country, the entire contractual relation between the partners may be damaged. The political risk may be incarnated in:

- a) Difficulties and delays (longer than a certain number of days, usually 180) in the process of transferring the money from the buyer's country, as a consequence of a general moratorium, regarding the extern debt, declared by

- the government of the buyer's country, by means of which the payment is accomplished;
- b) The impossibility to transfer those amounts from the importer's country to the exporter's country as a consequence of certain governmental actions in the respective country (the one of the buyer) stopping the accomplishment of the export contract or determining delays in the money transfer;
  - c) Introducing certain regulations regarding the export or import licences to the buyer's country, retiring or non-renewing the export licence or imposing some commercial restrictions, after the date of entering the risk;
  - d) War, civil war and other similar events, outside the exporter's country, making impossible the accomplishment of the export contract, if the damage is not insurable as a commercial risk;
  - e) Risks regarding the public buyers; by public buyers we mean those entities that cannot be declared in bankruptcy;
  - f) The losses resulting from the impossibility to institute legal procedures in the buyer's country due to the lack or to the bad functioning of the legal system of that country.

Especially, for insuring the export credits, the insurable risks represent dangers resulted from selling goods or performing services on credit, outside the country[3].

The prolonged non-payment represents a risk that may affect the insured one's financial situation. It is considered a case of payment delay when the debtor or the bail has not paid the part of the debt for a certain aggregated time, usually 6 months to the date of payment established by the contract. The cases of major force, the difficulties in money transfer, the insufficiency of the convertible quotations or other political causes, the natural disasters, the epidemics or any form of violence in society are mainly excepted[7].

Next to the protection needed by the exporters for the risks that may affect the transactions on an average and long term, the insurance bill eases the access to financing, constituting a guarantee for the financing bank and removing an important part of the risks.

The excluded risks for which the insurer will not pay compensations may be:

- Reclamations for delivering goods or performing non-corresponding services;
- Penalties or any other losses related to the non-execution of the contractual obligations according to the sales contract concluded by the seller (the insured one) and the buyer;
- Fines of any kind;
- Losses resulted from the differences of appreciation;
- Compensations as a consequence of the political risks;
- Compensations as a consequence of a declared or undeclared war – civil war, revolution, revolt, sabotage, etc;
- Compensations as a consequence of certain natural calamities (cyclone, floods, earthquake, sea flooding, storm, tornados or other similar events having a catastrophe feature), if the technical means available for the fight with such calamities could not be used or were inefficient.

This insurance type mainly contains the following types:

- Credit insurance, respectively the insurance of the intern credits, the insurance of the export credits, the insurance of the credit rates and the insurance of the investment credits.
- Fidelity insurance.

The credit insurances substantially remove the risk of financial loss, especially when it is about transactions of big values or the number of the business partners is relatively reduced this may determine the appearance of a difficult situation if one or several debtors cannot achieve their payment obligations. However, the credit insurances are not always profitable, especially when the individual credits are reduced, and the risks are dispersed on a big business number[6].

The credit insurance is a compensation insurance, because it supposes the compensation paid to the insured one for the suffered loss as a consequence of the insolvability or of the payment incapacity of the client of the insured one, and not the production of a “physical” even as it is the case of the other insurances. This is why it is about a pecuniary insurance of financial, not material loss.

The differences between the usual insurance of compensation and the credit insurances comes from the risk nature and of the interested parties, namely[9]:

1. The credit insurance involves 3 parts, and every part acknowledges the existence of the others.
2. The responsibility regarding the credit reimbursement belongs to the debtor, and the responsibility only if the first one does not accomplishes its payment obligation for reasons included in the insurance bill.
3. The insurer has no interest in the contract, except for the one of bail for the buyer.

By insuring the intern credits, the insured one is protected against the risks of prolonged non-payment by the buyer or of its insolvency during the time between production and distribution, usually before the final sale to the consumer. There may be several types of insurance bills:

- The bill for only one transaction.
- The bill for a certain lapse of time based on the business number.

The administration of such insurances is costly and needs a big work volume and this is why it is mostly used for big value transactions (industrial equipments, construction works, installations and others).

- The bill by means of which we obtain the protection for a number of transactions.
- The bill for one or several buyers, and the insured one is free to decide on them. It is usually contracted on a determined term (12 months)
- The general bill on the business number on credit, frequently used, insures all the seller's business with one or several buyers, on a determined term, usually 12 months.
- The bill for several accounts of an insured one, when the covering is limited to those clients crossing a certain determined level of the debts and whose prolonged non-payment will have a big impact on the availabilities in the money account of the insured one.

These insurance types suppose reduced administration costs and involve a relatively reduce quantity for it; at the same time, the insurer may avoid the anti-selection because the clients will require insurance for all the credit contracts, not only for the ones with a big risk, and there will be the possibility to

check the solvability and the credit worthiness of its clients by means of the evaluators of risk and of the insurer[3].

The most frequently used bill is the general bill on business number, distinguished by the fact that it refers to importers who buy on credit. The main difference from insuring the intern credits consists of the fact that, in case of the exports on credit, the importer of the insured one develops its activity in another country, and this is why the risk evaluation should consider many factors outside the buyer, respectively the factors related to its country. This refers to the country risk that is evaluated by an analysis preponderantly of the economic and political factors, where we add the legal regulations, the risk factors, the uses of the buyer's country. This analysis is very important because, even if the purpose of the credit insurance is identical for the dealers of any country, the definition of insolvency, of the insurance bills and the procedures necessary for paying the insured amounts may be different[1].

The advantages of the insurance bill of the export credits are related to the efficiency of the commercial activity, such as:

- The reduction of the costs that may be obtained by insurance, unlike the bank guarantee; the reserves that are constituted for losses of claims are bigger than the insurance prime; the size of the costs as a consequence of administrating the extern claims by the insurer; finding certain financing ways that are more advantageous for the insured societies, obtaining certain reduced collection costs by experimentally involving the insurer.
- Increasing the profits of the diminution of the reserves constituted for covering the potential damage; focusing on partners having a good payment experience, increasing the business number, reducing the costs, considering the tax effect.
- The possibility to increase the business number given the fact that the seller has no longer the risk to reduce the activity or even to stop it due to the non-cashing of the counter value of the export merchandises; using some competitive payment means; developing some exports of new products or with new partners; the possibility to accomplish some additional deliveries to the debtors who benefitted

from low credit limits before the insurance; granting bonuses at the interest share for credits.

- Reducing the management responsibility of the insured company regarding the parent choice and contracting commercial transactions, given the fact that at least a “part” of the transaction fail may be covered by the insurance bill.

- Protection against certain major losses and even saving the position of the financial management in case of damage; easing the financial planning; keeping an optimal level of the liquidities and of profitability.

Referring to the insurance of the export on credit on a short term, this should be seen regarding the sale on credit. The export on credit supposes the accomplishment of a payment after delivering the merchandises making the object of the sales contract on a determined term of maximum 1 year. In this lapse of time, the cashing of the counter value of the exported merchandises is determined by the importer’s financial situation and, in many cases, by the economic and political situation of its country. Obviously, the covered risks may be commercial and political. The commercial risks may be: the buyer’s insolvability, the incapacity of payment on its certain lapse of time and the refuse of the imported merchandises[4].

The political risks may be: war, revolts, social movements stopping the merchandise import or making impossible the transfer of the corresponding amounts in the exporter’s country[5].

The insurance may be contracted on different lapses of time of the development of a contract, namely:

- For the pre-delivery time, it is covered the buyer’s insolvability or the appearance of some losses for political reasons between the moment when accepting the offer and the one of delivering the goods.

- For the post-delivery time, it is covered the lapse of time between delivering the merchandise and accomplishing the payment.

- For the depositing time, in the situations when the dealers create deposits in other countries, the insured one is compensated if the merchandises are

confiscated, lost or damaged for certain causes specified before their release from the deposit.

- For the transition time, it is covered the risk of confiscation of loss of the merchandises for political reasons, when they are in transit.

For example, the insurance bill practiced by Romania’s Bank of Export-Import, EXIMBANK, covers the risk of non-collecting the extern claims in case of producing certain events making impossible the payment due by the extern buyers. The two categories of risks covered by this insurance bill are:

- a) Commercial risks, protecting against insolvability, as a consequence of bankruptcy or of other financial difficulties, and also against the delays in achieving the payment obligations of more than 6 months.

- b) Country risks that are related to the economic, political, legislative, social and even cultural life of the importer’s country; here there are also the economic situation, political events, changes of the legislation of the buyer’s country that may affect the development of the commercial transactions[2].

The insurance bill does not cover the non-payment determined by the non-accomplishment of the contractual conditions. It may cover either the post-delivery time, or the pre-delivery time and the post-delivery time altogether. The insured percentage is 85% of a potential loss. The cost of the insurance bill is formed by the insurance prime, where we add the commission for establishing the credit limit as a result of the financial analysis accomplished based on the information on the extern buyers of the insured one. For calculating the insurance prime, we consider the buyer’s country, the payment way and the collection term of the counter value of the delivered merchandises. For every extern buyer, it is used to establish a credit limit representing an estimation of the payment capacity of the extern buyer and it represents the maximum unpaid amount insured at a certain point[3].

### **3. Some consideration about financial risk insurance in Romania**

In Romania, the Governmental Order no. 14/1995 created the juridical framework necessary for stimulating and promoting complex exports that, next to specific tools, contains the insurance against the commercial and political risks on an average and long term. The insurance bill offered by EXIM BANK for insuring these risks offer protection for collecting the extern claims corresponding to complex exports, to the general contractors, producers or exporters of products supposing a long fabrication cycle. The offered types of bills are mainly distinguished by the object of the insurance contract – capital goods and works of constructions-montage. The insured part may be contained between 85% and 100% of the unrecovered costs (if the risk is produced in the fabrication time) or of the uncollected amounts (if the risk is produced after the delivery).

The level of the insurance prime is different depending on the insurance value, the insured time, the buyer’s “nature”, its country (the country risk), the payment way and the potential guarantees stipulated in the contract. It is paid at the same time with the conclusion of the insurance bill in a unique tranche in periodical rates, as it is agreed by the parts.

For insuring the export credits, there are certain international regulations expressly related to the contracts on an average and long term having a high risk of non-payment. Thus, according to the requirements of the OECD agreements and to the recommendations of the Bern Union, the extern contracts on an average and long term should accomplish the following conditions:

- 15% of the contract value should be paid in advance until the delivery moment (usually 5% at the contract validation and the rest of 10% at the delivery) so that the sale on credit could not cross 85%
- The part of 85% representing the sale on credit should be reimbursable in equal semi-yearly tranches starting in the latest case 6 months after the delivery.
- The credit time should be correlated to the nature of the goods (for example, for the capital goods, the maximum time is generally 5 years, but for big sized projects, a credit time of maximum 10 years may be also accepted).

- The credit time should be correlated to the transaction value.  
The local costs may not overtake the advance level.

#### 4. Conclusion

As an option of the credit insurances, it was developed the insurance of the credit rates that are used at present for the credits that are reimbursed in echeloned payments on a determined term. This type of insurance supposes a participation of the insured one of about 25% of the credit value. The insured one is the seller on credit, respectively the producer or the dealer. The insurance is generally contracted on the business number of the insured one in order to avoid the case when it insures only certain credits, in order to avoid the anti-selection.

The insurance of the credits granted for investments supposes the insurance of the account of debtors on an average and long term, practicing the insurance by the general bill on the business number on credit; this does not exclude the insurance of certain individual bills. It is used for the export of investment goods in parallel with the insurance in the leasing transactions..

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## Insurance Forms of the Export Credits Met in International Practice

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### Abstract

*In case of certain important objectives referring to product deliveries, the execution of works or the performances of services abroad, having big values, the international competition gets sharp forms. Some economical agents, for being placed on a more advantageous position in the competition where they participate, present firm offers valid for a certain lapse of time. The change of the economic conditions (price, interest, appreciation, financing conditions) during the validity of the firm offer in report to the one considered when accomplishing this one, could train for the exporter agent, in case of adjudicating the order, a loss that cannot be recovered from the importer..*

**Keywords:** insurance, investment, income distribution, export credits

**J.E.L classification.:** E20, E22, E24

### 1.Introduction

Credits insurance is meant to offer protection to economical agents against the risks specific to export. An export contract may have as an object merchandise deliveries, executions of works or performances of services, including sessions of licences or patent acts in favour of certain buyers or beneficiaries who live abroad[2].

When contracting parties agree that the deliveries, the works or the services making the object of the export contract should not be paid at delivery, but after a lapse of time, the supplier grants a commercial credit to the extern buyer. Consenting such a payment way, the supplier assumes the risks of the credit export, the treasury effects of the export operation with the payment on due date. As the credit export blocks the supplier's financial resources incorporated in

the products delivered on credit for a lapse of time, it is forced to complete them by calling a bank credit[3].

The supplying credit is granted on short lapses of time. In case of the export of big values, the supplier cannot block its financial resources for long lapses of time, without endangering its own financial administration. The buyer is forced to purchase the necessary resources for paying the import at the delivery of the products by the supplier. In this purpose, he addresses to a bank on the supplier's market, requiring the loan it needs and that is called a buying credit. This is a form of the financial credit featured by the fact that it is related to an export operation.

For the supplying credit, the contracting parties – the supplier and the buyer – accomplish only one document, the commercial contract, containing all the elements related to the delivered merchandises: structure, quantities, price, value, terms and payment way[4].

For the buying credit, there are two different documents: the commercial contract, concluded between supplier and the extern buyer, and the loan contract concluded between buyer, as a beneficiary of the extern credit and the creditor bank.

The export is accomplished either by means of the commercial credit granted by the supplier to its business partner, the extern buyer, or by means of the buying credit granted by a bank to the extern buyer, Both of the export credit forms follow the favouring of the commercial exchanges in the interest of the contracting parties and they are granted by private operators (suppliers, banks) in conditions similar to the ones practiced on the market (the interest rate, the time, the way of echeloning the reimbursement).

Next to these credit forms, we also met others having a helping feature, granted by

the states by means of their governments or by means of specialized public institutions.

The extern credits from public resources are granted in more advantageous conditions than the ones practiced by private operators (interests under the market level, longer reimbursement times, grace times). The help-credits from public resources are granted on bilateral or multilateral bases and they follow the favouring of the economic development of the beneficiary country[6].

Bilateral help-credits are related, they can be used only for paying certain imports of goods and services from the donor country.

Help-credits are not usually guaranteed by the credit insurers but they remain in the state task.

Ensuring the export credits covers many export risks that will be grouped depending on the moment when the risk and its nature interfere. Regarded by means of the moment when they appear, the risks covered by ensuring the export credits refer either to the lapse of time before signing the contracts or to the lapse of time after it[5].

## **2. Insurance Forms before concluding the export contract**

For getting its products on a foreign market, an economical agent is forced to prospect that market for finding out if and how he could export on that market.

Prospecting the extern market claims expenditures from the potential exporter, without the certitude that its action will be successful, will make possible the conclusion of export contracts. Even if, in some countries, there is the practice of the state that supports a part of the prospecting expenditures for the expenditures remaining in the task of the economical agent, the risk of the commercial bad job of the prospecting action cannot be neglected. For protecting it against such a risk, the potential exporter may contract a prospecting insurance at an organ specialized in such insurances[1].

In case of certain important objectives referring to product deliveries, the execution of works or the performances of services abroad, having big values, the international competition gets sharp forms. Some economical agents, for being placed on a more advantageous position in the competition where they participate, present

firm offers valid for a certain lapse of time. The change of the economic conditions (price, interest, appreciation, financing conditions) during the validity of the firm offer in report to the one considered when accomplishing this one, could train for the exporter agent, in case of adjudicating the order, a loss that cannot be recovered from the importer. The supplier is forced to lay down a caution in the buyer's favour that should guarantee that the supplier, in the hypothesis of adjudicating the transaction, will sign the extern contract in the conditions stipulated in the presented offer.

We may contract insurances against the risks devolved by the exporter remitting firm offers on long validity times.

## **3. Insurance Forms after concluding the contract**

After concluding the export contract, there may be two risk categories[3]:

a) Some of them in the lapse of time contained between the moment of signing the export contract and the one of externally delivering the ordered products accompanied by legal documents;

b) Others in the lapse of time of delivering the products on credit and until cashing their counter value.

During the proper production of the goods making the contract object for the exporter, there is the risk of cutting the contract because it is out of its control.

As long as the ordered goods, works or services are unique and, after being finished, they can no longer be capitalized by other beneficiaries, the cutting of the contract generates losses for the exporter.

The risk of registering losses for the exporter, in this phase of the contract development is a fabrication risk. If the exporter laid down a caution in favour of the buyer who should guarantee, in case of need, the return of the advance paid when concluding the contract or a quality guarantee, then the exporter loses the right on the guarantee.

In case of the works of international cooperation (the exporter executes certain twirled objectives abroad or certain works by means of the equipment, machines and materials that are to be distributed, after

accomplishing the contract), there is the risk for those material values belonging to the exporter to not be able to be brought again in the original country for political reasons[7].

During the commercial contract, the fabrication time may lie on a long lapse of time. In inflation condition, the fast increase of the intern prices could raise the fabrication costs of the delivery so that the contract should register losses instead of benefits. The risk of majoring the intern products may be protected by a guarantee of the economic risks.

After delivering the products (the loss of the executed works or the service performances) by the extern partner, for the supplier there is the risk of non-paying on term their counter value by the extern client.

The classic insurance society or a specialized insurance organism that acts of the order and for the account of the state may protect the exporter against such a risk. Guaranteeing the credit risk is granted by the credit supplier either to the exporter (in case of the supplier credit), or to the bank (in case of the buying credit).

The cautions laid down by the exporter in favour of the buyer by means of which it guarantees the good quality of executing the contract or returning the advance received from the buyer in case of non-accomplishing the contractual obligations by the supplier, may be capitalized in the established conditions.[7]

In this phase of developing the export contract, there may also be the risk of appreciation. Even if the extern client (debtor) honoured on term its commitment made to the supplier in case of the supplying credit or to the bank, in case of the buying credit on the export there may be the risk of registering a loss resulted from the difference between the existent appreciation when concluding the contract and the one practiced when paying the credit. Against the risk of appreciation, the exporter may contract an insurance that should protect him in such circumstances.

The risks of the export credit were approached by means of the moment when it manifests.

Such an approach refers to the nature of the respective risks that distinguishes the commercial risk, the political, exchange or economical risks.

The commercial risks, also called risks of non-payment, are related to the buyer's behaviour to its supplier. When the extern buyer is a private natural person or juridical entity, it presents the non-payment risk. Against it, we may act in justice in order to force it to respect the commitment made by the contract[4].

Against the public buyer that develops when accomplishing the contractual obligations that he made, there is no attack way in justice. For this reason, the risk of non-payment by the private buyer is considered a commercial risk, while the same risk coming from a public right buyer is considered as a political risk.

The political risk notion has a large content sphere, containing: the proper political risk, as the risk of non-payment by the public buyer and the risk of non-transferring the currency by the supplier.

The proper political risk refers to war, revolution, etc. and to the documents of the public authorities (nationalization, requisition, sequestration, interdiction or restraint of the import of certain products, limitation of the exchange transfer, forbidding the repatriation of the actives belonging to certain foreign persons ) stopping the contract execution.

The political feature also belongs to the measure taken by a public authority from the exporting country, of forbidding the export of a certain contracted product placed in the fabrication time.

The execution of a contract may be influenced by the measures taken by a third country[9].

Some insurance organisms assimilate the risk of non-payment of an export contract concluded as a public right partner, with a political risk.

The risk of non-transferring the currency to the exporter who granted a supplying credit or to the creditor bank, in case of the buying-credit, appears when the supplier cannot own the currency representing the counter value of its export because the money authority does not transfer the amount the importer agent has to pay to its supplier and for which it laid down the equivalent in local currency.

This refuse of currency transfer gets the feature of a political risk, being generated by

a measure taken by a public authority, and not by the payment incapacity of its client.

Some insurers of export credits assimilate the natural catastrophes produced on the territory of another country different from the one of the exporter of the political risk.

In case of a catastrophe, a usual insurer covers the disappearance or the damage of the ensured goods and an insurer of export credits covers the buyer's impossibility of owning the ordered goods or of paying them on term.

In their category, there are; the risk of appreciation, the risk of increasing the fabrication costs of the product making the export object and the risk of fluctuating the interest rate[2].

The risk of appreciation appears when the currency of the exporter's country and the currency of the importer's country are not related by a settled exchange report.

This makes the flow where the exchange of the two currencies is accomplished to evolve from a time to another, provoking negative or positive effects for the exporter.

For protecting against the risk of appreciation, the exporter demands the payment on due date, and so does the creditor bank that granted a loan to the importer, it may use different solutions.

a) Contracting an import in the currency of its client or in another currency, so that the risk of appreciation afferent to the payment commitment expressed by another currency different from the national one, complete the risk of appreciation afferent to its claim.

This solution should operate with identical amounts to be cashed abroad and to be paid abroad, payable at the same date and it should present the same risk of appreciation or a close one.

b) The exporter should sell its product at a flow settled before.

The exporter avoids the risk of registering a negative influence from the fluctuation of the appreciation, but also the one of accomplishing a favourable influence.

Every solution presents advantages and disadvantages and they sometimes present technical difficulties of application. The exporter addresses to an insurer of export credits for offering it the necessary protection against this risk. The exporter is submitted to the risk of appreciation not only when it sells

with the payment on due date expressed in another currency different from its own, but also when it concludes work contracted outs with the payment on due date in the entrepreneur's currency or in another currency.

The insurer of export credits covers the risks of appreciation appearing in both of the situations.

The risk of increasing the fabrication costs of the product making the export object appears as a consequence of the inflationist phenomena manifesting on the market of the exporter's country for the products with a long fabrication cycle, this risk is pronounced and it may make the cost increase be fast so that it would overtake the margin considered before and the transaction would sold by loss.

If the exporter, for reasons of prudence, includes a bigger margin in costs, it may get to a level of the offer price that makes it uncompetitive. If the exporter requires the inclusion in the commercial contract of a clause of reviewing the price, this solution might not be liked by the importer[8].

For protecting its interests, the exporter requires from the insurer of the export credits an insurance against the economic risks.

The risk of fluctuation of the interest rate perceived at the supplying-credit and also at the buying-credit. When they settle the interest rate the importer will pay to the exporter during the validity of the supplying-credit or of the creditor bank during the validity of the buying-credit, the supplier should consider the interest level where it could get the necessary money for refinancing. If the market interest manifests a majoring tendency, we should consider that when concluding the loan contract with settled interest. For a contract with settled interest, there is the risk for the market interest to be higher than the settled one stipulated in the contract, by disadvantaging the creditor exporter or the creditor bank.

For protecting the exporters and the banks from the risk of interest fluctuation at the credits granted by them, different solutions are applied[8].

In some countries, the mechanisms of refinancing the export with settled interest rates are administrated by public institutions. The state supports a part of the interest that the exporter should pay when he borrows from the market in order to complete its

financial resources; another solution consists of establishing the interest perceived by the banks from their extern clients. The difference between the market interest (the bigger one) and the settled interest, cashed from the extern client, is supported by the state during the entire validity of the credit contract[9].

No matter the organizational forms and their juridical statuses, the organisms specialized in insuring the export-import credits contract about the same insurance types, use the same types of bills, practice differentiated insurance primes.

Beside the insurances having identical or very similar, standard characteristics, some specialized insurance organisms also practice other insurance types.

Export Credit, Guarantee Department (ECGD) of Great Britain contract insurances for guarantees against the unjustified pretensions of the buyers, insurances for the investments abroad, insurances against the risk that may appear as a consequence of the fluctuation of the appreciation of the currency by means of which the payment is made[3];

- COFACE of France contracts insurances for exchange risks, insurances against the increase of the fabrication costs of the product meant to the export as a consequence of the inflation, insurances for guarantees;

- NCM of Holland contracts insurances for the exchange risks, additional insurances for guarantees and counter guarantees, insurances for construction equipments;

- HERMES of Germany contracts insurances for the leasing contracts, insurances regarding the risk of the capital investments, insurances for guarantees, insurances for the exchange risks.

- Istituto nazionale delle assicurazioni e sezione special per assicurazione del credito all'esportazione of Italy contracts insurances for: the exchange risks, guarantees, direct investments abroad, market studies, public contracts.

Irrespective of the organizational forms, of the activity they develop, of the insurance forms they contract, of the facilities they grant, the specialized organisms want to

promote the export of their country, to increase the production of the exports of their countries in the world export, to get the products of their country on several markets. The supply of the support needed by the economical agents of their country for increasing the competitiveness and the security of the export on extern markets[1].

The insurance of the export credit has certain limits, grants the protection meant for the insured one in the established limits and conditions. The loss suffered by the insured one should result from a risk contained in the insurance, the compensation meant for the insured one is paid to it at the expiration of the waiting term, the non-payment of the claim may be provoked by causes that are not related to the client's incapacity of payment, but to technical difficulties; a part of the risk, some percentages, remains in the task of the insured one, the export-import operation should be made by respecting the regulations of extern trade of the exporting country and also of the importing one, insuring the export credit does not cover the losses resulting from a litigation existing between supplier and buyer or between the one who makes the loan and the one who takes it.

The insurance of the state credit may be made only when the operation presents interest for the national economy.

During the world economic crisis, many countries dealt with difficulties that made it impossible for them to honour on term the commitments made by the extern creditors. Many countries, because of the lack of the exchange resources necessary for paying the service of the extern debt, were forced to demand to the creditors the re-echeloning of the payable extern debt[6].

This was determined by:

- The necessary putting up the price of the raw oil by the countries members of OPEC,

- Majoring the interest rate on the market of the loan capitals,

- Exacerbating the protectionism by the developed countries,

- The errors of economic, financial monetary errors of some countries importing capital.

At the non-cashing of the extern claims, other political causes contributed;

- Unleashing certain armed conflicts in certain areas of the world,
- Turning over some government by coups d’etat or changing some political systems,
- Dismembering certain federal states,
- Instituting the embargo against some states.

The political events have a strong impact on the economical increase in the countries where they also produce on the international commercial and financial relations. The exporters are more afraid of the political risks than of the commercial ones. In order to be protected from the consequences of such dangers, the exporting companies and the creditor banks demand the specialized governmental organisms to guarantee or insure the credits granted to certain external partners presenting more emphasized country risks[2].

#### 4. Conclusion

After 1982, the governmental organisms of insuring the credits paid to the insured ones compensations in amounts overtaking the cashed insurance price, for the negative sold of the yearly financial operations, calling the previously constituted reserve funds.

For crossing this financially critical situation, the governmental organisms of insuring the credits took measures:

1 – they stopped receiving in insurance the credits granted to the countries incapable of payment or that have almost reached this situation, they established commitment limits for the countries that benefitted from the unlimited insurance or they reduced the previous limits for others,

2 – they reduced the compensation percentage of the damage, by correspondingly majoring the franchise;

3 – they prolonged the term when the payment of the insurance compensation becomes exigible hoping that the debtor would find solutions for paying the owing credit;

4 – they majoring the perceived insurance prices;

5 – they restrained the application sphere of insurance.

By the measures they took, the governmental organisms of insuring the credits wanted to improve the report between the cashed primes and the payable compensations and the accomplishment of the financial balance by transferring the losses provoked by the political risks on the insured ones.

Beside the measures taken in their relations with the insured ones, the governmental organisms of insuring the credits also acted on the line of intensifying their collaboration with the big international private insurers for limiting the negative effects of the insured political risks. It is about the participation to the insurance of certain political risks as co-insurers and the mutual receiving and cession in reinsurance of certain important parts of the subscribed political risks.

The problem of the risk of appreciation got a bigger importance since the main convertible currencies freely fluctuate on the market.

The risks of appreciation appear as a consequence of the fact that the relations between the insured one and the insurer use two currencies: the national currency and another currency where the export contract was released. The flow where the currency of the extern client is changed into the national currency of the exporter (the creditor bank) fluctuates from day to day, in the appreciation, there are unavoidably financial influences advantaging or disadvantaging the insured one. The insured one may demand to the insurer to insert in the insurance contract a clause of appreciation based on which the latter one takes over the risk of appreciation.

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## Study on Sustainable Development Assessment Criteria

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### Abstract

*The theory and practice of sustainable development has to be based on the compatibility of quality provision policies for the results of human activity, on environmental protection policies, on drawing-up a business charter within the vision of sustainable development.*

*Sustainable development wants to be an alternative to post-war economic growth that because of the economic and social progress has caused negative effects. From this point of view, the supporting arguments of sustainable development are critics made to the weak functions of the type of economic growth.*

**Key words:** environment and environmental policy, social cohesion, development policy, sustainable economic development

**J.E.L. Classification:** E61, H12, O20, R11;

### 1. Introduction

In order to evaluate action means, we need criteria of economic and social efficacy and efficiency, equity, feasibility, acceptability and institutional ecologic compatibility.

At every level of sustainable development, strategic planning is necessary with clear objectives, with evaluation criteria and measurement indicators, with legal, economic and spiritual-cultural support mechanisms, with ecologic management of processes on every living cycle, as well as with the necessary audit with the development of technologies able to reach "zero effects"[10].

Business charter, within the vision of sustainable development has to comprise principles that have to be followed from production costs to incomes achieved together with educational management necessary both for those that produce and for those that distribute and use the products and services necessary for human life and environmental protection.

The age of natural environment, within the vision of sustainable development shows us that progress is an illusion if it can degrade the conditions necessary for a normal life.

The danger of climatic change on the Globe and the loss of food safety are two risks of development so far which make us conceive the new policy of sustainable development, first of all by raising the level of culture, civilization. Sustainable development has to be the basis for developing a reliable society able to fulfil its current needs without jeopardizing the perspectives of future generations by placing a moral concept at the basis of sustainable development – equity between generations[1].

The values on which sustainable development is based are those of rationality determined by the limitation of available resources in relation to the actual needs and hope resulting from the morality of chances equality of the generations that coexist and succeed in life.

Within the vision of sustainable development, the foundation rock of energetic systems will be solar energy, the efficiency of human activities will have to be considered in all the meanings that life requires, materials reuse and recycling will have to become a replacer

at large scale for fuels; biologic basis restructuration will be an essential condition for reaching prosperity and protection of future generations[2].

Sustainable development supposes a new set of values achieved within a general process of transition towards a reliable society where people can be attracted by the new ways of organizing their life and encouraged by knowing what would happen if they change their living way.

Placing knowledge and understanding processes at the basis of the two fundamental natural-human values – rationality and hope are the key for anticipating and causing the change from the point of view of sustainable development[7].

The age that humanity has gone through so far is that of a non-reliable world economy from the point of view of the surrounding environment based on unlimited growth phenomena. The new age that humanity will have to enter will have the common denominator of only one fundamental ideal: fulfilling the needs of current generations without compromising the potential of future generations to fulfill their own needs[9].

The ecologic age that will have to be established in the evolution of the world will have to begin with the design of a new reliable energetic system that will use solar energy as a renewable source.

Passing to the ecologic age of sustainable development will also mean materials recycling, waste decrease, change of products and people’s reaction, renunciation to the society of waste as elements of the strategy that gets closer to the final purpose of providing a maximum of welfare with minimum of consumption.

The vision of sustainable development organically integrates the strategy of rethinking urban transport taking into consideration that technology can become a good servant but a bad master if it is not conceived in direct

compatibility with human needs within a healthy environment.

The achievement of the new age of sustainable development supposes a period in which political leaders and citizens reevaluate their goals and dreams, redefine their success patterns in life and adapt their work and time use to a new set of values-principles aiming at prosperity and generations’ protection.

The strategy of sustainable development becomes operational through rational policies to the extent in which it favours compatibility of the systems that condition one another in time and space, regional and international cooperation and collaboration.

Within this long lasting process, the brake factor occurs beside the favourable factors. It is important to have a common powerful will in order to fulfill the objective in front of which all people are equal by nature.

## **2. The main problems of sustainable development**

Like any big project, sustainable development supposes an evolution that can be achieved by solving several problems[3]:

### **1) Demographic constraint**

From the point of view of sustainable development, population is of interest only as structure and health. From the number point of view, the theory of sustainable development has to give an answer to the following question: what number of people can planet Earth bear? What are the chances for this more and more numerous population to live in a preserved perfect environment and feed itself better and better?

As far as structure is concerned, the number of questions is not more important:

a) Taking into consideration the social and professional structure, the instruction level and population quality, sustainable development is facing the

following problem: where economic growth have to win both quantitatively and qualitatively in third world countries, the level of population's education suffers.

b) Distribution of the increasing population on the two large areas: urban and rural.

c) The logic of sustainable development does no longer allow for people's health to be sacrificed to the interests of profit.

#### 2) Technical constraint

The key question that sustainable development has to answer is the following: which is the maximum level possible of production that can be achieved under given conditions of technical progress without affecting the environmental balance.

The maximum level of production that can be achieved without altering the environmental quality is in direct proportional relation with the environmental absorption quality, the capital invested in anti-polluting plants and polluting agents dispersion volume or surfaces and reversely proportional with the polluting emissions that depend on the level of production and consumption.

3) Equity and compensation within and between generations.

Sustainable development becomes reliable only in the conditions in which an associative, tolerance, solidarity spirit occurs between generations and within the same generation.

4) Efficiency

The great confrontation faced by sustainable development is to find the necessary compatibilities between economic mechanisms propelled by profit and social-human finality of development;

5) Environmental economy which is a challenge for the theory of sustainable development to the extent in which it tries the attempt to humanize and ecologize the economy.

The unity between rationality and hope is the key of sustainable development.

Sustainable development has the essential components of demographic increase stabilization, reduction of the oil dependence, promotion of renewable energy resources, soil preservation, protection of the biologic systems of the earth, materials recycling, climatic stability.

The concept of sustainable development defines essential changes within the process quality and comprises several objectives of economic and social policy: economic growth resizing in the meaning of natural resources preservation, altering the increase process, fulfilling the essential needs for work, food, energy, water, houses and medical care for all inhabitants, providing a level of sustainable increase of the population; preservation and increase of the resource basis, technological restructuring and controlling its risks; integrating decisions regarding the economy and environment in an unique process[8].

Ecologically sustainable industrial development that is the industrialization pattern increases the industrial contribution to economic and social benefits for present and future generations without damaging the basic processes[4].

This is completed by the following concepts: sustainable forest works, sustainable energy, sustainable water management, sustainable economic welfare and sustainable jobs, most of them being the subject of a debate and international documents.

The essence of the economic system is represented by the maximization of the amount of goods, services, products but under the conditions of efficiency maximization the resources are used by all types of people. The objectives of the social system refer to the balanced allocation of goods and services at all levels, locally, nationally and globally,

engaging all the members of the society in the development process and maintenance of cultural diversity as a basis of chances equality and society adaptation to the alteration of social and geo-economic conditions.

From the point of view of the ecologic system, the main objectives are given by biodiversity maintenance as a support of the biosphere adapting possibilities. All these are based on the coordination of entities' objectives and actions and on the functions of every system.

Passing to sustainable development marks people's entrance in the environmental age where development risks have to be determined and removed. For these purposes, sustainable development first of all proposes to alter the way in which people perceive some elements of life. By means of education, culture and science, people can overcome a perceptual threshold that determines them to observe, produce and act for better on a long term. Therefore, humankind can go towards a moral border that proves that the matter of development has to be considered through interdependence in time and space[8].

In raising people's civilization level, we have to begin with the recalculation of the economic progress of altering the assets and liabilities of the natural capital.

Sustainable development has to be the basis for developing a reliable society able to fulfil its current needs without jeopardizing the perspectives of future generations by placing a moral concept at the basis of sustainable development – equity between generations.

The values on which sustainable development is based are those of rationality determined by the limitation of available resources in relation to the actual needs and hope resulting from the morality of chances equality of the generations that coexist and succeed in life.

Within the vision of sustainable development, the foundation rock of energetic systems will be solar energy, the efficiency of human activities will have to be considered in all the meanings that life requires, materials reuse and recycling will have to become a replacer at large scale for fuels; biologic basis restructuration will be an essential condition for reaching prosperity and protection of future generations[2].

### **3. Sustainable development a general process of transition**

Sustainable development supposes a new set of values achieved within a general process of transition towards a reliable society where people can be attracted by the new ways of organizing their life and encouraged by knowing what would happen if they change their living way.

Placing knowledge and understanding processes at the basis of the two fundamental natural-human values – rationality and hope is the key for anticipating and causing the change from the point of view of sustainable development.

The age that humanity has gone through so far is that of a non-reliable world economy from the point of view of the surrounding environment based on unlimited growth phenomena. The new age that humanity will have to enter will have the common denominator of only one fundamental ideal: fulfilling the needs of current generations without compromising the potential of future generations to fulfil their own needs.

The vision of sustainable development organically integrates the strategy of rethinking urban transport taking into consideration that technology can become a good servant but a bad master if it is not conceived in direct compatibility with human needs within a healthy environment. Together with the technologic revolution in infrastructure it

is essential to develop a new way of conceiving urbanization, in order for towns to be created for people, all these actually supposing a basic revision of policies so far.

In strong relation with these components sustainable development also supposes the passing to forests regenerative exploitation.

The achievement of the new age of sustainable development supposes a transition period in which political leaders and citizens reevaluate their goals and dreams, redefine their success patterns in life and adapt their work and time use to a new set of values-principles aiming at prosperity and generations' protection.

Within the background of common elements, sustainable development becomes an international action through adequate national policies to the extent in which it can allow compatibility of systems that condition one another in time and space, collaboration and cooperation with regional and international character.

Within this context, although the final objective of the sustainable strategy is the same for all countries, the actual problems that have to be solved, the financial sources as well as achievement ways, difficulties that may occur, the position of the population towards the objectives of such a lasting process as well as the costs to be paid, the stages and duration of goals proposed will be different[2].

Within this long lasting process, the brake factor occurs beside the favourable factors. It is important to have a common powerful will in order to fulfill the objective in front of which all people are equal by nature.

For the success of the new age of ecologic development besides national strategies based on its own resources and needs, regional and international strategies are important by taking into consideration by globalization of the

sustainable development and on the fact that it is necessary to redistribute the efforts and the intensity of the progress damages and natural environment by various states of the world.

#### **4.Conclusion**

The new strategy requires from economically developed countries to make a transition towards the basic restructuring of the economic and social activity of education, of health and natural environment for poor and underdeveloped countries the problem of economic growth is not necessary, but rather of finding those strategies that favourably answer to the problems of labour productivity increase as well as to the population, environmental people's life quality related problems. Within this complex and contradictory process, one cannot know who is more advantaged, countries that restructure almost all that they have created or the countries that have to think about the beginning of the new development age from the position of the delayed to the old development. Success in all countries will be favoured not only by the political will of the leaders but also by the decision that has to be taken individually and by us together[3].

The new vision of sustainable development has to comprise also new more balanced distribution strategies of the incomes and goods at the level of world's countries, a social superior order interested in the life of present generations focused more on planet and people's health rather than on material accumulation and power.

The group of factors interfering in the operation of national economy materialized in macroeconomic are directly or indirectly used in the economic growth processes. These factors have to be explained in a global vision because their influences are complex, conjugated, contradictory.

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## The Romanian Economic Policy “Censored” in the Parliament .Short Analysis of Motions of Censure in the Field of Economics Submitted in the Parliament of Romania Between 1992 and 2012

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### Abstract

*Motions of censure are an important tool used by the legislature to exert control over the executive. Censure motions by the opposition focus on essential national issues, the government’s inability to rule its country, as well as problems deemed highly important by the opposition. Regarding the effects of censure motions, few were effectively implemented or led to the government’s demise, as many functioned only as the opposition’s alarm signals about what they consider to be some gravely skidding off course. Thus the public attention is gained and the opposition has the opportunity to express its viewpoints. This paper focuses on the contributions of the motions of censure read, discussed and passed in the Romanian parliament, to shaping Romanian economic policy between 1990 and 2012.*

**Keywords** : motion, censure, parliament, government, economic

**JEL Classification:** H7, E6

### Introduction

The Romanian parliamentary regime implies, as do all parliamentary democracies, the government’s collective accountability before the parliament.

Motions of censure are political instruments used to hold executives responsible, and which can lead in certain situations to the demise of the government. This paper analyzes the censure motions debated in the Romanian legislature, with an accent on motions that covered economic issues, as they attempted to alter and

even radically change the national economic policy at the time.

Also studied in the paper are the moments chosen for introducing motions, their reading in parliament, their impact on economic policy, and the government’s concrete responses to these contestations.

The data for this analysis was collected from parliamentary debates transcripts and the public listings of motions on the web sites of the two parliament chambers. The resulting database underwent a content analysis, enabling the evaluation of motions based on the issues raised, and the identification of censure motions of an economic nature.

### The role of censure motions in parliamentary democracies

Motions of censure are in fact motions of no confidence. Their role is to act as a catalyst in a government’s demise, to determine the type of government in the making, by identifying the political parties responsible for policy failure, by questioning the government’s performance in key areas and increasing the risk of voluntary governmental dissolution [1]. Whether they result in the government’s demise or not, motions are evidently opportunities to hold them accountable and to draw public attention to lacking performance in governing. Motions aid the legislature in identifying and preventing abuse, arbitrary, illegal and unconstitutional behavior by the government and non-governmental agencies makes the government accountable for its use of taxpayer money, thus increasing the efficiency of governmental actions by identifying waste in the government machinery and public agencies [2].

The topic of non-confidence motions was interesting to researchers, and numerous empirical studies examined the causes of censure motions. In the literature we find various explanations for motions of censure, from their root in "the opposition's attempts to publicize the government's failures in a high priority political domain" [3], to the idea that they aid political parties, during difficult economic periods, to distance themselves from the government, by emphasizing its responsibility in the deteriorating economic situation [4].

A common theme in almost every study on motions of censure is that of them as vehicles attracting mass media attention on governmental failure, thus "consolidating the negative message about the government delivered to the voters" [5].

Evidently, the intentions of those introducing a motion of censure, beyond toppling the government, are to draw long term public attention, by presenting the motion's initiating party as having better solutions and providing a better representation of the electorate's interests.

In the case of minority governments, censure motions are real threats, and their imminence discourages the formation of governments without the backing of the parliamentary majority.

As research has shown, the effects of motions of censure range from providing only minor obstacles, easily overcome by the government, all the way to governmental reshuffling or a decision for anticipated elections [6].

The government threatened with a censure motion has the options to either ignore it, or to concede and resign. Regarding this, the literature has identified a paradoxical situation: the weaker a government's position, the more inclined they are to negotiate with the opposition, thus making censure motions less likely [7]. At the same time, a government can resign instead of ignoring the opposition's challenge, "when the benefits of holding office are sufficiently low", either in the case of "a high probability that the government will preserve power after the next elections", or when the overall concessions required to satisfy the opposition are deemed too high [8].

Laron Williams suggests that popular governments might resign, since they have a good chance of again forming the government after the elections, while unpopular governments will tend to cling to power, expecting to be negatively affected by anticipated elections.

The favorite subject of the motions of censure is the economic policy but it may extend to health, education, corruption, foreign policy, state of justice. When reflect the real state of the nation these motions are very effective. Therefore the economic issues are rarely introduced in times of economic prosperity. These motions are more able to generate a lack of confidence in the government during a crisis or a poor general economic condition.

The motions of censure are also analyzed in the specialized literature in Romania. For Simedru and Huiu "the motions are the only way to bring a prime minister in the parliament in order to introduce a debate on serious issues. ". In another article Huiu says that the political impact of the motions is related to three important democratic principles: " the challenge by an active opposition prepared to sanction the government, the participation of an engaged opposition who reacts critically against the executive and the representation by an opposition that synthesize a point of view of voters and citizens'

### **The Romanian legislation in the field**

In the Romanian legislation the motions of censure are regulated by the Romanian Constitution, Article 113, which presents the conditions in which are initiated, introduced and voted the motions of censure in the Parliament: "The Chamber of Deputies and The Senate, in joint session, can withdraw the confidence granted to the Government, by adopting a motion of censure with a majority vote of the Deputies and the Senators. The motion of censure may be initiated by at least one quarter of the total number of deputies and senators and the initiators have the obligation to communicate its filing date to the government. The motion of censure shall be debated upon three days of the filing date in the joint session of the two chambers. If the motion of censure fails to be passed, the Deputies and the Senators who

signed it may not submit another motion, in the same session, except for the case the Government assumes responsibility for that program or bill.

At the same time, the constitution allows the government to assume responsibility before the house, in a joint sitting, for a specific program, a general policy statement or a bill. In accordance with Article 114 "the government shall be dismissed if a motion of censure, tabled within three days of the date of presenting the program, the general policy statement or the bill, has been passed, in accordance with Article 113". Thus, a successful motion of censure brings about the fall of the cabinet. The same article further reads that "If the government has not been dismissed, the bill presented, amended or supplemented, as the case may be, with amendments accepted by the government, shall be deemed as passed, and the implementation of the program or the general policy statement become binding on the government" . As a consequence, a successful motion of censure becomes part of the governmental program, if the cabinet refuses to step down or it cannot step down because another cabinet cannot be formed.

**The analysis of the motions of censure submitted in the Romanian Parliament on economic issues 1990 - 2012**

During the five legislatures, 25 motions of censure have been discussed in the parliament as follows: 5 in the legislature from 1992 to 1996, 4 in the period 1996 to 2000, 2 in the period 2000 to 2004, 5 in the legislature from 2004 to 2008 and 9 in period 2008 to 2012. Regarding the distribution by years during a legislature, we can note that they are generally initiated in the first (8), second (7) and the third year (8) of the legislature, the only exception being the present legislature, when in the last year of governance were submitted two motions, one adopted (see table 1)

There is an explanation in this regard: in the last months, without the ability to organize early elections, decreases greatly the possibility of government reorganization and therefore the option to submit a motion of censure becomes less attractive, parties preferring to wait for the scheduled elections.

Two observations worth to be mentioned:

- That the fewest motions of censure were submitted during the Nastase governance, only two, that government enjoying a solid majority and the opposition being weak, fragmented and, therefore, not very active;

- At the opposite end is the period 2008 - 2012 with the highest number of initiated motions of censure, 9, two of them being successfully, an explanation of this fact could be the particular creation of the majority, by attracting a significant number of parliamentarians from the opposition, one of the parties from the governmental coalition has not actually participated in the 2008 elections. Also, the Boc governments (I, II, III, IV) assuming repeatedly responsibility have provoked constantly the opposition, who was in a position to answer, most of the times, by submitting new motions of censure.

As we have noticed from reviewing the literature in this area, in general, the motions of censure appear in a large number in times of crisis. Given this aspect, another explanation for the large number of motions submitted during the mandates of Emil Boc and Mihai Razvan Ungureanu (2008 - 2012) is related to the deep crisis that Romania was and continues to pass, the opposition feeling frequently obliged to delimit itself firmly on the unpopular decisions taken by the governments. The year 2012 brings a premiere in the Romanian politics after 1989 representing the year when the cabinet is dismissed by a motion of censure initiated by the opposition, the alternation in the governmental power is realized not by elections but by using this tool of the parliamentary combat.

*Table no.1 Voted censure motions by year of legislative term*

Year/legislature	1992-6	1996-2000	2000-4	2004-8	2008-12	total
1 <sup>st</sup> year	2	2		1	3	8
2 <sup>nd</sup>	2		1	2	2	7
3 <sup>rd</sup>	1	2	1	2	2	8
4 <sup>th</sup>					2	2
total	5	4	2	5	9	25

Even sometimes the direct and visible effects of a motion of censure covering an economic issue were minor, the government ignoring analysis, ideas, sometimes alternatives proposed by the opposition, the fact that the government shortcomings and failures were brought into the spotlight effectively contributed to the erosion of party holding power, supplying significantly the level of awareness of the public.

It could say that the last motion of censure filed in April this year, which resulted in the collapse of the government Ungureanu, effectively censored the economic policy and radically changed the direction of governmental policy. In terms of style, content and the drafting of texts motions, we notice texts that range from a few pages (a few hundred words) to large complex motions on dozens of pages (several thousand words), real data compendia statistics and indicators. The opposition endeavor to be credible can be identify both in trying to find more resounding titles and with more impact and the solid foundation of ideas using significant figures and statistics. Gradually, the emphasis in text moved from pure demagoguery and populism to realistic and convincing presentation of the economy, the legislators realizing that cannot attract the electorate only with empty words. Moreover, the government policy was the main subject of the motions submitted in the parliament, 90% of those treating this subject, whether they were simple motions or censure motions.

The opposition filed motions in an effort to draw attention to the key issues of Romania; more than to get electoral gains meaningless questioning the government. This explains why very few motions of censure on economic issues (1) were submitted in the 2000 – 2004 period, a period of consistent economic growth and prosperity compared to the 2008 – 2012 period (8), when the center right government faced the economic crisis and the social unrest.

Thus, in the period 1992 - 1996 the center left government faced three of five motions with economic subject; 1996 - 2000, all motions that center-right government faced had economic content (4 of 4); 2000 - 2004 was only a motion with economic subject; 2004 - 2008 for the right-wing government 2 of 5 motions of censure had economic content; 2008 - 2012 the center-right

government faced 8 of 9 motions of censure voted have dealt with the economic and social issues.

In order to have a representation on the consistency of the texts related motions and the economic conjunctures of the moments in which they were originally submitted, required getting in depth texts, analyzing them period by period. The realistic reflection in motion text of the economic and social realities, offering alternative solutions, is, from our point of view, strength for the opposition, highlighting its ability to formulate coherent economic policy, viable alternatives in the governing process.

At the same time, the detection of changes in the governmental programs as a consequence of the motions of censure represents strength for the government, proving responsiveness, flexibility and realism in the exercise of governance in favor of the citizen.

#### **1992 – 1996**

The first motions of censure introduced in the Romanian Parliament circumscribes the period 1992 - 1996, from 1990 to 1992 this tool was not used. Of the five motions of censure relating to this period, 3 had an economic subject targeting the reform program and the privatization process carried out at that time.

The first one was initiated at 100 days of government, criticizing the socio-economic reform strategy of the government program was a declarative motion, not based on figures / indicators. We have not found a direct influence of the motion on the governance act, the government practically ignored this motion.

The motion's text refers to the program presented in the parliament by the Vacaroiu government called "socio-economic reform strategy of the government program" and considers that it is not a real government program but "a set of heterogeneous and conflicting goals of economic and social policy, missing concrete solutions, time of application and country resources available to achieve them.

The second motion that concern economic issues, from December 1993, only repeat the negative aspects noticed in the first motion. Also declarative, without substance, without concrete elements, the motion is limited to the request of the cabinet resignation. Rejected in the

parliament, it brings nothing new in the political landscape.

The last motion of censure on the economy was introduced in December 1994. Unfortunately in this case was seen that the opposition had no concrete ideas about solving problems. Limited to note “ the inability to govern and the government's lack of will to solve the difficult and the real problems of the economy and the population. The motion has not produced any effect beside the media.

As a first conclusion, the motions of censure submitted in the mandate of 1992 - 1996 had little or no influence on the economic policy of the government. We noticed the lack of experience of parliamentarians in drafting motions that would represent the true pressure on the government, the real threats addressed to it. No substance, no solutions these motions were only simple expressions of general dissatisfaction.

#### **1996 – 2000**

All motions of censure initiated in the legislature 1996 - 2000 had a socio-economic character. The epoch of the Democratic Convention was the one when the process of privatization and reform really started in Romania. Like any process of reform, was a painful one, which produced many popular discontents. The unemployment rate increased, inflation reached alarming levels, there have been many layoffs, the purchasing power decreased, etc.

On this background the opposition attacked questioning the ability of governments to govern the country, the program of global reform measures, the solutions to accelerate the reform. The attitude of the opposition was in consent with the wave of social complaints constantly eroding confidence in the cabinets in place, which resulted in the end the elections loss by Democratic Convention – Democratic Party – Democratic Union of the Hungarians in Romania coalition and for the Christian-Democratic National Peasants' Party, the main ruling party which has given two of the three prime ministers of the coalition: Victor Ciorbea and Radu Vasile, leaving the Parliament.

We notice the opposition's ability to produce more elaborate motions, based on figures, on indicators, highlighting some specific situations

that demonstrate various government inabilities. The motions, better prepared, even if not led directly to the fall of the governments against which they were initiated, led to a quasi-general idea that the governments of the Democratic Convention are incompetent. For this inability was mainly blamed the Christian-Democratic National Peasants' Party which lost parliamentary representation in 2000. The experience of the Social Democratic Party politicians was proved by the capacity to speculate effectively all mistakes and the ability to draft comprehensive texts that aimed virtually all aspects of economic, political and social. Without presenting alternatives, the motions of censure initiated by the Social Democratic Party have echoed among both population and media, and being publicized the ideas presented were acquired by the electorate.

#### **2000 – 2004**

The Nastase government faced, during the four years, with the least contestations. Two motions of censure were filed during this period, one on economic and social issues and one on corruption and the mafia widespread at central and local administration level. Although seen as a highly corrupt government, The Nastase cabinet was considered, both by the population and the media, an effective government that knows what to do, which has solutions and the ability to implement them. Having the advantage of a general economic growth, felt in the population's pockets too, the government has been appreciated, not actually threatened with fall by a weak, fragmented and disoriented opposition.

The only censure motion targeting the economy was initiated as a result of the assuming the responsibility on the general policy statement regarding the balance of the first year of governing and remained without effect, and The Nastase cabinet continued to work undisturbed. Moreover, the popular disgruntlement against The Nastase government did not target the efficiency of the governing act, considered satisfactory or good, but the generalized corruption and the arrogance of the Prime Minister Adrian Nastase.

Without immediate consequences on the government economic policy program, the only censure motion filed on economic issues failed

to alter confidence in the executive and did no significant changes in its economic policy. Adrian The Nastase and the Social Democratic Party did not lost the power due to the economic situation of the country but primarily due to the disastrous internal and external image related to increasing corruption and inefficient justice.

#### **2004 - 2008**

The period between 2004 and 2008 was extremely interesting from the political point of view. If at first there was a parliamentary majority formed DA Alliance, DUHR (The Democratic Union of Hungarians of Romania) and the Conservative Party, then, from 2007, DA Alliance has broken, LDP (The Liberal Democratic Party) withdrew from governance, NLP (The National Liberal Party) and DUHR formed a minority government.

This government resisted, always succumbing to the negotiations with the opposition, and especially with the Social Democratic Party, until 2008 at scheduled elections. Four censure motions have provoked Tariceanu government, including two on economic and social issues: Tariceanu Government - Facts and Lies and 1000 days of chaos, The end of the right government.

The first motion, submitted after a year and half of governance is the longest motion ever submitted in the Romanian Parliament (over 9500 words / 28 pages).It was an exhaustive motion, reaching all the economic and social issues, from taxation to European integration, bird flu, health, education, flood, tourism, environment, highways, European projects, inflation, environment, film production in Romania. All in one! It is simply the motion of motions! This motion seems to be written without a specific purpose but from the desire to create a motion to criticize, no matter what and why.

Without representing realistic points of view, with Romania recording an economic growth in 2006, 2007, 2008, naturally, the motion was not a threat even from the viewpoint of the media exposure. It was intended a censure motion, was made one and that was the effect.

The second motion of censure on the economy was initiated in September 2007, when the government was a minority one, with only 20% of parliamentary support. Although the

motion mentioned that " who will vote the motion of censure vote not only to end of an incompetent, unstable, artificial and arrogant government, but for a different direction of the development of the country", however the motion was rejected, which showed that the opposition did not really want to take the governmental power.

Although it was stated that the Social Democratic Party has solutions to solve the economic problems, however, the motion is not presented any. It was a motion consistent in data and numbers, attacking almost all range of the economic and social problems, including justice and foreign policy. This motion had no direct effect.

It was intended a change of direction but with no results the motion being rejected, although the Tariceanu government was a 20% government. The opposition preferred to obtain benefits through negotiation than simply take the governmental power.

#### **2008 - 2012**

This period represents by far the most active period of the Romanian Parliament in terms of motions of censure: 11 initiated, 9 voted, 2 adopted. Also, the most loaded in terms of motions with the economic message, 8 of 9 being focused on the economy.

The first motion is dedicated to the governance program considered as a contempt against the electorate of the Liberal Democratic Party and the Social Democratic party that formed the government. The electoral programs, full of promises more or less attractive were abandoned, the state budget approved having no connection with the promise of wage and pension increases.

This is the first motion in which the National Liberal Party, this time in opposition, defends itself to the accusations against the prime minister Emil Boc and highlights the mistakes and babbles of the new government. It is criticized the introduction of "flat tax", giving up the flat 16%, the increase in general taxation, the lack of ideas regarding the Romanian economy revival, the politicization of public administration, the investment failure.

A consistent motion that demonstrates the experience gained by the National Liberal Party in the act of governance, the first in a long series

of motions that led to the gradual erosion of the government, and, finally to the shift of the Liberal Democratic Party in the opposition.

The third motion that challenged the Boc government was a response of the opposition to the government assuming the responsibility on three laws, one of them regarding the unitary pay law. Considered unconstitutional, the attitude of the government was criticized by the opposition, at the same time with the union complaints, resulting in the street demonstrations. There are mirrored the Tariceanu Government achievements and the failures of governance of the Social Democratic Party and the Liberal Democratic Party. The motion blamed the lies, the arrogance, the lack of government's communication with the population, the quarrel between different socio-professional categories, and the discriminatory treatment. They are, in fact, the most common complaints brought to the Liberal Democratic Party both by the opposition and the press and ultimately even by citizens who, in the January 2012 get out in the street for the same reasons. The motion did not have direct consequences but dug the confidence in the government.

Eventually abandoned before the general election by the Social Democratic Party, the Liberal Democratic Party remains in power with DUHR and face the first real threat from the opposition: motion 11 against Romania!

Considered unrepresentative and unconstitutional, the government is accused of "economic and moral Romania's destruction" and characterized as a tool by which Romania is "sunk in poverty" and which came into being "the foundations of an electoral fraud in favor of candidate Basescu." Interesting is that into the picture appears the substitute of Emil Boc, namely Klaus Johannis, Mayor of Sibiu. To be more credible, like the German model, the opposition came with an option for the prime minister position supported by 60% of the parliamentarians. The motion is adopted, the government falls. Expectations were all headed to replace Prime Minister and changing direction of government.

Instead, Traian Basescu, taking advantage of some ambiguity about the constitutional term to replace the government and the concrete ways of solving the situation, extended the interim Boc,

refused the option of the opposition and nominated for this position Lucian Croitoru, technocrat, a National Bank of Romania counselor. This together with his cabinet fails to pass in the parliament and it is made a new appointment, the mayor of Sector 3 Bucharest, Liviu Negoita from the Liberal Democratic Party. The second option had the same result in the parliament; do not even reach the vote of confidence, being blocked by the parliamentary procedure. The problem is solved with the presidential elections: Traian Basescu wins again, a new coalition is formed and Boc goes again as Prime Minister.

June 2010 bring to the government a new motion of censure: Stop the social genocide! As a response to the wage and pension cuts approved by the Boc government with the IMF and publicly supported by Traian Basescu as the only "correct solution", the motion inventoried negative effects that these cuts will cause. Considered an attack on the national security, the austerity measures represent, in the opinion of the initiators, an extremely dangerous precedent that cannot be tolerated

The government is considered like a "butcher surgery" that cuts without a head. The lack of economic recovery alternatives is also sanctioned. The motion refers to a plan of alternative measures, which have a different view with jobs problem as a priority. This motion produced consistent effects, not by replacing the government, because it was rejected, but through the image created of an arrogant, incompetent and corrupt government with a puppet prime minister.

The following three motions, filed during 2010 and 2011, attacked the government on the same economic and social coordinates taking advantage of the disastrous economic situation and the lack of communication at governmental level. Low wages, high unemployment, bankrupt companies were subject to analysis.

The government Basescu - Udrea - Boc was accused of corruption, theft, restricting the rights and the democratic freedoms of the citizens. All these motions were aimed at public exposure of the government inability to lead the country through crisis.

Realizing the lack of support in the Parliament, the opposition chose, however, the

path of initiating motions, not necessarily because they hope will replace the government, but rather to attract public attention. To ensure that motions will be rejected, the parliamentarians' power chose not to vote but to remain in banks, a situation encountered for the first time in Parliament, namely a mute power.

The intense parliamentary activity during 2008 - 2012, the opposition efforts to write and initiate motions have not remained without effect. Being consistent with the way most Romanians considered the act of governing of the Emil Boc cabinet, these permanent red flags held in Parliament on Romania going in the wrong direction eventually led to the discharge of the Liberal Democratic Party from the governmental power.

"Stop the blackmail government. This way, never!" Is probably the last motion of censure in the mandate 2008-2012. Although new, this instrument of parliamentary fight has shown efficacy. The approval of this motion of censure led to the replace of the Ungureanu government. Three issues were addressed in the motion: the illegal privatization of the natural resources, money from the budget allocated according to political criteria and the violation of university autonomy.

We can consider that the motion had such result because actually was placed on a background of dissatisfaction and lack of confidence in government and on an internal situation of the Liberal Democratic Party, facing numerous political desertions among the most resounded that of the party vice-president - Sorin Frunzaverde, Caras-Severin county chairman.

The political inability of Prime Minister Ungureanu, the Liberal Democratic Party arrogance, the betrayals inside the ruling party, the volatility DUHR, party formed mainly of former members of the Social Democratic Party, have contributed to the loss of power and pass it into the hands of Liberal Social Union, National Liberal Party-Social Democratic Party Conservative Party alliance, which has led to the mess of the Liberal Democratic Party and its categorical defeat in the local elections.

## Conclusions

A careful analysis of the motions addressing economic issues, debated and voted in Parliament till 2012 allows us to distinguish some general patterns that characterize the use of these important legislative tools that synthesize the relations between government and opposition, the political parties work, the important public policies for the opposition, the way the Romanian realities were reflected in the parliamentary agenda and the moments chosen by the opposition to challenge the government.

Primarily, from the large number of motions presented in Parliament, the motions of censure have been used sparingly which highlights the fact that legislators have realized the role and the power of these tools. We notice a more intense use of the motions of censure in the mandate 2008-2012 when the popular discontent and the bad economic situation have created the premises for government reorganization.

Secondly, we notice the opposition effort to attract public attention on the government policy mistakes. For most motions of censure the result was known and the initiators knew that they will not pass but were initiated for public exposure in the media and later the electorate.

Thirdly, we have identified an effort of the opposition to learn how to write motions and motions that became more consistent and more analytical. If in the early years, the motions were without substance; with deep demagogical accents later they became much more documented and sometimes offering alternative solutions to solve problems more efficiently.

Fourthly, we noticed the increasingly serious connection between the motions in the reality. The opposition better speculated the political power mistakes managing eventually to use the full potential of this instrument by removing the government and taking over the governance.

Finally, the impact of the motions with socio-economic character, which were based on the wave of popular discontent, was significantly higher among population than other motions with the same content. Practically the motions written as a street request were the only motions with direct and obvious effects.

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# Comparative Analysis between Rehn-Meidner Model and the Swedish Model

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## Abstract

*This thesis studies two different models; the Swedish model and the Rehn-Meidner model. It shows their similarities and differences, and explains why it is inaccurate to put an equal mark between the two of them. An extensive discussion on the models is presented in order to give them each a fair assessment. It is shown how and why the Swedish model has failed, as well as how Sweden has failed to apply the Rehn-Meidner model in a consistent manner.*

**Keywords:** models, organization, economic policy

**JEL Classification:** E, E6

## 1. Introduction

The Swedish economic system, categorized as a social market economy, is distinct in the way that there is no central planning and the market is privatized, but there is high level of income redistribution and mature social welfare system operated by the government. Sweden, among all the social market economies, is the most welfare-state-oriented and corporatist, characterized by its system of corporatism, wage solidarism and government intervention in labor markets.

Corporatism is a special political and economical system in Sweden. It is the centralized wage bargaining system, to maintain low unemployment rate and low inflation. Corporatism exerts control over the social and economic life of respective areas. There are two types of corporatism, authoritarian and liberal.

Authoritarian corporatism is known as state corporatism. It refers to the use of state established and recognized organizations to control wage bargaining, hence limit the

power of civil society. This form of corporatism mainly exists in fascist economies.

## 2. The Welfare State and the Global Economy

Liberal corporatism, on the other hand, is mainly a voluntary and self-organized process of bargaining between labor, capital, and government. Government only plays a supportive role in liberal corporatism. This form of corporatism is practiced in Sweden, with its strong labor party rule in the economy. The Saltsjöbaden Agreement, signed in Sweden in 1938, established the centralized wage bargaining process that was largely practiced until 1983. It labels the Swedish corporatism, but also balances the power between conflicting groups, named “conflict corporatist”. This type of liberal corporatism emphasizes on the role of labor hence achieve greater equality between conflicting groups. Nevertheless, “consensus corporatism” was also practiced in Sweden in the form of EFO model. This model stated that the standard of wage increase depends on the improvement of productivity in the internationally tradable goods sector.

There are similarities between the Swedish model and the Rehn-Meidner model, and more importantly some significant differences.

One example of active government labor policies is the Rehn-Meidner Plan which encourages the retraining and reallocation of workers from falling to rising industries through government program. Another significant policy is the wages fund, which “was to be created by a payroll and excess profits tax and would buy up shares of corporations to be owned by the unions”. However, this plan was not in practice any more after the change in government

ideology. Sweden is well-known for its complete and mature welfare state programs. However, these benefit programs cost high government spending, hence, high tax rates and inefficiencies in public sector. High tax rates also reduce labor supply and encourage the rising of underground economy. Nevertheless, although the welfare state program and high taxes in Sweden have caused lots of problems, Sweden is still one of the countries with the highest income and wealth equality.

First of all, the solidaristic wage policy is something that is prominent in both models. It is argued, however, that this idea has been pushed to its extreme limit and has moved towards “equal pay regardless of work”, rather than “equal pay for equal work”, which was the original idea of the Rehn-Meidner model. This movement away from the idea of Rehn and Meidner is argued to have decreased the interest in growth.

Another similarity is the collective bargaining, which is one of the most important features of the Swedish model still today. The strong position of labour unions was also something that Rehn and Meidner considered necessary in their model.

Regarding the labour market, which is the foundation of both models, it is possible to see similarities in its policies. The Rehn-Meidner model advocated active labour market policies, which is something that has also been followed in the Swedish model, mainly during the 1950s and 60s. Lately, however, policies in the labour market have become less and less active.

Furthermore, the fundamental goal of full employment is apparent in both models. Differences are obvious, though, in how this goal was supposed to be achieved. The Rehn-Meidner model required all of its instruments to be used, as they are interdependent, which the Swedish model did not recognize this interdependency and neglected parts of the Rehn-Meidner model.

One major departure from the Rehn-Meidner model was the failure to keep down inflation. Keeping down inflation was important for Meidner and especially Rehn who used the motto “hate inflation”.

It is obvious that the Swedish model and the Rehn-Meidner model do have some similarities, but it is equally obvious that they are not identical – they do have some crucial

differences as well. The most clear corresponding characteristic the models share is the labour market policy, in which it is feasible to count also the solidaristic wage policy and collective bargaining. The strong position of trade unions in Sweden does also have much to do with that.

The most noticeable departure from the model is the economic policy in Sweden, which has not been as tight as proposed by the Rehn-Meidner model. This has resulted in a failure of the ambition of a low inflation. This is something that has been much recognized, for example by Rudolf Meidner himself.

Sweden's welfare ambitions were probably incompatible with the Rehn Meidner model. For example, it is obvious that relatively equal incomes, regardless of work, have been advocated in Sweden, which is not in line with the solidaristic wage policy of the Rehn Meidner model.

### **3. The failure of the Swedish model**

It has been shown that the Rehn-Meidner model was never applied, and is not the same as the Swedish mode. Some obvious differences, as well as similarities between the two models have been outlined. Furthermore, the Swedish model is thought by many to have failed, especially from an economic point of view. While it was easy to see that the Rehn-Meidner model failed, it is more difficult to analyse the failure of the Swedish model.

One of those criticizing the model is economist Klas Eklund, who argues that the Swedish model has indeed failed. He claims that the Swedish model was too little influenced by the Rehn-Meidner, and that is part of the reason why the Swedish model failed, and yet another relation between the Swedish model and the Rehn-Meidner model worth discussing.

First of all, a more differentiated labour market where human capital was regarded more important than previously complicated the use of the solidaristic wage policy. The notion “equal pay for equal work” eventually led to equal pay regardless of work, which led to a shortage of skilled workers. This wage solidarity reduced incentives to study,

which also resulted in a shortage of skilled workers [1].

Marginal tax rates grew rapidly. Deductions were generous. Hence, looking for loop-holes was interesting. Many Swedes then started to plan their lives, work, savings and investments according to what was good for them personally, not for the social economy. As Gunnar Myrdal said: “the Swedes are turning into a nation of cheaters”. Absenteeism and early retirement also increased as the benefits did too [1].

Some factors were directly related to departures from the Rehn-Meidner model, such as how the Swedish model, the way it was shaped in the 1970s, was too rigid, unable to respond in a flexible way to globalisation, and how neither monetary nor fiscal policy was as tight as Rehn-Meidner wanted [1].

German sociologist and philosopher Jürgen Habermas is following the same track, and argues that a crisis of confidence is born when the people are not willing to contribute to the security that is demanded. In *Legitimationsproblem im Spätkapitalismus* from 1973 he writes:

“The division of labor between the state and the private sector that forms the basis for the Swedish model requires that a continually increasing share of the national product be transferred to the public sector [it is now 64 percent]. Technical and economic changes must be accompanied by enormous public investment in order to insure the stability of society. There is a point where a dislocation in the social structure, caused by the free play of the market forces, becomes so great that people are no longer willing to pay the price for the necessary remedies. The demand for security remains, but the desire for each person to contribute to the cost of this security diminishes. The welfare state then faces a crisis of confidence.” [2].

This “crisis of confidence” is what Sweden is argued to have experienced, and a reason to the failure of the Swedish model. It is simply becoming too costly to contribute to the welfare state. This is related to what Myrdal suggested when he was talking about Sweden turning into a nation of cheaters, as discussed above.

More criticism comes from the historian Urban Lundberg who points out that another sign of the failure of the Swedish model is

the increased deviation from the model by its foremost advocates – the Social Democrats. Lundberg takes up a number of reforms that work as examples of this: deregulation of the currency market and the bond market; increased privatization; tightening of the qualifications for sick leave; liberalization of the labour market; a lower level of compensation [3].

The failure of the Swedish model is not as simple to recognize as the failure of the Rehn-Meidner model. The Rehn-Meidner model failed since it was never applied consistently – the interdependency of the instruments of the model was neglected. The Swedish model is more complex, and so is its failure. The failure of the Swedish model is mainly argued to concern the unwillingness of the Swedes to pay the high cost of the model. Also, the model requires homogeneity, both socially as well as economically, that is not worthwhile.

As the Swedish model is argued to have failed, and the Rehn-Meidner model is argued not to have been applied consistently, a myriad of questions arise concerning the future of Sweden, its economics, politics and models. A few of them are discussed in the next chapter.

Unquestionably, these labor market institutions have contributed to the success of Swedish economy. Sweden, with these three unique labor market characteristics, is the most successful redistributionist social market economy. Swedish economy combines the free market output, private ownership with active government intervention in labor market, has practiced corporatism (centralized wage bargaining), complete state welfare security, and wage solidarity. Sweden has benefited from these policies, with high economic growth and great income and wealth equality. These three market institutions set up the base for the Swedish economy model. However, experiencing difficulties since 1970s, the Swedish economy has been adjusting and changing to restore the competitiveness of Sweden. These three institutions may not maintain unchanged anymore, but they certainly still serve the foundation of Swedish economy.

#### 4. Conclusions

To conclude, in order for the Rehn-Meidner model to work properly, it is required that all its instruments are considered since they are interdependent. This is where Sweden has failed in terms of the Rehn-Meidner model. As it has been shown, the Rehn-Meidner model has influenced Sweden in the creation of the Swedish model, but to say that Sweden adopted the Rehn-Meidner model is definitely not accurate. The main reason for this is the interdependency between Rehn and Meidners instruments that has not been considered in the Swedish model.

The main objective of this thesis was to sort out the Swedish model and the Rehn-Meidner model, and analyse their relation. It was found that there are obvious similarities between the models, but more importantly that there are crucial differences.

The core of the Swedish model was found in four different ideas: the basic concepts of equality and solidarity as a foundation of the Swedish model, were found in Swedish Prime Minister Per Albin Hansson's idea of „the people's home“; the level of state intervention to guarantee welfare is apparent, but not excessive, which is recognized by Marquis Childs in his idea of Sweden as the middle way between capitalism and communism; this reasonable level of state intervention was accompanied with an agreement between labour and capital in order to secure the welfare, which Walter Korpi called „the historical compromise“; and finally, these ideas have led to a system where citizens are not dependent on the labour market for a certain high standard of living, as Gösta Esping-Andersen's concept „de-commodification“ means.

The Rehn-Meidner model is more concrete. The goals of full employment, low inflation, high growth and equality were to be achieved by solidaristic wage policy, restrictive general economic policy, labour market policy and marginal employment subsidies. Important for the model was that these instruments were interdependent. This interdependency was failed to be recognized in Sweden, and hence the model was never accurately applied. The model had its obvious influence in Sweden, however, and some similarities to the Swedish model, but since the interdependency of its instruments was neglected, it is incorrect to say that it was applied.

The Swedish model is also argued to have failed, but for completely different reasons. It is argued that the Swedish model requires homogeneity, socially and economically, that is not worthwhile for its citizens, and that people consider it too costly to contribute to the model.

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## Applications of the Rehn-Meidner Model

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### Abstract

*The Swedish Model is a term that pops up here and there. The purpose of this background report is to summarize the elements of literature and investigate what referring. However, it is important to initially clarify that although the Rehn-Meidner model can appear to be central to the emergence of the Swedish model, so began the development of Swedish society long before it was presented. Rehn-Meidner model is more a theoretical document that summarizes the policy which culminated in Sweden sixties. It is after this thesis that the outline drawn. First, a review of the Rehn-Meidner model and the effects it had on society. This is followed by a more detailed review of the mixed economy, ("korporativismen"), the general welfare policy, active labor market policies, and finally wage formation with the central negotiations.*

**Keywords:** Rehn-Meidner Model, economy, economic policy, corporatism

**JEL Classification:** E, E6

### 1. Introduction

After World War II prepared the Swedish economists on a similar crisis after the First World War. This appeared, however, never, and instead stood before Sweden demand-pull inflation and labor shortages. There was a conflict in which the state wanted the union would work to reduce wages in order to halt the rise in prices, but where the union refused. Instead, the union felt that it was the state's responsibility to regulate demand so that it became adapted to the amount of employed labor.

The solution was formulated under the leadership of two LO economists Rudolf

Meidner and Gösta Rehn. They constructed a model in which the interaction and interdependence between the state and trade union movement's actions were used both to achieve more even distribution of wages and economic growth. Commentators have argued that this model represents the "core" of the Swedish model: "The importance of the Rehn-Meidner model for post-war Social Democratic regulation in Sweden cannot be underestimated. It was the paradigm. That informed the regulatory practices That rendered the universal welfare state compatible with the reproduction of the national capitalist economy; That is, the policy routines of wage determination, labor market policy, and macro economic policy. These can be said to constitute the core of Sweden fordism mode of regulation "

An important component of the Rehn-Meidner model was the wage policy of solidarity, which built on the principle of equal pay for equal work. Rate of pay was therefore independent of the work species, and independent of the solvency of the company. With this, there were essentially two purposes. First, they wanted a reduction of wages and increase the salaries of the most vulnerable groups. Second, the policy became an instrument to accelerate the closure of unprofitable businesses and industries. Pay policy therefore led to a structural rationalization and modernization of society.

The risk with this model, however, was that it could generate inflationary pressures in the market.

This could be prevented by a Treasury dampening demand policies also could provide a good starting point in contract negotiations between the various parties on labor market. In practice, this led to a Keynesian stabilization policy that saved in economic upturns, to spend more money in downturns. The model also resulted in an urbanization of the country, and hence to

forced labor to move where the jobs were. In order that the workers would move took him more than small differences in income, and this inertia led to the transformation of the market went slowly. To facilitate the urbanization, the state invested in the so-called "Million program", which resulted in the emergence of new suburbs to the big cities. A example, Tensta and Rinkeby outside Stockholm.

The egalitarian wage policy and the restrictive demand policy led to risks of structural unemployment. This problem was handled by the increasing mobility of workers designed a new and more active labor market policies. The result was the formation of Labour Market Board (AMS) 1948 and by giving workers more information about position (employment), and relocation allowances. They also began to train the unemployed to school them in the expanding business where it was needed labor. In connection with this was also the labor forecasts of future labor needs to preventing bottlenecks in economic upturns.

Another effect of the model was that the profit distribution was undesirable effects on income distribution. These were dealt with by taxing and regulating the capital market, which was designed to support the main growth forces. The emphasis of taxation was progressive individuals and low on income from work. The company was however, it is designed in a different way, as they so long as capital remained in the company was low. The rules relating to depreciation of capital was favorable and it was easy to fund profit margins. They wanted this encourage businesses to use the profits to investment, but it did instead of capital mobility decreased and also the importance of the stock market. In conclusion led Rehn-Meidner model for high growth, high employment and balance of payments. It managed, however, never quite achieving the goal of price stability, which Meidner complained the 1973<sup>rd</sup>.

The low unemployment and rising export figures, however, gave an increase in demand that created pressure on inflation in Sweden in the fifties and sixties. The reason for this was, according to Magnusson, Political: "In general terms, were the causes of this dilemma is mostly political. 1950 - and 60's was a period of rising expectations. The

public was subject to an annual standard increase of several percentage points. And politicians helped to lull the public into the idea that this economic growth was a natural state".

## **2. Among the economy with limited state ownership**

Rehn-Meidner model and the Social Democrats' economic policy led to what in literature is called a "mixed economy" in which market forces are combined with socialist control. State ownership was never dominant, and has never exceeded 10 per cent of the number of employed. Instead, there was state influence with a more or less invisible hand of the market in the expansion behavior and directed in the direction they felt was best for society. This is something that Schonfield (1974) places emphasis on when he describes Government's role in the sixties: "The Fact That the government does not intervene – indeed is publicly seen not to intervene - not does it mean That Fails to let ITS views to be known Those concerned. " The goal of the Swedish model policy has primarily always been focused on the full Jobs. The characteristics of this policy is regulatory, not economic planning and state ownership. These regulations have, been the dominant the residential, agricultural and financial sector.

In the housing sector rents were more or less frozen from 1942 to 1975, where the norm in rent-setting was similar collective party negotiations between the tenant and landlord. The rent was for the "use value", the apartment's standard, and this price was also as a template for the private housing market. Other regulations in the housing market was among other things, that it was possible to rank the housing applicants, and residential construction determined by state standards for what a good standard meant. The regulations were intended to prevent segregation in the housing market and increased quality differences in housing assistance.

In agriculture, increased tariffs and a number of subsidies were introduced to farmers would to live on his farm. Instead of food prices was by supply and demand; the party was settled in negotiations between the state and agricultural interest groups. This

Not only was the peasants' sake, but also because Sweden could remain self-sufficient at the time of war. Food cartelised was with some sectors (Eg sugar industry) had a near monopoly on their products.

The Social Democrats also introduced controls over how freely capital could not move. Savings controlled and directed over to social priority sectors housing. Banks, insurance companies and pension funds were required to place funds in mortgage bonds. This policy results included in the construction of public pension fund (AP Fund). It also ruled the capital market, currency regulation, which has also had to seek permission for capital transactions as portfolio investment or loan transactions with foreign countries. The government oversaw all trading in foreign currencies through so-called exchange banks were regulated by special laws.

State ownership has been an impact, albeit limited, component of the Swedish Model. The modern roots of state ownership in commercial plant origins during nineteenth century, when such a state televerk and the state railway was established. There was already a post office, and in the twentieth century came Waterfall Board, National Lithographic Establishment, Defence factory work and the CAA. The reason they where in the state-run low in the expectation that private profitability criteria could not guarantee that they worked and worked for the good of society. State ownership also resulted in a public limited company sector expanded right up to the seventies. Approximately up to the fifties, so businesses were nationalized to avert the threat of closures and unemployment, which the state took over as owner during periods of crisis or for to organize activities in a better way. Organization The argument used among another at the nationalization of Wine and Spirits Center.

Some scholars argue that the expansion of state ownership in the sixties was as an end in itself. however, argues that this is not true, and proffers numbers where the state's gross investment is reduced during this period. However, he argues that there is a third reason nationalization to add the two as mentioned earlier benefits of mixed economy. These were mainly related industries at the time considered strategic -

telecommunications, energy, etc.

### **3. Strong social movements and "corporatism"**

Beginning in 1945, increased the influence of various organizations in Sweden. This occurred on the expense of parliamentary importance, which effectively disowned his power to the government. Instead to make decisions in parliament, were in reality behind closed doors at Harpsund between government and various interest groups. This is often seen as an expression of corporatism, Thus a model in which organizations work together or become incorporated with the state apparatus. The involvement of government decision-making apparatus began in the early twentieth century. Already 1902, there were five representatives from the workers and five representatives from employers in Workers' Insurance Board of the Council. In the thirties, was expanded this model to include more state agencies, where the LO and SAF in particular, were represented in different boards. Through this presence and participation in various investigations and consultation bodies organizations won considerable influence over policy. This image was also reproduced by Schonfield: "In Sweden there is a Society in Which no residual groups are so Strongly Organized, Their Democratic basis so firm, and Their habit of bargaining with one another Independently from the government so well Established, that 'here, if Anywhere, 'Indicative planning' in the full sense - that is planning without any dependence of the state - looks as if it ought to be feasible. (...) (T) he government is Meant To keep the ITS distance. It is not Merely That it is Excluded from the colloquy between the two sides, it does not even, any longer, Attempt to exercise guidance " Firstly, it was organizations representing groups in the community where the size decided how much influence could be exercised over the decision-makers. Second, it could organizations exert influence through ideological similarities, such as in the case the relationship between SAP and the LO or the Centre Party and the LRF. Information and knowledge played also matters. If policy makers could obtain important knowledge of collaboration, greater empowerment of

Organization of decisions. The organizations produced Also own investigative material and had its own research institutes. Altogether, this was about intrasseartikulering, intrasseaggregering and expertise.

Important to mention is that the degree of influence and organizations in policy does not determined by agitation or aggression, but of objectivity and the importance of organization could be for policy makers. The reason, according to Nils Elvander, was that organizations considered to be working for the people and the public interest best, so they own interests were linked with society. This view indicates a holistic view of society, in which the peculiar interests aligned the whole. This can be linked back to the marginal importance of agitation. The organizations selected a lobbying approach that fitted better into the society's public game rules for lobbying activities would be assessed. A break of these standards would a lower degree of influence. The consideration of public interest was not purely tactical motivated: 'Organizations' efforts to identify and harmonize the group interest of public interest need not be perceived as merely tactical. It may well be honestly meant. The habit of arguing on the basis of interest can exert a educational impact, organizations are becoming more intent on the merits adapt their requirements and desires to the needs of society, to see their own area of interest as part of the whole. "This view is reinforced by Schonfield who says that "They (union) see Their Purpose as being like that of a skilful pilot in a sea of the currents and high winds, who sets out to employ the energy of the elements to bring his boatload of Passengers to Their destination. "But he never draws the conclusion that one should ask Sweden for a corporatist state in which organizations have a special legal status and acts as independent entities.

The standards upon which the organizations' strong role in the Swedish model is Walter according Korpi in the Swedish society's history. He argues that the fragmentation of Catholic diocese was a secular base, without which the emergence of the model would be impossible. Further emphasizes Korpi importance of linguistic and ethnic homogeneity, and the importance of industrialization came so late. This

allowed the industrial unions and labor movement to building to strong without to competitive of any hantverkarorganisationer or being distracted by conflicts based on linguistic or ethical grounds.

But it is also possible to interpret the organizations' involvement in decision-making as something more than corporatism and direct exercise of power. This view has been put forward including by Bertil Ostergren was SACO Chairman 1961st He wrote an acclaimed article where he presented the thesis that 'role as a force outside parliament and the Government gives the individual another venue to engage in debate. Under this assumption has party democracy's failure to pick up citizens' views and activism has been replaced by organizations' distribution democracy. "

#### **4. General welfare policy**

Although the term "general welfare policies" often figures in the public debate, it is not always its meaning is defined. According to Rothstein comply with a welfare system requirement generality of its general allocation rules, is universal, or both. In this definition model therefore placed contributions as housing, social assistance and child care outside the general welfare, as they are selective and targeted. However, this can be criticized on grounds that the rules surrounding the housing and welfare payments are not less general than those that control ATP or student aid systems. Molander therefore concludes that definition of what a general welfare policy can never be exact. Whether or Sweden, or has had a general welfare is therefore up to each one and what definition one chooses to use.

In the Swedish welfare state model is primarily thought important, as it is from this that welfare policy was born. It referred to here is Per Albin Hansson's welfare state based on community and solidarity. Welfare state idea grew from the thirties even stronger and evolved over time into a project that aimed to eliminate the social distress and allocate the increased revenue in the most equitable manner possible. This goal was to trade union movement could not accept the structural changes that come as a result of Rehn-Meidner model, even though it meant a certain party of the working class: "Society's

task was to allocate the increased revenue in the most 'egalitarian' way.

It also meant that the trade union movement supported the necessary rationalization and restructuring that was emerging philosophy condition. "

What distinguishes The Swedish Model welfare policies from other countries is not costs, without reconstruction. Gosta Esping-Andersen understands that what makes the model is unique mainly four different elements: a general universalism, equality, the strength of the social, civil liberties and efficiency. For these ideals to be put into practice, requires a State that provides services and models that meet all classes of society demands and needs. A minimum living guarantee is not enough, and therefore welfare system is inevitably costly.

Another factor that makes the Swedish welfare spending is the productivity-promoting and preventive social policy. This means that a very Money invested in employment, retraining, education and prevention of disease and accidents. The goal of this policy is to minimize the social distress and maximize jobs. Esping-Andersen explained the reduction in class differences, employment and the reduction of poverty as the distributional effects of welfare policy.

The Swedish welfare system is not only a result of the Social Democratic leadership policy, but it has also been limited by external factors. Since the party itself is never able to dictate their demands based on their parliamentary power, then welfare policy designed with the support of different class coalitions. The economic efficiency has also consistently recognize that the Swedish economy has been small, open and export dependent.

Furthermore, the struggle for social citizenship had to go before the democratization of ownership and egalitarian ideals.

Women's role has also been an important component of the Swedish welfare system. Social democracy has always strived to eliminate poverty, reduce class differences and a more equitable distribution of life chances. The inclusion of women in the labor market has been a means to increase the efficiency of the system. This was done through, among other things investment in the family to distribute purchasing power and

the promotion of industrial modernization through a solidaristic wage policy pointing out that a policy aimed for full employment gave women a stronger position in the labor market without the at risk of exclusion. The elimination of women's wages in the sixties meant that the average salary for the twenty years rose from 60% of men's earnings to 90%.

The Swedish welfare state's various stages of development characterized by distinct concept of solidarity, from a proletarian micro-socialist solidarity, through a national Solidarity comprehensive "little people", the current model which includes all wage workers. But the Swedish model also contains a system of stratification, as it managed to get the general solidarity accepted over other solidarity performances that dominated the other welfare states, such as England. These stratifikationsformer generated Social identities and political loyalties that have been decisive for the balance of power in the country.

## **5. The active labor market policies**

As one of the Swedish model's slogans was "work instead of contributions" so it came about natural for an active labor market policy became a vital part of this model. The targets that were behind the reforms was a high employment, low inflation, solidaristic wage policy and rapid economic growth - in other words, the linchpins of the Rehn-Meidner model (which developed in section 2 of the report).

The unusual thing about the AMS was that it was a body that had unusually high level of autonomy against the State. This meant that the AMS is not bound by central regulations and had extensive powers. The reason was that you wanted them to rapidly changing labor market conditions could be met by prompt and flexible measures tailored to specific situations. AMS independence made it to yet a power in the political game, and in its Board were also representatives from all parties. Moreover, it was these representatives also partial responsibility for the business, then they got a direct decision-making positions. Rothstein consider that this opportunity could be a way to get organizational representatives to act more accountable and align their interests for the

common good. The bill that formed the basis for this model provided: "Participation from organization representatives' side not only in the deliberations but also in decisions are also likely to build confidence from the individual's side, thus strengthening Board's authority. This is of particular importance considering that the findings, which arrive on board, in many cases must be assumed to become the fragile nature of a negative impact on large populations. "

It works throughout the active labor market policy was based on was not a pure corporate machine, but it was also based on trade union domination, and was imbued with social democratic ideas and policies. This is what Rothstein term as a "Social democratic cadre organization within the Swedish state apparatus."

The organized class interests came to have great influence on the AMS Board of Directors. Organisationsinvolveringen also expanded to include various permanent working groups various issues to varying degrees contributed to the implementation of labor market policy. On these pages you will find even more details about the battle over the various lines around the constant support lines.

## 6. Conclusions

During the sixties, The Swedish model negotiations admired at several locations in the world. As a leader of the British trade union movement came to Sweden to study negotiation methods applied, he was greeted by a world very different from that he was used to: "The secret was Either too banal or too opaque to yield to intelligent investigation. "All They cancer tell you When You ask Them how to do it ', he said, some Describing Particularly Difficult Decision Which Involved the Concerted Action of comp thing rather than the residual groups, 'ice: We speed a Meeting ".

This quote describes well the mood that the Swedish model's negotiation policy was of. It was suggested that the circumstances

surrounding its origins, and it is clear that Social Democrats' 44-year-old power holdings have played a major role. This in turn reinforced by the ideological thrust of LO, Which is largely done in order to promote class solidarity at the expense of professional interests. In addition there was a strong LO, well organized and negotiation-oriented economy, and a rather weak and fragmented middle class.

The incentives for the parties to rally around what later came to be Saltsjöbaden agreement was around a troubled past with violent strikes and conflicts. These were formed around the former collective agreement and what Åmark call "open cartels' where competition for prices and sale of labor was limited. The high conflict rate by an subsequent political debate about industrial peace finally gave rise to a number of legislative proposals regarding how conflicts could be reduced. In the end, the threat of legislation to protect "Third parties" in labor disputes LO and SAF to open negotiations. 1938 Saltsjöbaden agreement through which they created a system of rules for the party determined conflict resolution.

This ideological aspect may be due to the LO long joined forced its members to Social where they may have been the ideological exercise and dimension they did not get Only by involving union.

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# Modelling Belief Systems with NLP: Linguistic Pathways to Communication and Negotiation

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## Abstract

*Beliefs influence our experience and interpretation of reality by connecting our experiences to our criteria or value systems.*

*Neuro-Linguistic Programming provides perhaps the most powerful model of the mind and set of behavioural tools in existence. Through the processes of NLP, beliefs and belief strategies may be explicitly mapped and directed.*

*Beliefs connect values to our experiences through statements of 'cause-effect' and 'complex equivalence'. Beliefs can be a matter of choice. We can drop beliefs that limit us and build beliefs that will make our life more successful.*

*Beliefs influence behaviour. They can support particular behaviour or inhibit it. This is why modelling beliefs is so important.*

**Key words:** limiting beliefs, cause-effect, complex equivalence, NLP, business communication.

**J.E.L. Classification:** D83

## 1. Introduction

The beliefs that we each have about ourselves, others and the way the world is have a major impact on the quality of our experience.

One of the simplest ways to model the beliefs of people with outstanding abilities is to ask them questions about *why* they do what they do. The answers they give us will be rich of insights into their beliefs and values. Beliefs will take one of three main forms. They can be beliefs about what things mean, what causes what (cause-effect) and so give rise to the rules we choose to live by, or what is important and what matters most, so giving rise to our values and criteria. In modelling our beliefs, we focus on those that

are most relevant to and supportive of the particular skills and competencies that we are interested in. We build beliefs by generalizing from our experience of the world. But how do we know what experiences to generalize from? According to O'Connor and Seymour (2002: 83) [1], "Some beliefs come to us ready made from the culture and environment we are born into [...] When we believe something, we act as if it is true. Beliefs act as strong perceptual filters. Beliefs are not just maps of what has happened, but *blueprints* for future actions" (emphasis added). Beliefs are expressed in simple terms: if I do this ... then that will happen. I can ... I can't ..., and these are translated into: I must ... I should ... I must not ... . Language is an essential part of the process we use to understand the world around us and express our beliefs.

## 2. The basic structure of beliefs

The main aim of our beliefs and belief systems is to link core values to other parts of our experience and maps of the world. The belief statement, "Consensus in business requires good negotiation skills", links the value "consensus" to a particular class of activity ("negotiation skills"). The statement, "Consensus in business is mainly a matter of talent", connects the same value to a different cause ("talent"). As these statements illustrate, beliefs are fundamentally statements of relationships between various elements of our experiences.

From a linguistic perspective, the basic structure of beliefs is framed on *complex equivalences* and *cause-effect* relationships since "the *combination of complex equivalences and cause-effect* relationships form the *basis for our belief systems* and are the fundamental processes behind *programming*" (Dilts and DeLozier 2000: 145, emphasis added) [2]. These verbal

patterns may be looked upon as the building blocks of our beliefs and are the linguistic structures which help us build our maps of the world.

The first linguistic element, i.e. *complex equivalences*, implies equivalences between different aspects of our experience ( $A=B$ , or  $A$  means  $B$ ). Through this language pattern definitions of values are generally provided and evidences for whether or not values have been met are established. For example, statements such as:

- e.g. *Having a lot of money means you are successful.*
- Not attaining the objectives properly means a lack of professional competence.*

could be examples of complex equivalences reflecting beliefs.

The second linguistic element, i.e. *cause-effect relationship*, represents the causal link between values and other aspects of our experience. This is frequently characterized by verbs like *cause*, *make*, *force*, *leads to*, *results in/from*. Such linguistic structures are used to define the causes and consequences of particular values.

From the NLP perspective, the sayings *power corrupts*, *money talks*, *time/love heals* are perceived as statements concerning the consequences of values related to our experiences. As a matter of fact, cause-effect statements and complex equivalence are those which connect values with our experiences, or, as Dilts and DeLozier put it, “Values are what give our beliefs and experience meaning” (Dilts and DeLozier 2000:99).

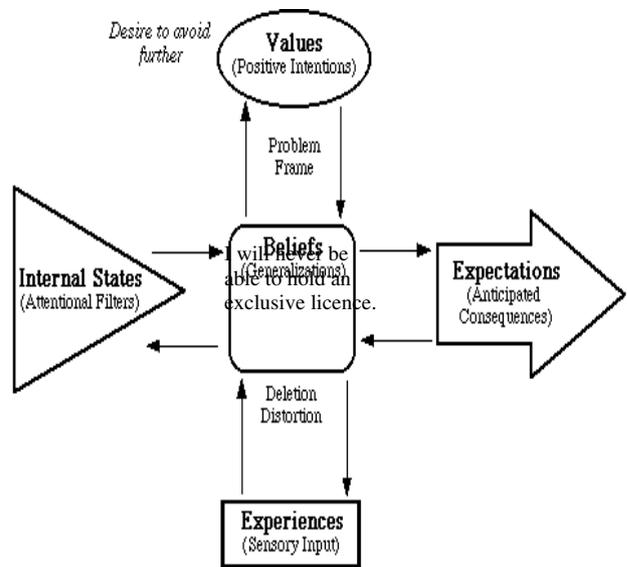
### 3. The meta structure of beliefs

Beliefs can also be limiting, a fact which will have a negative impact on all the other levels, especially on the capabilities level. The meta structure of beliefs implies that all our beliefs are **generalizations** drawn from our map of experiencing the world (Dilts 1990 [3], Dilts and DeLozier 2000, McLaren 2000 [4], Molden 1996 [5], Molden and Hutchinson 2006 [6]) whose function is to link together various components of our personal and professional experience (sensory experience, values, expectations and

internal states). All these together make up the map of our beliefs, or what Richard Bandler called the “fabric of reality”. As an example, let us think of a person who has serious doubts about whether he or she ever succeeds in signing an exclusive agreement or contract:

- e.g. *I will never be able to hold an exclusive licence.*

Such a limiting belief creates a “problem frame” and can result as a shift in any of the four components mentioned above to a negative formulation.



(Source: Dilts and DeLozier 2000:101)

According to Dilts and DeLozier (2000:101), “When limiting beliefs and *generalizations* stay connected with the intentions and experiences from which they have been established, the *deletions* and *distortions* eventually become updated or corrected as a result of new experiences, changed in internal state, and revised expectations. New data or ‘counter examples’ that do not fit with the generalization will lead the person to reconsider the validity of his or her limiting belief” (emphasis added).

Linguistically, beliefs which are limiting rather than permitting are rendered by negative expressions. Many beliefs turn out to be limiting as a result of unanswered **how to** questions. Beliefs can be transformed by providing the answers to the **how** questions

and thus develop a much clearer picture of a person’s identity and mission. For example, a person who does not have experience in how to mastermind the activities of his/her firm may develop the belief ***I am incapable of successfully running this company.*** Similarly, in order to address a belief such as ***It is risky to evade my income taxes,*** one should answer the clarifying question ***How have you managed to evade your income taxes and get away with it?*** (you haven’t been made responsible or punished by law).

Limiting beliefs can be explored by applying specific verbal frames for eliciting limiting belief statements because “No matter what one’s actual capabilities are, if one has limiting beliefs resulting performance will tend to fulfil the negative prophesies because the capabilities will, to a large extent, be blocked” (Katan 2004:55) [7]. For example:

e.g. ***I can’t make a discount.***

***It’s impossible to make a concession.***

***I’m not up to making an improvement.***

***What if I can’t make a compromise.***

Other simple statements which indicate an impasse or strong resistance relating to a belief usually begin with: *This sounds crazy but...; This doesn’t make any sense but...; It just isn’t like me. I don’t understand it.; I just can’t!; Logically I know it isn’t true but...; It is not possible for me to...; I’m not capable of...; I must not be...; I’ll never be...; People should...; They don’t want...; Everyone / no one thinks... :*

e.g. ***I can’t find better suppliers anywhere else.***

***People never take my suggestions seriously.***

***She is easily intimidated.***

***They should give this project priority. / They shouldn’t waste any more time on this project.***

***Accepting these terms and conditions is impossible.***

***I’m no good at running my finances.***

Molden and Hutchinson’s (2006:20-22) research on limiting beliefs makes it clear that at work many people are held back by such limiting beliefs. The two NLP theorists’ opinion is that limiting beliefs are workplace determined and act as a barrier on improving

performance. They prefer to describe them metaphorically by mentioning that “Holding a limiting belief is like wearing blinkers – you see only what you expect to see. [...] Beliefs can be stubborn defying the most rigorous logic”.

For many (Dilts and DeLozier 2000, O’Connor 2001 [8], Knight 2002 [9]), beliefs are the inner maps which guide our behaviour and strongly influence our capabilities. They also make sense of the world we live in and shape what we do. O’Connor and Seymour (2002:83) also agree that shared beliefs are “the guiding principles which give a deeper sense of **rapport** and **community** than shared work”, being explicitly mapped and directed. Functioning at a level which is different from that of behaviour, beliefs act as strong perceptual filters that influence our interpretation of reality by connecting our experiences to our value systems, what NLP calls our “core criteria”. Beliefs stated in the positive are permissions to further explore the world of possibility. They “turn on our capabilities, create results and [...] keep us resourceful and capable of succeeding in the end” (O’Connor and Seymour 2002:84-85). Beliefs stated in the negative, i.e. limiting beliefs, centre around modal verbs in the negative form like *I can’t...; I must not...; or I would not...:*

e.g. ***I can’t dance on the rope.*** (do many activities at the same time)

***I wouldn’t dance on the manager’s tune.***  
(do what he wants me to do)

***I can’t dance attendance on him.*** (do everything possible in order to please him)

***I mustn’t give my subordinates too much rope.*** (give them a lot of freedom to do their work in the way they want to do it)

The solution to find out how far one can “push” his/her capabilities is to pretend that one can do whatever thing, in other words, to counteract “can’t” with “as if”, and act “as if” one can. A change in belief triggers a change in behaviour. By way of illustration, the following sentences can be considered:

e.g. *If I handle such situations, I **will** have a rise in pay.*

*I **can** handle such situations, and I **must** have a rise in pay.*

*I **can** handle such situations, and I **should** have a rise in pay.*

*I **can't** handle such situations, and I **must not** have a rise in pay.*

Looking at such examples, we realize that the words we use express our beliefs. Consequently, the language we use is a means of communicating our thoughts, beliefs and values.

Our *values* are the embodiment of our beliefs. *Webster's Dictionary* (1996:1578) [10] defines values as the “principles, qualities or entities that are intrinsically valuable or desirable”. In accordance with O'Connor and Seymour's (2002:83) perspective, Dilts and DeLozier (2000:1519) find a direct relationship between values and rapport, pointing out that people feel more congruent and have a sense of satisfaction when their values match each other, “When people's values are met or matched, they feel a sense of satisfaction, harmony, or rapport”. Our outcomes are usually influenced and directed by such values as **a sense of achievement, recognition, praise, success, creativity, or responsibility**. We set ourselves goals which match our values and motivate us. For instance, a manager whose goal is to “stay ahead of the competition” is more likely to value *a permanent improvement in products and services*. A venture capitalist whose goal is to “invest money in new businesses” most likely values *creating more wealth*, in the same way that a high-powered business tycoon who has a value of *expansion* will relate his goals to “undertaking more prosperous economic activities”. The importance of values cannot be overstated. People who have a strong sense of what is important to them usually have a real sense of purpose that acts like a propulsion system, which moves them towards it.

#### 4. Conclusions

Beliefs can be positive driving forces in people's lives but they can also be disempowering and limiting. When we believe something, we act in a way that

validates it. That is true whether it is a positive or negative belief.

Many limiting beliefs originate from a vacuum at the capability level, in other words people do not know how to do something. If they do learn how, their beliefs often change spontaneously. If, after a few goes, people continue to struggle to grasp how to do something it is easy for them to slip into believing it is not possible. Limiting beliefs hold people back or prevent them from doing things.

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## The Repercussions of the Medical Staff Emigration Phenomenon on the Romanian Sanitary System

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### Abstract

*The migration tendency of the health care staff represents a major problem which affects the great majority of the EU states. The Romanian sanitary economy presents an alarming situation, because not only that the number of health care workers leaving the country is high, but it is continuously increasing. Cumulating the issues determined by the sanitary system's under-financing with the exodus of specialist doctors we reach the conclusion that the health care system urgently needs undertaking some real measures in order to diminish the negative effects and to improve the services provided to patients.*

*In order to achieve these goals, the main objective of this paper is to identify the causes which determine the international migration of Romanian doctors and to elaborate a series of recommendations which would be useful in solving some problems generated by the lack of health care staff.*

**Key words:** sanitary system, health care staff, workforce migration, European salary, health care services.

**J.E.L Classification:** F22, I15

### 1. Introduction

One of the economic environment globalization's positive effects was the liberalization of world trade, goods and services, including the workforce. Surpassing the issues generated at a global scale, the workforce migration phenomenon has considerably developed and this is to be

noticed in national and international statistics.

The migration phenomenon manifests as a process of shifting a part of the active population towards economically developed areas in order to find proper workplaces which would be better paid as compared to the national salaries [1].

The economic factor has always been considered the main cause of migration. This factor determines two immigrant categories in the European Union: highly prepared immigrants (doctors, for example) who can contribute to economic growth, on the one hand and those who are not professionally prepared and accomplish activities specific to unskilled workers, on the other hand. Although the last few years hadn't been favorable to economic development, there still exist some countries which have managed to balance the work market, becoming more and more attractive to immigrants. However, beyond the positive aspects of working elsewhere (for example, the improvement of life quality, the growth of the living standard, the social development etc.) we should take into consideration the repercussions of the migration phenomenon, especially at a macroeconomic level. This is also the case of Romania, which has become Europe's main workforce exporter in specific sectors of activity. One of these sectors is the health care system. The migration of medical staff (especially the migration of specialist doctors) has become an international problem, as many Eastern European countries reported a considerable increase in what regards the health care staff migration in the Western countries. In this new era of migration, regardless the country, doctors occupy a very important position, as their departure from that country is perceived as

“the migration of health quality”, because quality is a vital element in the medical field.

The medical staff migration phenomenon has continuously increased over the last few years in Romania, if we take into consideration that the effects of economic crisis are still present in the medical field. Being based on a strong motivation of leaving the country, many Romanian doctors chose to do their job under better circumstances offered by countries with greatly developed sanitary systems, such as Germany, Spain, France or Great Britain. It is obvious that this thing was the equivalent of significant losses for the entire Romanian health care system. This phenomenon has led to medical staff deficits in some areas, especially rural ones.

## **2. Romania – Europe’s main doctors exporter**

The numerous deficiencies of Romania’s health care system has led, over the last three years, to a growth in what regards the requests of working abroad, coming from the part of doctors and medical aids.

This high amount of requests is due to the fact that Romania and its health care system aren’t points of attraction anymore and, moreover, they are discouraged. The insufficient funds of the hospitals, the lack of professional medical equipment (there are many medical units which do not possess the equipment they need and there are others which do not have even the basic medical tools, such as medicaments and bandages) and the unattractive salary are just few of the causes which determine the Romanian doctors to move abroad. Besides the financial reasons mentioned above, there are also some non-financial motivations such as the possibility of working or demonstrating their professionalism in a place where they are respected and appreciated and where they are offered all the necessary work conditions. If we take into consideration causes such as the doctors’ professionalism (because they would not leave the country if they weren’t able to adapt to other development systems), the impossibility of putting into practice all knowledge apprehended during all the years of study or the political conflictive situation which is transferred to the sanitary system (causes which have been identified by the

Romanian College of Physicians) we understand why the number of emigrants faces a continuous growth.

Statistics show that the great majority of those who have already received certificates of conformity in order to work abroad fall into the 35-50 years old category. Therefore, the Romanian sanitary system lacks experienced doctors.

All costs which appear as a result of the long period of majoring in a specific medicine branch should represent a long term investment for Romania. Unfortunately, the sanitary system does not have the ability of keeping its doctors, assuring the health of the human capital. This is also to be observed by specialists in the medical field; in this sense, Dr. Ionel Sinescu, the new rector of “Carol Davila” Bucharest University of Medicine and Pharmacy, said that “in the context in which the state pays 8.000 Euros for six years of study per medicine student, the loss that the state undertakes by doctors’ migration is huge”. The calculation shows that there are approximately 64 million Euros corresponding to the departure of the 8.000 doctors which have left the Romanian sanitary system starting from 2007 until the present day. The President of the Romanian College of Physicians also noticed the fact that the losses are highly significant for our country, recently saying that “if the situation continues to develop in the same direction, we will reach the negative level of having highly equipped hospitals functioning only as museums. They would be visited by patients, but they wouldn’t provide any medical assistance”. According to his ideas, “we invest in individuals, but we do not possess the knowledge of keeping them in the country”.

Looking back to 2010, we notice that from the total of 40.000 doctors with practice license, almost 2.800 requested professional certificates of conformity in order to work abroad. 2011 registers, in this sense, a number of approximately 2000 primary and specialist doctors migrating abroad because of the Romanian sanitary system’s under-financing.

The main medical branches that Romania lacks specialists are General Medicine, Family Medicine and General Surgery, most doctors wanting to leave abroad coming from Bucharest. Because of doctors’ exodus we

face the situation of having some branches left uncovered.

Starting from 2000 we have been registering increases of number of doctors per inhabitant in all European countries (with only one exception: the Slovak Republic). The average of the EU member states indicates a growth of density in what regards the number of doctors with a rate of 1.5% per year. Currently, the numbers show an average between 3.3-3.5% doctors/1000 inhabitants at a European level. It is obvious that in the context of a massive emigration, Romania is under average (with a percent of 1.9 doctors/1000 inhabitants).

### 3. The work offer in the health care system at the EU level

The liberalization of workforce circulation has brought a series of advantages for many EU member states.

At a European level, the work offer in health care specialists' domain is extremely disproportioned, as there is a surplus in many countries, while other countries face a lack of workforce. In 2008, Greece had the highest number of doctors per number of inhabitants, with an average of 6 doctors per 1000 inhabitants, almost twice the EU's average. Austria, Italy and Norway had at least 4 doctors per 1000 inhabitants. In what regards this average, Turkey, Poland and Romania have the lowest values [3].

Table 1: Number of physicians related to 100.000 inhabitants in some EU's countries, in 2008

Year 2008	
Bulgaria	Croatia
360.47	266.12
Hungary	Greece
309.06	601.05
Slovenia	Norway
238.01	400.65
Germany	Italy
365.74	412.54
Poland	Romania
216.17	221.43

Source: National Institute for Public Health [4]

Table 2: Number of physicians related to 100.000 inhabitants in some EU's countries, in 2009

Year 2009				
Austria	France	Latvia	Portugal	Spain
467.81	344.15	299.49	367.10	354.02

Source: National Institute for Public Health [4]

It is estimated that over the next few years there will be approximately 10.000 physicians choosing to work abroad. This will have devastating effects for the Romanian sanitary system. The main countries that Romanian doctors choose to emigrate to are France, Great Britain and Germany.

The situation is getting worse and Romania avoids taking measures in order to keep its physicians.

The last few years had been characterized by the development of a significant workforce recruiting companies which help the health care staff to find better paid jobs abroad.

Manpower Romania is one of the leaders in the domain of human resources. The company is specialized in permanent, temporary and contractual recruiting, based on assessing, evaluating, professional development, externalization and consultancy in the HR field [6].

Manpower Company is currently developing a special project of recruiting Romanian physicians from the medical field for jobs in France (Manpower Professional Romania is developed in collaboration with a specialized team belonging to Manpower Professional France).

This project refers to workplaces in pediatrics, radiology, internal medicine and work medicine. These workplaces are based on a permanent employment contract; this is the reason why these types of jobs are dedicated to those who want a permanent relocation in France. At the same time, it is good to know that a French physician earns 4300 Euros a month. But this level can be achieved only if that specialist is registered to

the Council of the *Ordre des Médecins* in France.

Because of salary decreases, a resident physician earns as much as 680lei/month in Romania, while in the European Union the average is 1200Euros; in Romania, a specialist physician earns approximately 500Euros/month, while the European average is of 7000Euros/month. However, Romanian physicians can also choose the private environment. They have the possibility of being employed or to develop their own business in the health care field. The spokesman of Manpower Company declared that “in the private sector, the salary level is superior to that obtained in the public sector, varying according to institution, specialization (residency) or the candidate’s experience”. However, there is a problem which can stand in the way of obtaining a job in France: the candidates are required to be advanced French speakers.

Generally, the process of hiring abroad has various different features according to country, as the recognition of diplomas and specializations obtained in the country of origin undergoes different methods of being accomplished. In the case of physicians, the situation is a little bit different, in the sense that for applying for a job abroad they get their diplomas recognized only on the base of some certificates of conformity. Besides all the necessary documents, it’s possible for some countries (Italy, for example) to focus on the candidate’s experience in the field or to request a residency stage when needed (in case of major differences between the programs of the two countries).

Taking advantage of the opportunity of migrating to countries where they could earn financial benefits and other benefits, there is only one dilemma for the Romanian physicians: “should I leave the country for working in better conditions or should I remain in a less efficient system?”

#### **4. Conclusions and recommendations regarding the developing and putting into practice of various measures of reducing the health care staff’s migration**

In order to diminish the health care workforce migration, The Ministry of Public Health, in its quality main regulation organism of Romania’s sanitary system, has

developed a series of measures such as: decentralizing the residency by giving the medicine students the possibility of working in both public and private health care units or with family doctors.

Taking into account the fact that the number of physicians choosing to leave the Romanian medical system hasn’t changed, but it is continuously increasing, we consider that it is necessary to make a warn in this sense. The improvement of health care services’ quality has become the main objective of all efficient medical systems. We, as direct beneficiaries of the services provided by the Romanian sanitary system, are all interested in the ways of improving this sector. On one hand, these are not luxury services, as all citizens should have access to them. On the other hand, health services cannot be substituted according to preference. Their quality should be permanently assessed, because it is impossible to preserve a specific type of service, of a specific quality, in order to reuse it later, when we really need it.

A first step on the path of obtaining health services quality is building a highly effective system, consisting of subsystems and components which would collaborate in an efficient manner in order to provide a good functioning of the whole system. Romania still faces a series of problems when it comes to achieving this goal, because the sanitary system functions with independent sectors and the primary assistance is not related to that provided by hospitals; there aren’t any obvious relationships between the health promoting assistance and the curative one. It is obvious that the effects reflect upon the entire society. The specialist in this field underline the fact that we face a major problem by not integrating the health services in the sanitary system and this issue should be rapidly solved. From our point of view, a good development and coordination of activities from the entire health care system (at a both macroeconomic and microeconomic level) represent a good motivation for young practitioners.

We are aware of the fact that in the actual economic context the Romanian medical system cannot offer physicians a proper income in order to remunerate their work (before and after becoming physicians) and the responsibility they have in what regards

the patients and the entire society. However, we consider that keeping our specialists in this sensitive and highly disturbed system is a vital thing for the future of the Romanian health care system. Regardless the age or experience, a good salary is an enough motivation for our doctors and they could be persuaded to remain in the country where they studied. However, this goal cannot be achieved immediately, but the salaries could be progressively increased over the next few years.

Another recommendation we consider extremely important is that of creating a safe workplace, in the sense of paying malpractice polices by the health care unit where the doctor works.

The development of a strategy referring to keeping the doctors from leaving abroad, with highly defined objectives, must be done as soon as possible in order to improve the Romanian medical system.

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**Section II**  
**Business Economy and Administration**

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**Subsection 2**  
**Marketing – Management**

# Apprenticeship Fee, Entrepreneurial Skills and Small Scale Enterprises in Nigeria

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## Abstract

*Nigeria is not exempted with the present global issue with the focus on reducing poverty level using local content. This paper focus on apprenticeship fee, entrepreneurial skill through training and small Scale Enterprises in Nigeria as countries differs so the appropriate solution differs. The technique adopted is ordinary least square method using binary probit model to analyse primarily sourced data. The financial constraint remains of the major problem facing SSE and government at all level need to design programme to address recent economy issues.*

**Keywords:** Apprenticeship, Entrepreneurial Skills, Small Scale Enterprises

**JEL Codes:** J39, M53, L26

## 1.Introduction

In Nigeria the traditional commercial banks have not been able to provide the necessary finance for the SSEs, because of the latter's inability to offer physical collateral, among other reasons. Thus, local finance organizations which are able to acquire information about entrepreneurs' characteristics at a lower cost than the banks have therefore been promoted as a method of enabling the small scale enterprises to acquire productive capital. However, many

of the credit organizations in Nigeria, for instance, Lift Above Poverty Organization (LAPO), Co-operative and Credit thrift societies, and other micro-credit institutions that make only small loans have also failed owing largely to high default rates. This corroborates the studies of Yaron (1992) which on different countries found out that, although many programmes have been instituted in support of SSEs in a bid to providing credit in many developing countries, success has always eluded them.

Based on the foregoing, the role of apprenticeship comes to play in the development of informal financial markets available to the SSEs. First, if entrepreneurs charge fees to train apprentices, this can form a substantive source of working capital finance to the SSEs, and second, the labour of the apprentices whether they are charged fees or not constitute a cost of production which might have important ramification for credit markets. In fact in many of the SSEs the proportion of apprenticeship to total labour force of SSE has been found to be as high as 91 percent (Olaniyan, 2000), thus the importance of this relationship between apprenticeship and SSEs in Nigeria.

In spite of the inherent contribution of the apprenticeship training to the SSEs in particular and the economy in general, the Nigerian government and policy makers have paid little or no attention to the effective functioning or growth of this institution. This little interest is predicated upon the belief that apprentices and the apprenticeship institutions are mere reservoir for potential

entrepreneurs. Given the above, this study aims at determining the relationship that exists between apprenticeship Fees in the SSEs and credit markets in Nigeria.

### **2.1.Apprenticeship Training in Nigeria**

Apprenticeship training in Nigeria is such that is not based on any particularly defined rule. The organizational orientation of training under the apprenticeship system is basically informal, while the training in its entirety is carried out on-the-job. Basically the training contracts are informal and verbal in nature. This is so because there are no clear-cut legal frameworks for the training of apprentices. In spite of the absence of a legal framework, the surviving apprenticeship contracts, undoubtedly represents a significant proportion of the population of training contracts, which encompass a vast majority of young teenage secondary school leavers. Drawing up an informal training contract is quite common in Nigeria, and an agreement signifying apprenticeship training in Nigeria often covers issues such as length of training; amount and mode of payment for training; the performance of freedom ceremony; and hours of work.

Although many agreements are made verbally, apprenticeship training contracts are entered into in the presence of a master craftsman or enterprise owner (as the case may be), the prospective apprentice and the parents or guardian of the prospective apprentice in the master-crafts man’s residence or workshop. The process largely follows a fairly established pattern, where certain conditions are negotiable, while others are rarely questioned. It is in this manner of contractual process that disputes arising over the fulfilment of obligations are often settled, without any recourse to legal or judicial authorities. After the recruitment of an apprentice, he or she is not considered in the enterprise as a worker with a definite hours of work at the inception, until a later period when he is thought of as a part and parcel of the enterprise, where he or she is expected to perform several other activities that are unrelated to the training agreement earlier reached. This is because the apprenticeship training system is considered by both the parents or guardian and the master crafts man or the enterprise owner to

be more than just a training, but a part of the traditional African setting and belief of a large process of bringing up a child (which is a part delegated to the enterprise owner or master crafts man). This process is what Mabawonku (1978) referred to as “fosterage”, since the pattern of training is not different even when blood relationship is involved.

The apprenticeship training in its entirety is carried out on-the-job through a hierarchy of authority with the master crafts man or the owner of the enterprise being the head and the sole issuer of authority, followed by the most senior apprentice or a graduated one who works as a journey-man, who in turn delegates or assigns works to be done to the junior apprentices and so on down the line of duty. The length of training of an apprentice in many small scale enterprises in Nigeria strictly depends on factors such as age, level of education and the type of trade that is to be learnt. The average length of training is noted by Ekpenyong and Nyong (1992) in their study of the auto repair and furniture sub-sector of the manufacturing sector to have ranged between three to six years. Also they reported that about 70% and 80% of workers in the small scale enterprises are in their teens and barely completed primary school education respectively. In the area of apprenticeship fees, quite a significant variation exists. Fees in many cases are charged arbitrarily with a few exceptions where trade associations are in existence. However there are enterprises where fees are not charged for the training of apprentices, where the reasons are largely due to inheritance and the motive of preserving their special family trade.

In Nigeria, apprenticeship training is a predominant means of transferring, selling and acquiring entrepreneurial skills, since there are little or no apprenticeship training ground in skilled crafts, professions and service trades. To further substantiate that the informal sector provides a training ground for future entrepreneurs through apprenticeship. Despite this, there exists no particular policy focussing on the training of apprentices per se, but there are programmes by the government that implicitly encourage apprenticeship training.

## 2.2. Small Scale Enterprises in Nigeria

Small Scale enterprises in Nigeria are characteristically different from other form of enterprises. These characteristics however are not very well known, in spite of the works of ILO (1972, 1985) and the de Soto (1989). Small Scale enterprises in Nigeria were relatively few before 1981, representing only 4.5% of enterprises in existence in 1970 and about 16.4% up to 1980 (see Abumere, et.al. 1998). The above assertion does not necessarily mean that SSEs in Nigeria are a recent phenomenon, but rather suggests a high mortality rate. The mid 80s however to date witnessed the proliferation of SSEs, which is attributable to the structural adjustment programme instituted by the then Federal Military Government.

The ownership structure of SSEs has been found to comprise 83.4% individually owned enterprises, which varies across towns and cities. The eastern part of Nigeria displays a sole ownership rate of 98.5%, while for the other parts of the country a sole ownership rate of at least 80% is common. (See Abumere et. al, 1998). Other forms of ownership in the SSEs in Nigeria such as partnerships, joint ventures, co-operatives and limited liability companies are negligible and sometimes non-existent. With respect to legal status and registration procedures, two approaches are in existence, .one formal registration with government and second with the appropriate association, union or guild.

In terms of finance, many studies on Nigeria recognised that SSEs source their funds and finance from both the formal and the informal financial and credit markets. The bulk of finance for the SSEs however is sourced from the informal markets. SSEs in Nigeria source funds through personal savings, rotational savings contribution (esusu) etc. (see Olaniyan et. al., 1998; Ekpenyong and Nyong, 1992, and Abumere et. al. 1995). The location of SSEs is another basic characteristic that is peculiar to Nigeria. Many of these small entrepreneurs use their residences as workshops, offices and shops (as the case may be). This location pattern cuts across both the rural and the urban areas. There are however other locations where small scale enterprises carry out their activities. These include, the market place,

the streets, specially built workshops and in some cases open spaces.

## 3.0 Methodology

### 3.1.1. Model Specification

In order to examine the impact of credit markets on apprenticeship in Nigeria, we specify a binary probit model. The model is to help examine the influence of capital market features as well as other performance variables on the probability that a firm charge fees to the apprentices. We denote this event for SSE  $i$  by a dichotomous variable ( $apprentice_i$ ) which equals 1 if the event occurs and 0 otherwise. Our model is expressed as follows:

$$Prob (apprentice_i = 1) = \phi (X_i' \beta)$$

Where  $X_i$  is a vector of explanatory variables taken to influence the probability of charging apprentice fees.  $\beta$  denotes a vector of unknown parameters to be estimated and  $\phi$  (.) denotes the standard normal cumulative distribution function.

The explanatory variables include the following: Capital market behaviour dummies (The dummies variables take the value of 1 if the variable holds and 0 if otherwise.). This includes, whether firms holds a bank account; whether firms has ever received bank credit; whether firms received informal credit; and whether firms receive advance payments for goods or services. Sector Dummies (The dummies variables take the value of 1 if the variable holds). These include, manufacturing; and services

### 3.1.2. Data and Sampling Approach

The data used for this study are drawn from a survey of small-scale enterprises in manufacturing and services business in Nigeria. Our small-scale enterprise is defined in terms of employment. This is because it is easy to apply and that it is closely correlated to size measured in terms of capital or output (see Little, 1987). We define a small-scale enterprise as a business employing 0 to 25 workers including owner, apprentices, and workers (both paid and unpaid). This study employs primary data, derived through the

administration of questionnaires in a survey as described above. This is however complemented with a Focus Group Discussion in order to give more meaning to the result obtained from the survey.

The Population for this study comprised all small-scale enterprises in Nigeria. For the sake of an in depth study, we have limited our study sample to the South-Western Nigeria. Our choice of states was based on factors such as cultural homogeneity, geographical proximity, prevalence of trade and the demand for the acquired skills as well as the cosmopolitan nature of the two states in terms of literacy level and urbanization. A total of 1500 questionnaires were administered on enterprises in the services and the manufacturing sectors. In order to avoid systematic errors in collecting the data, we started by identifying the SSEs. The list for all SSEs operating in each of the sub-sector identified above was collected from the local association of operators of each sub-sector<sup>1</sup>. Thereafter, firms were randomly chosen from the list of registered firms. Our interest has been narrowed down to three main sub-sectors viz. Textile and garment, metal work SSEs (e.g. Welders, Iron benders and tinkering,) and Artisans (e.g. Barbers, Hair dressers and Mechanics). These are grouped into manufacturing SSEs and services SSEs.

The sampling of the cases was carried out by way of systematic random sampling, where the first respondent was chosen at random from the list of SSEs, while the next respondent was selected after an interval of five SSEs. The urban centres were chosen using the purposive sampling method based on the prevalence of a special trade and also to cater for the macro economic impact of policies directed towards SSEs.

There are two sets of questionnaires. The first one is the enterprise owner/master questionnaire while the second is the apprentice questionnaire. The owner

questionnaire was administered on the entrepreneur, and the apprentice questionnaire was administered on the most senior apprentice. The owner questionnaire seeks to obtain the following information; Nature and characteristics of business enterprise; Enterprise owner characteristics; Apprenticeship (number, fees charged, allowances paid, apprenticeship labour; and Sources of finance and working capital and relationship with the credit market. The second questionnaire, which is the apprentice questionnaire, seeks to obtain information on the background of individual apprentice, the nature of contracts and the source of finance for training. In administering the questionnaire, we placed no restriction on the legal status of the SSE. However, the self-employed with no fixed place of business were excluded.

#### **4.0 Findings**

##### **4.1.1 Focus Group Discussion (FGD)**

Focus Group Discussions (FGD) was organized to complement the information obtained through the administration of questionnaire. It consisted of some numbers of unstructured interviews meant to address the motives and the incentives for entrepreneurs and apprentices in the labour and the training market. One of the key elements of the group session method is the selection of participants. In this regard, entrepreneurs and apprentices were carefully selected in some selected manufacturing and services firms in each of the sampled states. Trained moderators, experienced with groups of this kind, led discussions in each state. The moderators followed the topic guide that ensures that the same subject matter is discussed in each state. However, it is worthy to mention that the discussion guide was not meant to be a full-fledged questionnaire, nor to be followed rigidly by the group moderators. It was an aide-memoir to be referred to by the moderators. In specific terms, the discussion centred on the following issues:

##### **Recruitment process**

In most cases, the would-be trainee signifies his or her own intention to train under a particular master-craftsman or trainer. The decision is taken at the family level and conveyed to the trainer who accepts or rejects the trainee depending on whether

<sup>1</sup> Our initial survey shows that the lists from the association's of specific SSEs are more comprehensive than the one with the Ministry of Trade and Commerce. Since the list from the ministry does not exhaust the population of SSE any sub sample chosen based on the list (and by extension the sample) would not be random.

or not the basic terms of the contract are fulfilled by the trainee and his or her parents or guardian. On the part of the entrepreneurs, the motive or the incentives for recruiting apprentices include among others, labour supply potentials, fund, raising family relationships and continuity or preservation of particular trade or skills. On the part of apprentices, the desire to undergo apprenticeship training revolves around the need for a means of livelihood and the attractiveness of a particular trade, craft, or skill (i.e. the expected rate of return).

### **The Contract**

The contract specifies the obligations of the trainee, his parents and the master craftsman. It covers issues like length of training, amount and mode of payment for training, hours of work, performance of the freedom ceremony etc. It may be verbal or written. Violations of the contractual agreement is settled without any recourse to legal or any judicial authorities as earlier on stated. Such settlements are made by the officers of associations of specific SSEs. Normally each association has a set of rules and regulations which guide the activities of each member. Whether an apprentice will stay with the master throughout the course of his training depends on his ability to endure and submit himself to the discipline peculiar to the training, his determination to succeed in life, the degree to which the master can accommodate him and parental support and encouragement. His apprenticeship life-cycle depends on his age, and his ability to learn and internalize the skill imparted. Whether the apprentice will be retained after training depends on his output, his willingness to remain with the master and his moral character.

### **Perception of the labour and the training market**

Entrepreneurs are of the opinion that there are many opportunities for both apprentices and master craftsmen who distinguish themselves in their chosen skills or trade so long as there is increased demand for their goods and services. The same opinion was expressed by the apprentices citing their masters as examples.

### **4.1.2 Result Analysis**

For our analysis a firm is considered to have received credit if he takes bank loan, cooperative loan or gets credit from money lenders while he is considered otherwise if he gets fund from advance payment for jobs or through non-loan source. From the first estimation result, firms that charge apprenticeship fees have been found to be less likely to involve in taking any form of loan-able fund that is they indicate limited use of the credit market as a source of their working capital finance. This result shows a significant correlation between the independent variable, particularly that which relates to the credit market (see Table 1). This result indicate that a relationship exist between credit market behaviour and the use of apprenticeship fees. Also there was a negative relationship exist between the credit market behaviour of small-scale manufacturing SSEs and apprenticeship fees. Thus SSEs who charge apprenticeship fees are less likely to source loans from the credit markets and vice versa. This is illustrated by the negative sign of the estimated coefficients, (see Table 2). The estimates and the t- statistic are both significant at 5% and 1% levels. In an attempt to run the probit for the services sub-sector to ascertain whether there is any relationship between the charging of fees and credit market behaviour was not successful owing to the fact that the dependent variable was not having any variance, hence the conclusion does hold for the services sector in this study.

#### **Estimation 1. Probit Regression of apprenticeship variable on credit market behaviour of owners.- Full sample**

=====  
=====  
Dependent Variable: CREDIT  
Method: ML - Binary Probit  
Sample: 1 1500  
Included observations: 1500  
Convergence achieved after 4 iterations

Covariance matrix computed using second derivatives

```

=====
=====
Variable   Coefficient Std. Errors-Statistic
Prob.
=====
=====
      APPFEE   -1.308247  0.057376  -
22.80110  0.0000
=====
=====
Mean dependent var  0.087000  S.D.
dependent var 0.281976
S.E. of regression  0.317492  Akaike info
criteri0.698271
Sum squared resid  100.7007  Schwarz
criterion  0.703178
Log likelihood  -348.1353  Hannan-
Quinn criter0.700136
Avg. log likelihood -0.348135
=====
=====
Obs with Dep=0      1313  Total obs
1500
Obs with Dep=1      187
=====
=====

```

**Estimation 2. Probit Regression of apprenticeship variable on credit market behaviour of owners.- manufacturing Sector sample.**

```

=====
=====
Dependent Variable: CREDIT1
Method: ML - Binary Probit
Sample: 1 1460
Included observations: 1460
Convergence achieved after 3 iterations
Covariance matrix computed using second
derivatives
=====
=====
Variable   Coefficient Std. Errorz-
Statistic Prob.
=====
=====
      APPFEE1   -0.726158  0.071608  -
10.14076  0.0000
=====
=====
Mean dependent var  0.189130  S.D.
dependent var 0.392039

```

```

S.E. of regression  0.439482  Akaike info
criteri1.149270
Sum squared resid  88.65323  Schwarz
criterion  1.158251
Log likelihood  -263.3320  Hannan-
Quinn criter1.152806
Avg. log likelihood -0.572461
=====
=====
Obs with Dep=0      1273  Total obs
1460
Obs with Dep=1      187
=====
=====

```

**5. Conclusions**

It could also be observed that apprentices are very important to SSEs because they do not have to be paid. Specifically, the study analyzed the effects of apprenticeship training on the credit market behaviour of firms that train apprentices. It reveals that apprenticeship fees constitute an insignificant proportion of the working capital finance of SSEs. Furthermore it shows that the firms that train apprentices source fund from the credit markets both formal and informal. However, firms who charge fees participate more actively in the informal credit market than those who do not charge fees. Also firms who do not charge fees participate more actively in the formal credit market than those that charge fees. In addition, our analysis also reveals that large SSEs have more access to loans compared to smaller SSEs who rely heavily on non-loan sources of finance. Besides, SSEs in the manufacturing sub-sector have more access to loans than their services sector counterparts. It is however noted that SSEs still face finance constraints, despite, their potential benefits in terms of skill generation and industrial development. It is therefore important that programmes of assistance are designed for SSEs in Nigeria if their full advantages/ potentials must be realised.

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## Relationship Types on the Romanian Vegetable Chain

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### Abstract

*The paper studies the role of business relationships in the Romanian vegetable supply chain. In this respect, the paper draws on Williamson's governance structure of non formal relationship and formal relationship existing between farmers and buyers in order to see what type of contractual relationship is prevalent in the vegetable supply chain. The analysis reveals that informal contractual relationships are prevalent on the market while in many cases the contractual enforcement is at stake.*

*The paper employs a qualitative analysis based on structured questionnaires in order to assess the type of contractual relationship between parts.*

**Key words:** contractual relationship, vegetable, supply chain

**J.E.L. Classification:** Q13

### 1. Introducere

Although several studies were carried out in order to study the type of contractual relationship and the vegetable commercialization channel at the European level, there is no empirical evidence about Romania. The analysis is necessary to assess the needs and constraints of the stakeholders involved both at farmer-wholesaler-processor level and processor-retailer level.

As far as it concerns the contractual relationships, there is a typology of relationship produced by a matrix of different strategic options of vertical co-ordination and relationship-specific characteristics (e.g., independence, exclusivity), [1]. Gorton shows that relationships become more complex with increasing level of formality and of vertical co-ordination. While price, supply and demand are at the core of spot market relationships, property rights, trust

and negotiations increase with growing vertical collaboration.

The paper uses Williamson's governance structures, [2] and accordingly two relationship types, formal and non-formal are described:

Non-formal relationship types:

- Spot or 'open' markets (immediate transaction at actual prices),
- Repeated market transactions with the same buyer/supplier with non-formal, non-written contracts.

Formal relationship types:

Formal (written) bilateral contracts (contract terms and obligations are legally enforceable).

Financial participation arrangements (both parties are legally independent entities).

In the last 20 years, the vegetable supply chain in Romania experienced a dramatic evolution following the destruction of the former fruit and vegetable commercialization companies which led to the year-round domestic vegetable supply failure and production fragmentation.

Moreover, stricter quality requirements imposed by large chains are hardly met by small scale farmer but even though when these requirements are met by larger farmers the contractual terms are not respected, or even worse the hypermarkets avoid concluding the contract. Also, the main problem the farmers have claimed that they have to face is the non-execution of concluded contracts.

### 2. Data collection and methodology

The paper is based on data provided by 30 farmers and 8 processors located in the S-E region of Romania following a survey conducted in this region in 2007. In total, 30 structured questionnaires were applied to farmers and 10 questionnaires to processors. The analysis is mainly a qualitative one and takes into consideration stakeholder answers

to the questions regarding the type of existing contractual relationship along with a set of questions regarding their main commercialization channels. An open comment has been also introduced in the questionnaire.

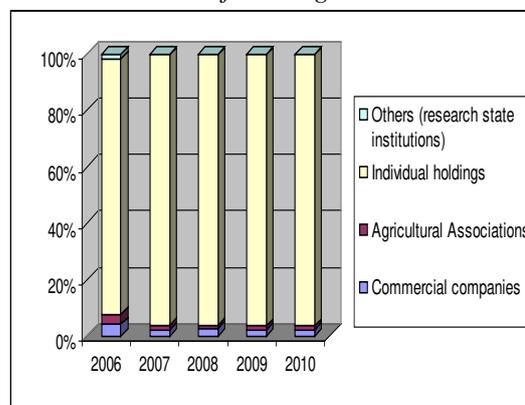
In valoric terms, in 2010, the production of vegetables accounted for 24% of the total crop production value. Nevertheless, following the EU integration, the vegetable supply chain seems the most negatively affected sector, due to the high share of imports and the farmers’ impossibility or incapacity to maintain stable contractual relationship within the chain. In addition, many of them are not able to enter or form producers’ groups either because of lack of trust or willingness to cooperate. The high fragmentation and dispersion of cultivated areas (especially for field vegetables) is a result of the reinstatement of the private property in agriculture after 1990. The high number of existing plots creates major limitations for technological upgrade (agricultural works, production structure, professional training of farmers, etc) and the increase of the production costs. On the other hand due to the lack of experience in using insurance instruments any negative climate phenomena, diseases or pest attack create a direct loss for the producer. At the same time the large number of farms producing primarily for own consumption but also selling part of the harvest from their doorsteps or via unofficial selling points do not allow a clear separation between commercial and subsistence farming and consequently makes it difficult to implement a coherent fiscal policy.

All these factors have a direct influence on fluctuations of farmers’ income, promotion of consumption, and enhancement of the environmental safeguards as well as a strong impact on the improvement of the competitiveness and market orientation of the fruit and vegetable sector.

The land area under vegetables accounted for 3.3% of total cultivated arable area in the year 2010. At the European Union level, the share of area under vegetables is quite similar; the difference is that currently in Romania the consumption needs are not fully covered by the current domestic supply. In the year 2008, the main cultivated vegetables were the following: tomatoes 18%, cabbage

17.7%, and dry onion 14%. The individual holdings have the highest share in the cultivated areas in the vegetables sector (over 95%) (Figure 1).

Figure 1: Share of cultivated areas by types of holdings



Source: MAFRD, 2008

The figure depicts the situation at national level; in the region where the analysis was carried out, the vegetable production is also obtained in the individual holdings (more than 96%).

The methodology used is based on statistical analysis of the stakeholders’ answers to the questions addressed in a structured questionnaire. The description of the methodology and the data collection methods were structured as a set of criteria and questions that were answered and analysed by employing the structure proposed by Williamson’s governance structures.

### 3. Empirical findings

#### 3.1 Contractual relationships

The relationships types as described by Williams are classified into 2 categories, namely formal and non-formal. Respondents were asked to present which type of contractual relationships they use in their business and further, they were asked to choose more than one of the four relationships, i.d. spot market, repeated market transaction, formal-written contracts, and financial participation arrangements.

Table 1: Percentage of formal relationship

	Farmer– buyer (wholesale r)	Farmer- process or	Processo r- retailer
Formal relationships %	1/30 3%	2/30 6%	1/8 12.5%

Source: Field survey, 2008

Table 1 reveals the relationship type for the three chain stages. The answers show that the percentage of formal relationship is extremely low both at farmer-wholesaler level and farmer-processor stage. A higher percentage of formal relationship can be noticed in the case of processor-retailer level. The formal relationships include formal written contracts and financial participation arrangements, including prices, qualities, quantities and any other financial support. Retailers tend to choose more formal relationships with processors, in comparison with farmers, showing that downstream businesses are more likely to coordinate and organize their relationships more systematically and in a standardized way. Similar findings are also presented at the European level [3], with the difference that the percentages are much lower in Romania’s case, especially at the farmer-buyer and farmer–processor level. As far as the relationship and contractual aspects are concerned, the respondents were asked to rate on a scale from 1 to 4 (1: extremely poor to 4: very good) their opinions on the following aspects concerning: the quality of the relationship, trust, contractual terms and the level of enforcement of the contracts. Table 2 reveals the answers of the interviewed stakeholders.

Table 2. Farmer-buyer relationship and contractual aspects

	Very good	Good	Poor	Very poor
The history relationship with the buyer is	7%	13%	33%	50%
The respect of contractual terms	0%	13%	43%	43%
The trust in our partner is	3%	13%	33%	50%
The enforcement of this contract is	0%	10%	37%	53%

Source: own calculations

The enforcement of the contract is seen as the biggest problem the farmers have to face, 53% of them answering that the enforcement of the contract is extremely poor. The level of trust in partners and the history relationships are seen as poor and extremely poor. Also the farmers suggested that there is no real enforcement of contracts. The structure of contract is taken in consideration in the analysis. This category includes practically all the aspects concerning prices and payment mechanism.

Table 3. Processor-retailer relationship and contractual aspects

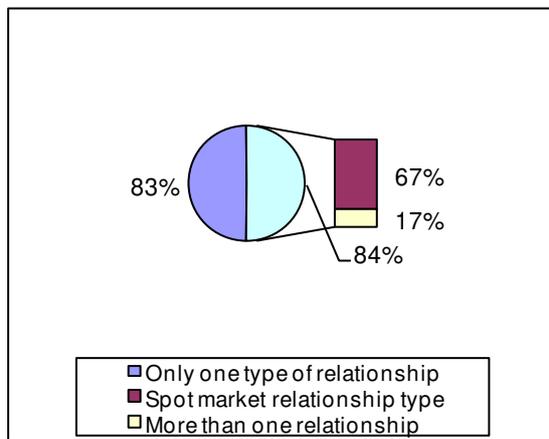
Source: own calculation based on field survey

	Very good	Good	Poor	Very poor
The history relationship with the buyer is	0%	23%	60%	17%
The respect of contractual terms is	0%	23%	75%	20%
The trust in our partner is	0%	20%	60%	20%
The enforcement of this contract is	0%	13%	60%	27%

The relationship and contractual aspects at the processor-retailer level were assessed in a better light by the respondents, but still there is a lack of trust and a bad enforcement of contracts among stakeholders.

Farmers were also asked to choose the type of relationship they are involved. 67% of them are involved only in a spot market relationship (sale at the farm gate to different wholesalers) while the rest might choose some other relationships (repeated market transactions, formal contracts, and financial participation). 83% of them are involved in only one type relationship while 17% are involved in more than one relationship type (Figure 2).

Figure 2: Relationship types



Source: farm survey 2010

Another problem reported by the respondents, is represented by imports, the quality of which is not rigorously checked at present. For many vegetables, production has a seasonal nature, and the products have to be consumed immediately after harvesting. That is why the prices greatly fluctuate throughout the year. In general, immediately after harvesting begins, prices go down fast. For example, the prices of tomatoes, eggplants and peppers may decrease by up to 50% in 2 weeks.

As long as the area under heated glasshouses is low, the producers cannot benefit from the high prices during the winter; in this period of the year, most vegetables come from imports, mainly from Greece, Netherlands and Turkey.

#### 4. Conclusions

Effective business relationships can help to reduce environmental uncertainty (e.g., by securing a more stable inflow of orders); contribute to better access to crucial resources (e.g., raw materials, capital, specialised skills); and/or result in higher business productivity (e.g., by enhancing loyalty among suppliers), [5].

Nevertheless, the results obtained reveal that in Romania's case there is a high degree of uncertainty among stakeholders both in terms of contractual relationships and contract enforcement. The share of contractual relationship is higher at the processing-retailing level which is in line with the EU findings, but much lower than in the EU both for the farmer-buyer and the processor-retailer level.

This sector lacked a coherent strategy in the period 2000-2007, being characterized by the diminution of the capacity to face the market competition. At the same time, as a result of Romania's joining the EU, its competitors from the EU both in the production and processing sector are testing the Romanian market; in case the Romanian vegetable sector is not able to get reorganized and benefit from the established intervention measures, it will not be able to face the strong competition coming from the Single Market and not only.

#### Acknowledgments

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## Strategic Directions in Business Services

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### Abstract

*Recently, business services are experiencing an important growing, explained by several phenomena such as urbanization, increased demand for services, technologic progress, trade liberalization and trade development. On the other hand, the phenomenon of business services expansion is supported and substantiated by appropriate strategies. Service companies are able to adopt strategies to increase the use of internal development, external development or choose a combination thereof.*

**Key words:** business, services, expansion, strategy.

**J.E.L.Clasification:** L 24, L84, G34

### 1. Introduction

The continuous development and diversification of the global economy structures, the extension of technical progress and anchoring in everyday life are just some of the elements that favored the affirmation and development of services, encouraged a greater participation in to various business processes and increased their role in the economy. Position of services sector in today's world economies is the result of a complex evolutionary process, supported by profound changes in economic and social life. The importance of services and their position in the national economic system are bounded closely with economic growth and social development as a condition of entire modern society development.

The increasing presence or services in the economic and social life, along with

reconsidering labor character in this sensitive sector of the economy, lead to a unanimous opinion of specialists in the field in recognition the services as a factor of progress, enabled to stimulate the economic growth. Many economists characterize today's world as a society of services, arguing that the share of services in employment and the creation of gross domestic product (GDP), exceeds 70% in the developed countries. In these conditions we discuss more and more often about the tertiary tendency of modern economy, the service sector being considered as the "engine" of economic growth.

### 2. Points of View in Expanding the Services

Trying to explain the phenomenon of expansion of services business, literature brings together many viewpoints and many determinants. According to some authors, a category of determinants such as *urbanization* - this phenomenon is followed by an increase in consumption of services - , *low labor productivity* - explained by relative productivity of services in many countries (the ratio between the share of services in GDP and the labor force in service sector relative to working population), that registered high values, sustained growth and expansion of technical progress in the branches of service -, *factors endowment* - mainly cheaper labor in developing countries and of course, cheaper services[1] -, the role of government - revealed as implementation of some welfare programs (in health care, education, etc..) in developed countries and as governmental institutions in developing countries, resultins numerous jobs in the service sector.

A study of Canadian Economic Council[2] estimates as the first determinant of business expansion in services: *increased demand for services* along with *technological evolution, increasing the complexity of tasks* that requires specialized enterprises, *trade liberalization and foreign trade development*, leading to new opportunities for firms that provides services, *increasing demand for industrialized services* as a consequence of higher living standards, implying services as: food, entertainment, recreation, personal services, *increasing demand for public services*, as companies are aware of the importance of protecting and investing in human capital.

The opinion of other authors regarding factors that induce services business expansion, refers to: continuous growth in demand for services as a result of increasing incomes and based on expenses for services higher and higher every time; intensification of *outsourcing services*, due to: businesses attention is focused on core activities as a result to increased competition, total costs are reduced as a request from companies providing services, the need to use specialized knowledge to solve problems, access to additional resources such as skills, technology, management, recovery of capital; *technological development and its impact on productivity services*, low compared to other sectors of the economy, because services are less dependent on new technologies; *the emergence of services society* understood that a new society, pointed by a revolution in services, which is the binder between industrial society and new society development.

Millions of businesses are starting now worldwide, but business services, which have exploded in the recent years, are in the spotlight. Trying to define the concept of expansion, we enter the land of strategy, widely debated by the specialized literature.

As Business English Dictionary says, the expansion is a business strategy in which growth is achieved by increasing the number of stores from where customers can buy products or services of the company. This involves new stores opening in different physical locations, while maintaining the current location (business) [3].

On the other hand, the Oxford English Dictionary gives the following meanings of

the concept of expansion, namely: (1) the action of getting bigger and larger, (2) small increase in industry and (3) political strategy to expand the territory of a State.

We notice that both definitions have a common denominator, namely strategy, which is one of the concepts most used today, generally due to the growth economic and social complexity, but also to highly dynamic aspect of contemporary society and to the increasing national and global competition.

The concept of strategy was undertaken by economists from the military area, where it targets enemy destruction through effective use of resources. In the literature there are a relatively large number of definitions of strategy, but most of them converge to the idea that "*strategy is a plan to know how to act in an uncertain future circumstances*" [4]. This involves a set of rules on actions to be performed under certain circumstances. Other definitions capture the following strategy's issues:

"*A strategy is a model or plan that integrates the major goals of the organization, its policies and sequential actions in a whole*"[5].

"*Strategy is not only a general point of view, but that particular configuration of activities to be taken by a company compared to its rivals*"[6].

The importance of strategy is outlined and assessed by the difficulties as cause of its absence; ignoring strategy is a source of business failure. These difficulties relate to two aspects: the emergence of strategic gaps and the organizational fragmentation. Strategic discrepancies relate to serious backlogs that the organization, industry or country can register. Organizational fragmentation is effect attracted by the lack of strategy identified as the danger that each branch, organization, department to act autonomously, in different directions and mutually disturbing activity. In other words, the strategy "*acts like a powerful magnet to unify all entities for the same purpose*", obtaining synergistic effect [7].

Companies providing services establish their market strategy based on the objectives they pursue, their available resources and the development environment in which they operate. "*The strategy of a company providing services should be a coherent set*

*of key objectives on long term, together with main ways to achieve them, with the resources and time required and with the expected effects in terms of market competition, resulting from a broad and deep review process of internal and external environmental of the company providing services"*[8]. The main components of the strategy approached by company providing services are: premises, mission, goals, strategic alternatives, strategic directions, resources, time, competitive advantage.

### 3. Strategies of Growth Means in Business Services

Companies providing service are able to adopt strategies to increase the use of internal development, external development or choose for a combination thereof. However, studies show that organizations prefer first the external development strategies, followed by paths used for a combination of external and internal development.

1. **Internal growth (organic)** is the classical way of self-increasing organization through: building new capacities, adding the means of production, research and distribution (built on the organization's own resources, namely: financial resources and human resources). The essential feature of organic development is reinvesting profits from previous years, but also appealing to financial resources provided by shareholders or banks. The organization reasons for such an option are focused on: the existence of strong demand for its products, launching new products such research, financial capabilities resulted from major self financing, human potential that can support the development of new products. The organization holds its own contractor, taking control in all its structures. The process is relatively slow, it refers, mainly to the provision of new working area, equipments and trained staff and it is supported on short and medium term by commercial relations of the organization with suppliers. The internal development is preferred by small and medium organizations due to situations such as: unavailability of partners for external development, managers want to keep control of the

organization, merger or acquisition is prevented by the high cost of land or unfavorable regulations, resources and skills are available internally, etc. This type of strategy is associated with both advantages and disadvantages. The advantages consist in the organization ability to choose: selecting the location of new buildings, purchase the most appropriate equipments, appropriate staffing, choosing those items that match what already exists, the risk being higher when they keep elements incorporated into a system that worked for a while. The disadvantages are related to long period of time to reach normal operating parameters of the new entity, the threats coming from the external environment changes.

### 2. **Merger and acquisition** (English Merger & Acquisition)

**The merger** is a transaction that involves the existence of two or more firms, which become a single company. Other generic definitions of this concept are: taking ownership of an asset by purchase; taking control of a company by buying at least 51% of portfolio shares [9]. The process between companies of similar size is "friendly" and consists of the union of all resources held by each organization in a new, larger organization, including the same ownership structure. The transaction is difficult and long-term, which is due to negotiations, evaluation and processing of all related operations.

**Acquisition** is a "marriage" between unequal partners, understood as purchase of a company by another company, the bought company being absorbed and its shareholders cease to own the new organization. If the two organizations were competing, the purchase is called horizontal integration, and if the two organizations were one another supplier or customer, the purchase is called vertical integration [10]. Acquisition can be "friendly", when there is consensus between the two entities; in order to maintain jobs and wage levels for managers of purchased company ,or may be "hostile" generating a war between the two organizations involved.

The reasons for adopting the strategy of mergers and acquisitions are numerous: growing market share in order to increased profits and more power to dictate the market

price, reducing competition, access to new technologies, achieving economies of scale.

The literature provides a classification of acquisitions and mergers, as follows [11]:

- vertical acquisition or merger, as purchase of a supplier or customer;
  - horizontal acquisition or merger, as buying a competitor;
  - product extension by acquiring a company to gain access to complementary products;
  - market-expansion by acquiring a company to gain access to complementary markets;
  - conglomerate, when there are no strategic links between the companies involved.
3. **Joint venture** is formation (temporarily) of a new organizational entity, in order to obtain a synergistic effect, keeping partners and judicial independence. This strategy is practiced particularly by organizations wishing to internationalize their businesses, between businesses who want to maintain independence and do not want to merge or when this is not legally possible. Joint ventures is practiced between private companies and public companies of residence state or of another state or at international level, between companies belonging to different national economies.
4. **Alliances** are long-term associations between several competitors or potential competitors who choose to join efforts to achieve a specific objective or project. Alliances allows keeping judicial identity and independence of organizations working together and are created especially to enter new markets. They are widespread in services and air passenger transport. As an example: Star Alliance, which includes Singapore Airlines, Lufthansa, United Airlines, Austrian Airlines, Turkish Airlines, etc. Alliances work as long as there is trust between partners, offering many advantages associated with the possible synergies: entering new markets, economies of scale, transfer of know-how, reduce costs, risks and uncertainty.

Although when they are speaking, managers worldwide say they intend to engage procurement activities, mergers and

acquisitions market is declining, characterized by caution, especially in China, India, U.S., Brazil and Indonesia.

Current economic environment provides companies cheap ways of funding, but lack of confidence in forecasting global economic recovery and long-term failure of market value are reflected in substantially lower volume of worldwide mergers and acquisitions against 2011. Companies that run, however, such operations, rely on organic growth [12].

Also in Romania, mergers and acquisitions market in 2010 totaled a value of about three billion dollars, down 14% compared to 2009 due to economic crisis. Total number of transactions was 106, the largest being achieved in the service sector: the first was in the real estate field (value: \$ 363 million) and the second in telecommunications field (value: \$ 264 million).

#### 4. Conclusions

Small and medium businesses prefer the way of development through personal effort, because they don't have enough business relationships to identify external competitive partners and because their managers fear they could lose control of the business. On the other hand, large companies adopt the strategy of mergers and acquisitions aiming to grow market share, increase profits and market power. By this strategy, large companies cut their competition, gain competitive advantages and even dictate market trends. When strategy aims only part of the companies objectives and they do not want to merge, but, in order to work together to achieve common objectives, keeping independence at the same time, they choose joint ventures or strategic alliances.

In real life, companies prefer to wait although financing is cheaper in the current economic climate, given the uncertainty of the market value of companies, which led to lower market mergers and acquisitions.

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## Organizational Learning and Knowledge Management: Towards an Integrative Framework

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### Abstract

*The literature about organizational learning (OL) and knowledge management (KM) is characterized by use of diverse terminology, where these two concepts are often employed but rarely discussed together. Recognizing that no single overarching framework has been proposed to clear up this conceptual confusion, this article proposes a model that integrates OL and KM while establishing a theoretical link between these constructs and performance.*

**Key words:** organizational learning, management, knowledge management, performance strategy.

**J.E.L classification:** M14

### 1. Introduction

In the 1990s, the rapid development of information technology and the Internet has allowed the development of sophisticated knowledge instruments. But while consultants provide learning and knowledge management solutions to managers, university teachers have expressed their concern with the lack of consistent terminology of cumulative (research) works and of a widely accepted framework ensuring the link between the domain of learning and that of knowledge.

### 2. Organizational learning and company performance

In this section, we integrate existing work dealing with OL and OK and propose a theoretical link between these constructs and firm performance. We define performance as the success or failure of the company to achieve financial and non-financial targets (e.g., reputation with regard to quality, growth).

Proposal 1: Learning is the process whereby knowledge is created and developed.

Current knowledge affects future learning. Researchers have opposing views on the impact of learning and knowledge on company performance. On one side of this debate there are those scholars who have established a positive link between these concepts. Whatever the underlying interpretations of the OL, “there is always the assumption that learning will improve future performance.” The perspective of the knowledge-based viewpoint points to a further positive link between knowledge and performance. It is assumed that a particular sub-category of knowledge, which is valuable, rare, inimitable and irreplaceable [2] would lead to competitive advantage.

On the opposite side of the discussion there are authors [1] that do not see any direct relationship between learning, knowledge and performance. Entities can learn wrong and learn correctly that what is wrong. Complementary to this point of view is Zach's description [7] about how core rigidities are deeply rooted knowledge that hinders innovation. Increasing profit (or which should increase) sustains the equivocal link between knowledge and performance.

While having sound knowledge base means that the company is able to multiply profits and increase its competitive edge, a poor knowledge base would cause the company to lose its advantage or lose it only for the future.

In conclusion, the OL and OK perceptions on the impact of learning and knowledge on the performance would vary. While OL literature shows a clear connection between learning and performance, the literature on knowledge suggests that knowledge, if recognized as a source of competitive edge, explains the difference in performance levels. Recent empirical endeavors have found arguments in support of the direct impact of learning, knowledge and human and social capital on performance. It is important to note, in conclusion, that "the more the amount of learning, the better" or "the more the amount of knowledge, the better", and that effective learning and relevant knowledge can have positive effects on performance. In our model, we have stressed out that, when studying learning and knowledge as the history of the company's results, it is essential that contextual variables and in particular strategic variables should be also included. Learning effectiveness can be assessed based only on its usefulness in guiding behavior in relation to the relevant line of business of the organization [3].

Proposal 2: Co-alignment between the learning / knowledge strategy of a company and its business.

The objective pursued by this article is to reduce the conceptual confusion on OL and KM, while providing a synthesis and integration of these otherwise closely related concepts. To achieve this goal, we have reviewed previous studies with a critical look, in an effort to understand how they can be marched and how they can intersect into a conceptual model that is richer in meaning for both researchers and academics, and for practitioners. We propose this framework as a tool to facilitate communication between researchers. Our intention is not to have this model match at all costs, but to build on previous research in an attempt to open the way to a challenging and creative dialogue that will further develop this integrative model.

We have also underlines in our discussion the strong connection between the learning

processes and the associated knowledge processes. In our model we have recognized that learning can be defined in terms of processes such as knowledge creation, storage, transfer etc.

A final conclusion of our model is that learning and knowledge acquisition lead to better corporate performance only when they support and are aligned with the business strategy of the company. In this paper we are advocating the idea that researchers interested in studying the OL and OK impact on performance should to be more precise (exact) about those traits of the knowledge that foster performance and about the conditions under which learning leads to competitive edge. We have proposed the co-alignment of the company learning/knowledge strategy, as a moderator of the impact of learning and knowledge on the corporate performance. We believe that there is potential for further theoretical development of the "learning/knowledge strategy" concept and we are inviting researchers from these two domains to work together and define the critical decisions or the compromises that managers need to address in terms of the learning resources and the knowledge inside their companies.

A direction for a future empirical work is to put these to proposals test. In their testing, future research should address the issue of choosing the appropriate actions and methodology. Several tools are available in academic and managerial literatures related to OL and OK. In particular, it will be important to find or to develop measurements that capture the nature of learning as a process and of the knowledge as the content of learning. Furthermore, future research could build on the theory of Bierly and Chakabarti [5] of an operationalization of a knowledge strategy in the pharmaceutical industry. To operationalize the coalignment between the business strategy of a company and its knowledge / learning strategy, researchers can build on the empirical works in the domain of contingency theories and the configurational theories, which are studying the fit between concepts and how the fit affects performance results.

Organizational learning interventions, alike other planned changing efforts, often fail to achieve the goals that they are pursuing explicitly. We believe that that

change initiatives can attain varying degrees of success in the different parts of an organization, depending on the interpersonal context. Early papers on organizational change have suggested that psychological safety is a crucial factor in reducing resistance to change and in helping people to cope with change. Recent research has shown that psychological safety varies significantly from one group to another within the same organization. Building on these observations, we may theorize that the same organizational learning intervention can lead to different results in different groups in an organization, due to variations in psychological safety. To further explore this approach, we have investigated the results of a change program designed to promote organizational learning in a large manufacture company. Study sheds light on the question as to why different parts of the organization may show different responses to one and the same program. We are discussing the implications for research and practice related to organizational learning interventions.

### **3. On the boundaries of OL (organizational learning) and OK (organizational knowledge)**

There is a growing interest in studying the alignment between the *firm's knowledge* and its strategy, structure, environment and *leadership* [4].

In a nutshell, OL focuses on learning as a process of change, while OK emphasis knowledge as a resource that generates competitive advantage and studies the processes associated with its management. Both share common views on how firms should actively learn and manage knowledge.

The definition of borders summarizes our findings about the OL and OK domains and the borders between them. We see these boundaries as fluid. They will evolve as the dialogue between the members of these two domains progresses. We are presenting the OL and the OK as two research areas that overlap in part, but we recognize that there are topics which are treated primarily in one of these two areas, as well as topics with respect to which the thinking in one domain is more advanced than in the other. For example, we see OL as the more advanced in terms of the delivery of a theory of

organizational learning on several levels. We also see that OL speaks of an OL system or an OL infrastructure where knowledge deposits across the organization - strategy, structure, systems, culture and procedures - are aligned. In contrast, we find that the OK focuses on creating a *knowledge-based view of the firm*, where the creation and integration of knowledge is why the very *raison d'être* of the firm.

### **4. Conclusions**

The following 10 points summarize our observations:

1. Each of these two areas has its own component of prescriptive literature. One aspect in which the OK literature can learn from the OL developments deals with the distinction between prescriptive vs. descriptive works. While the OL literature has clarified the confusion between the concepts of “organizational learning” and “learning organization”, the terms “organizational knowledge” and “knowledge management” still means different things to different communities - we can see how the OK exhibits strong academic roots. On the other hand though, we may conclude that KM is more concerned with providing and prescribing ways to bring pro-active knowledge inside organizations.

2. From a positivist perspective, a basic difference between OL and OK is that where OK is focused mainly on understanding knowledge as an asset (valuable asset) or as a deposit, OL is primarily emphasizing the process by which knowledge is acquired. In other words, there is a clear cut distinction between studying what is being learnt and understanding the learning process, or between studying the content vs. studying the process, which stresses out the need to understand learning as a process when it states that “the possibility to develop organizational capacity can be important in creating competitive advantage than the specific knowledge gained.” OK sees knowledge as a firm resource, which can lead to sustainable competitive advantage. Thus, we have positioned the firm's knowledge base within the borders of the OK domain. The discussion is centered on the attempt to understand what knowledge is, on defining knowledge typologies and on the contrast

between knowledge and concepts such as data and information. We have come to the conclusion that OK has a more static view on knowledge (content-based), while OL is first and foremost concerned with the changes (processes) in knowledge.

3. Although we have made a distinction between the studying of static knowledge (OK) vs. the studying of how knowledge changes (OL), we have shown that the two areas overlap to some extent, because there are studies in the OK domain (e.g. knowledge conversion and knowledge development processes) that examine knowledge evolution in time.

4. There various OL literatures are increasingly agreeing that learning occurs only when a change takes place in thinking and behavior. OK literature, despite its strong cognitive side, discusses the knowledge and the knowledge process as being based on action and as processes that require both cognitive and physical activity. Moreover, constructivist approaches on knowledge emphasize that knowledge is built from the interaction with the world out there, that knowledge is rooted into practice, being relational, mediated by artifacts, contextualized and dynamic. We have concluded that, while the OL domain has been most specific in explaining the cognitive and behavioral aspects of the learning phenomenon, the OK field has expanded its scope over thinking, to include action-orientation and the use in the action of the knowledge gained.

5. As suggested earlier in this article, OL and OK also overlap to some extent because organizational learning has been increasingly defined more in terms of knowledge processes. For example, Argyris [1] defines learning as “*knowledge acquisition*”, a process through which members of a community share, generate, evaluate and combine knowledge. In addition, as we have mentioned in point 4 above, knowledge is no longer seen as purely cognitive. Hence, the concept of static knowledge is replaced by dynamic knowledge and the priority shifts from knowledge asset management to studying the processes associated to knowledge, such as creation, preservation and transfer of knowledge. There is a wide opportunity to unify the insights of both communities - OL and OK.

6. When studied from a social constructivist perspective, OL and OK are both recognizing that learning and the process of knowing are seated in practice. This research includes the study of the common set of practices and work systems. The basic idea is that learning cannot possibly be separated from work and that knowledge exists in socially distributed work systems, where participants apply their knowledge situated in a context that is developing on the spot. In response to this changing situation, participants learn, meaning that their knowledge and behavior will inevitably develop.

7. In terms of levels of analysis, several authors in the domain of OL and OK [3] have proposed the idea that learning occurs and that knowledge exists at individual, group, organizational, inter-organizational or network level. This fourth level of analysis has attracted particular attention of the researchers interested by the role of learning in alliances, joint ventures from different countries, strategic groups and inter-firms, in general. However, other researchers associate learning with knowing only with the individual or only with a specific subset of these four levels. The debate in the specialized literature focuses mainly on the organizational level, because of the preoccupations with anthropomorphism. “All learning takes place inside individual human heads; an organization learns in only two ways: (a) by the learning of its members; or (b) by ingesting new members who have knowledge the organization didn’t previously have”. Hedlung [4] argues that “although organizational learning occurs through individuals, it would be a mistake to conclude that organizational learning is nothing but the cumulative result of their members... Members come and go, and leadership changes, but organizations’ memories preserve certain behaviors, mental maps, norms and values over time” In our analysis, we have found that the two domains move towards such a direction and that authors agree that organizations are more than a multitude of people and that, by acknowledging the existence of non-human deposits of knowledge and OL systems, firms can be attributed the ability to learn, know and have a memory.

8. Once the different levels of analysis acknowledged, the next step is to provide a theory to link these levels together, explaining the micro-processes through which learning and knowledge at one level become learning and knowledge at another level. Schwandt's dynamic Organizational Learning model [6], for example, is moving right in this direction. According to Schwandt's model, organizational learning is a dynamic social system defined as “a system of actions, actors, symbols and processes that enables an organization to transform information into valued knowledge which in turn increases its long-run adaptive capacity”. Four learning subsystems (environment interface, action&reflection, dissemination&diffusion and meaning&memory) and their associated processes explain how individuals and groups within organizations are collectively engaging in social learning actions. From our analysis on this work, we may argue that OL is more advanced than OK in the delivery of this multi-level theory on how learning occurs at individual, group and organizational level, how learning at one level influences learning at the other levels, and on how knowledge flows from one level to the other levels. When talking about the multiple levels of knowledge, the OK agenda has focused on tacit knowledge versus explicit knowledge and transfer from person to person. However, the cognitive and behavioral processes involved in these learning flows must be identified, in order to come up with prescriptions (rules) that are useful for firms.

9. To develop a multi-level knowledge theory within organizations, OK must also establish relationships between the various processes associated with knowledge at different levels. For example, what for an individual is knowledge sharing may be perceived as knowledge acquisition (learning) by a group of people; likewise, what for an individual is knowledge creation (learning) may be seen as access to knowledge by a group. In addition, when, for example, the transfer of knowledge is discussed at group level, what the transferor sees as transfer of common knowledge may be an acquisition (gaining) of new information in the eyes of the recipient. These examples show that OL and OK involve many knowing processes and that

there are significant opportunities for the two domains to work together in building up a theory to ensure the link between processes at different levels of analysis.

10. Finally, we have concluded that the OL literature has tackled to a great extent with the idea of developing a learning system or a learning infrastructure consisting of learning embedded into the firm's strategy, structure, culture, systems and procedures. Such a learning infrastructure affects and is affected by the learning processes, and the various elements of the systems must be aligned to one other for the firm to be successful. Building further on the conclusions from this initial review, the following section presents a proposals designed to integrate the learning and knowledge constructs to firm performance.

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# The Improvement of Human Resources Management within Romanian Companies Through the Transfer of Specific Practices

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## Abstract

*Human resources represent an important asset for modern organizations in the context of knowledge based society. The Romanian companies striving for the improvement of their performances have to consider the importance of human resources management field. In the last few years, the transfer process of human resources management practices has been largely discussed at international level. This paper presents a point of view regarding the transfer process as a solution to improve the human resources management practices within local companies. It indicates that the influence of institutional and cultural background of our country should be strongly considered when such a process is discussed. The latest changes in local specific regulations indicate that a company has new possibilities to improve its human resources management practices. We have to mention that such a transfer process will enhance along with the development of more consistent European approach on human resources management practices*

**Key words:** human resources management practices, transfer process, Romanian companies

**J.E.L. Classification:** M12 Personnel Management

## 1. Introduction

The evolution of economical activities has

proved that the human resources are the most valuable assets of a company. Specialized literature presents various studies regarding the human resources management.

An important theme developed in the past years concerned the transfer issues toward the human resources management specialised practices. Specialists have argued over the transfer process:: how it is done and what are the effects?

Romanian companies have acknowledged the importance of human resources management field in the past few years. They are striving to compete in a globalized economy and a modern approach of specialized practices could represent a valuable asset. In this paper we tried to analyse this issue starting from the theoretical background of transfer process, presenting the state of human resources management practices within romanian companies and finally discussing the transfer of specific practices and its impact over the human resources management field.

## 2. Transfer theories

Specialized literature hosts different debates concerning the transfer process. We consider more relevant to present such debates at European level.

The process of European integration generated different debates among human resources management specialists about the convergence/divergence process of human resources practices [1].

There are many arguments for both theories. Convergence theorists sustain the

idea that we can talk about an ongoing process of diminishing the differences between European countries based on the common institutional framework promoted across the European Union.

Divergence theory promotes the idea that noticeable differences exist between European countries (groups of countries are identified) based on specific institutional regulations, cultural dimensions etc.

Another point of view regarding the human resources management practices at national level and therefore with important implication upon the transfer process, indicates that there are three major categories of factors that have to be considered [2]:

- **The international institutional context** – supranational organizations (such as European Union) will impact upon the human resources management field within different countries;
- **National culture** – cultural approach has already been considered in order to explain differences between countries;
- **The national institutional context** – every country has its own institutional system that will affect the structure and business organization. Therefore, human resources management practices will be affected by this specific country context.

The human resources management practices are analysed at the international level based on two major approaches [3]:

- **The rational approach** – the companies will develop the practices that will enable them to fulfil their objectives in a rational manner and efficiently. According to this point of view the managerial practices will be similar within a specific sector of activity for the same country, even for different countries. This approach assumes a high degree of managerial autonomy.
- **The institutional approach** assumes that the companies are influenced in a decisive manner by their environment. Thus, their practices will be adjusted considering the regulations and compulsions of this environment. Therefore the

managerial practice will be different not only from a country to another, but from a sector of activity to another. These differences are explained by various elements such as different regulations concerning the business within a country, the relation between unions and management etc.

Such approaches should be analysed when the transfer of the human resources management practices is discussed.

It is clear that the transfer process of human resources management practices is not a simple task. It is necessary to establish in a clear manner what has to be transferred and what can be transferred what elements can enable or jam the transfer process in order to successfully complete the transfer process.

### **3. Romanian companies and human resources management practices**

The Romanian companies have assumed different human resources management practices, especially from the theory and practice of Anglo-Saxon countries and accordingly to the UE specific legal framework.

We consider relevant for the stage achieved by the human resources management within the Romanian organizations, a study undergone by Interact and Gallup Romania. This study tried to determine the main cultural values of our society, using the G. Hofstede methodology. Based on this, the most suitable approaches and practices of human resources management have been identified.

The most relevant results of this study are presented below [4]:

- **Human resources planning process** - due to the dimension of uncertainty avoidance, in the human resources planning process the human resources department has to analyze the job positions and to avoid the frequent changes within the organizational structure;
- **Recruitment and selection** - in the recruitment and selection process the fact that the Romanian people are more compelling with the job satisfaction than the promotion

- opportunities or the stimulating side of job position has to be considered.;
- **Performance appraisal** - the use of a system for the appraisal of the performances proves to be a difficult task. This is due to the fact that a clear statement of specific objectives and an enhanced attention paid to performance measurement generates anxiety among the subordinates;
  - **Reward** - for the Romanian employee the level of payment, the certitude at the work place, the working condition are more important than the job perspective or the content of job position;
  - **Employee’s training and development** - the cultural dimension of collectivism determines that the employees are waiting for the company to provide them training and protection.

The results of the above mentioned study indicates that the cultural context of our society represents an important issue that should be considered when the transfer process is developed.

Regarding the human resources management practices used by the Romanian companies we appreciate as relevant the results of a specialized study undergone in 2011. These results summarize for the 4<sup>th</sup> quarter the following [5]:

- For the period considered the human resources department budget has been increased compared with the same period of the past year;
- The recruitment activities are still in the front, the number of companies investing in such activities increased by 14% and also the budget for this activity has been increased;
- The training and development activities are still the most used methods to learn and develop. It can be noticed that the classical training starts to loose field against the e-learning platforms. It also should be notice an increase of using external funds for these activities;
- In order to retain the most valuable employees, the companies are using training facilities, official recognition of work performances and providing of a pleasant work

environment;

- For the period considered the participant companies have reported and increased activity of recruitment and selection for the entry levels throughout the universities and student associations.

Based on the above mentioned results we can argue that the romanian companies are focused on the improvement of human resources management practices. This can be proved by the increase of the budget for the specialized department. It also can be noticed the used of modern training methods such as e- learning platforms. In order to improve the efficiency of such activities the studied companies have attracted external funds.

We have to notice that the administrative activities regarding human resources management are still the most important (the attention paid to the recruitment and selection activities) compared with the strategical one such as human resources planning process, career management etc.

The Romanian companies proved themselves preoccupied with recognition of work performances and with the insurance of training programs in order to maintain and develop the competences of their employees.

When the transfer process is initiated it should be considered the legislative framework in our country. The last Labor Code promoted by the Romanian Government generates a more flexible legislative context for the companies in order to promote different human resources practices such as:

- Working time;
- Hiring and firing process;
- Reward and its connections with employee’s performance etc.

Considering the above mentioned we can argue that the institutional theory regarding the transfer of human resources management practices is more suitable for Romanian companies.

The transfer process should consider the constraints of legal framework, cultural dimensions of Romanian society and other issues that will determine which practices are suitable for transfer and the ones that are not.

As we mentioned before an important role within this process is played by the legislative framework which can provide

changes that will be perceived as compulsory by the companies and therefore accepted.

#### 4. Conclusions

The Romanian companies need to constantly improve their management practices. Considering the importance of human resources for the modern companies, the development of specific practice should represent an important objective for them.

The transfer process represents the solution for our companies in order to improve their human resources management practices.

Such a process proves to be no easy task. There are many issues to be considering when the transfer issue is discussed.

This paper aimed to present the main approaches related to the transfer issues at international level, considering the EU membership of our country. These approaches underline the main possibilities and also the potential difficulties related to that process.

The results of several specialized studies indicate the progress made by the Romanian companies in the past few years toward a modern human resources management.

The mentioned results also prove that an institutional approach regarding the transfer process is the most appropriate for our country. In this situation there are several limits related to the institutional and legislative framework, the cultural dimensions of Romanian society etc. Therefore, there are some practices that are more suitable to be transferred in Romanian companies, meanwhile others will be rejected.

The transfer process proves to be an important source for improvement of human resources management within Romanian companies. It is possible that such a process be enhanced along with a change of perspective toward a more relaxed attitude.

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## Human Capital Management Based on the Harvard Approach: a Solution for Reducing Human Capital Erosion

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### Abstract

*Human capital management is a pragmatically new approach of what used to be called personnel management. Human capital represents the only inexhaustible resource of creativity, solutions, and new, innovating and valuable ideas. The Harvard approach recognizes a common element in every business, the fact that human capital (personnel) represents a group of important stakeholders in an organization, and they have their own needs and preoccupations as the other groups of stakeholders, such as customers, shareholders. Organizations – in this knowledge based economy – are challenged to ensure their need of qualified human capital on labor markets through complex, unequal evolutions.*

**Key words:** human capital, management, erosion, personnel, stakeholders

**JEL:** M54

### 1. INTRODUCTION

Unfortunately we are still dealing with the global financial crisis. And despite the fact there are countries that register economic growth (such as Germany) Romania is still struggling to combat the negative impacts of the crisis and maybe in the nearest future to register an economic growth.

As a consequence of the crisis we discover in our country two important forms of human capital erosion, namely: the under-use of human capital (this being reflected through the high unemployment rate), or as a paradox the over-use of human capital (as a consequence of the massive dismissals).

People are considered one of the most essential resources necessary for achieving the objectives of an organization, as well as for organizational development. But they are a very special type of resource, they don't only work for the organization, they are the organization.

Human capital represents the only inexhaustible resource of creativity, solutions, and new, innovating and valuable ideas. Other resource categories (such as financial, material) of the organization are important and useful, but human capital and its' management are very important for resolving unknown situations and identifying optimum solutions.

### 2. FROM PERSONNEL MANAGEMENT TO HUMAN CAPITAL MANAGEMENT

In 1980 we noticed that the term personnel management is being replaced with human resource management. For about 15 years there was a period of conceptualization in which many specialists analyzed what is the difference between personnel management and human resource management. The following years the important questions were regarding the effects of human resource management upon organizations and organizational performance.

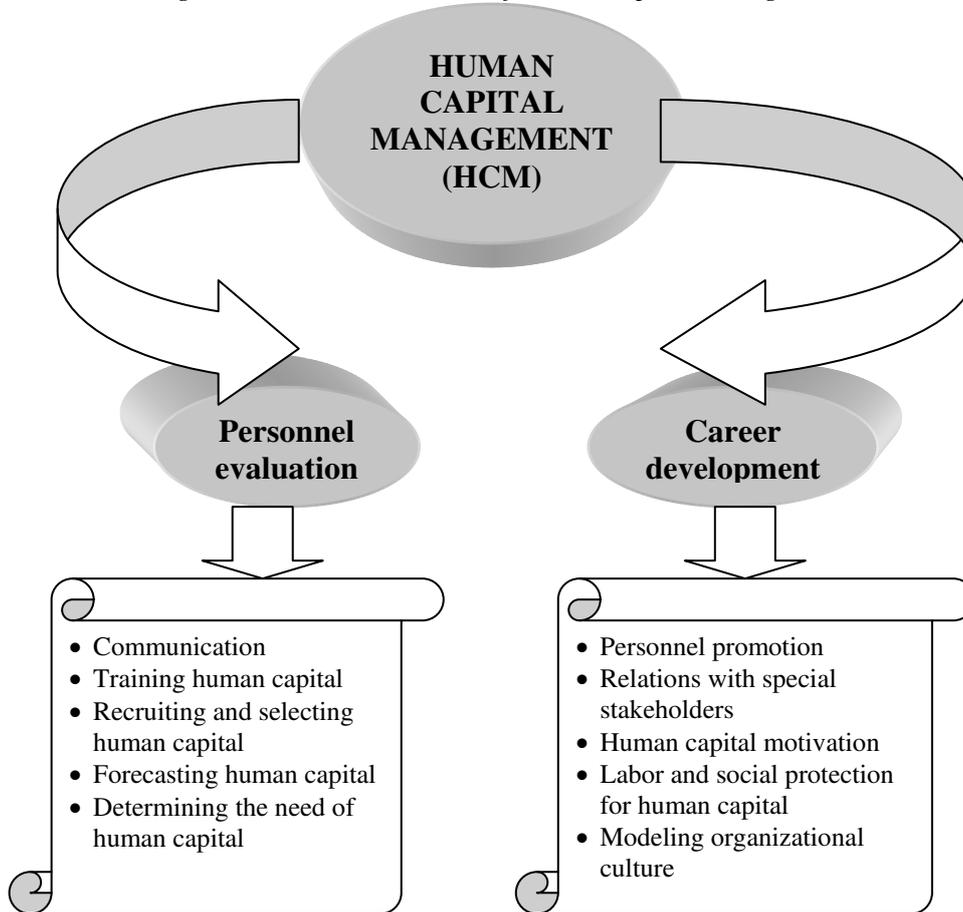
The appearance of human resource management was part of a major change in the nature and meaning of management at the end of the 20<sup>th</sup> century. The important evolutions in the international competition's structure and intensity determined organizations to make radical changes regarding their work practices.

Recently, specialists began to use the term human capital, because they consider it to be

more adequate. Human capital is more than a resource and therefore it shouldn't be considered a resource, because human capital is the organization itself.

The basic activities of human capital management are represented in Figure no. 1

Figure no. 1 Basic activities of human capital management



Source: Projection made by the author

### 3. THE HARVARD APPROACH: A SOLUTION FOR REDUCING HUMAN CAPITAL EROSION

Human capital management is considered a strategic process which uses at maximum level the human capital in an organization. Therefore human capital politics must be correlated with the organizations' general strategy.

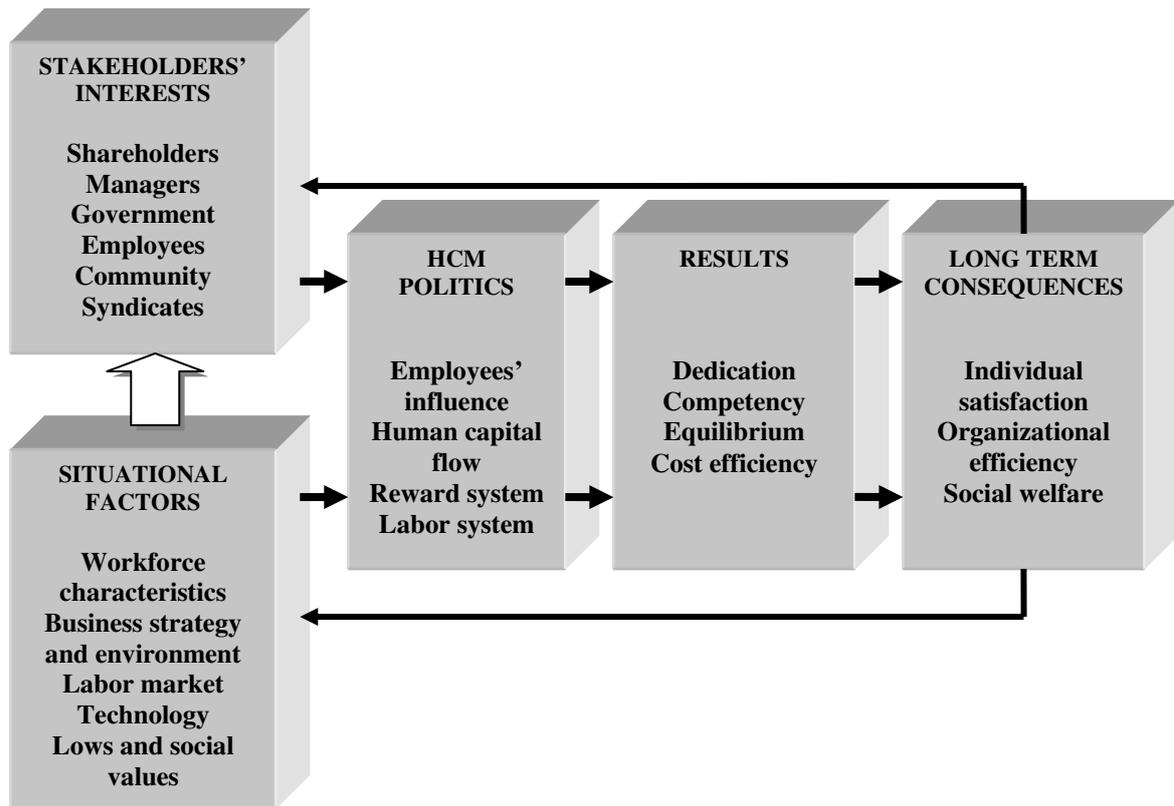
The Harvard approach was inspired by the behaviorist science and it is also known as the “soft” version of human capital management. This approach disagrees with the Michigan approach (the “hard” version of human capital), according to which human capital represent only resources and they

should be managed in the same manner as equipments and raw materials; that human capital should be obtained at the lowest costs and exploited at maximum.

The Harvard approach recognizes a common element in every business, the fact that human capital (personnel) represents a group of important stakeholders in an organization, and they have their own needs and preoccupations as the other groups of stakeholders, such as customers, shareholders.

We can state that we evolved from personnel management, which uses the Michigan approach, to human capital management, which uses the Harvard approach.

Figure no. 2 The Harvard approach



Source: Beer et al., *Managing Human Assets, The Free Press, in A. Price, Human Resource Management in a Business Context, Thomson, 2004, p.41*

Although the Harvard approach is widely used among all types of organizations, there still are organizations, especially small and medium size enterprises (SME's) in Romania that apply the Michigan approach.

As a result to this, the human capital is under-used because even if there were massive dismissals in the last period, there are a lot of organizations that are in need of human capital. At the opposite side we find the Romanian SME's which over-use the human capital in order to reduce their expenditures.

#### 4. CONCLUSIONS

From the organization's perspective, human capital represents its personnel and the potential human capital available for that business. People come in organizations with a wide range of qualifications, skills and knowledge that may or may not be useful to that organization.

Some of them identify with the organization and are motivated to reach the organization's objectives, and others consider

the organization as an opportunity to satisfy their own purposes.

As a result we identify situations in which human capital is over-used, and some situations in which human capital is under-used.

The under-use of human capital, as well as the over-use of human capital are forms of human capital erosion. Unfortunately, in Romania we find both of the forms of capital erosion, this given to the fact that the Harvard approach is not fully implemented in all the organizations, and there are still organizations that do not want to give up the Michigan approach. On the one hand, the under-use of human capital due to the massive dismissals, and on the other hand, the over-use of human capital due to the fact that there are not enough employees and the few employees that are in organizations, are over-worked.

In the new economy – the economy based on knowledge – the volume of information and knowledge which is absorbed by human capital is superior to the existent volume from several decades ago. Organizations – in this knowledge based economy – are

challenged to ensure their need of qualified human capital on labor markets through complex, unequal evolutions. Therefore human capital becomes more important and, of course, human capital management becomes more important for every organization.

In conclusion, I strongly recommend that every organization uses the Harvard approach because this could be one of the solutions to reduce human capital erosion, and maybe to “survive” through this critical time when a lot of organizations disappear from the economic market.

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# Gaining Competitive Advantage by Emphasizing the Positive Attributes of Resources Held

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## Abstract

*This paper aims to present the elements of the internal environment of firms and how they contribute to achieve a relative advantage.*

*Although VRIO framework is a precious strategic management tool it can be effective only in correlation with analysis of the external environment given, for example, need to find external references for estimating the value, scarcity and inimitability of a resource and selection of reference elements from the same market or the same strategic group.*

**Keywords:** resource, competence, capability, VRIO

**J.E.L. classification:** M21

## 1. Introduction

Generating strategies to improve the competitive position of companies involves an external environment analysis to identify opportunities and threats and, also, taking into consideration of their internal potential – their available resources that define their competitive strength and profile. Since internal environment is the primary source of its performance and the strategy is determined by the resources available to it, by the history of its development and by its behavior in the past, the formulation of policy options implies an analysis of its internal environment focused on identifying the different elements that can be used as sources for creating performance and how they contribute to a relative advantage compared to similar companies operating in the same area. This way, the company will work towards improving its competitive position by emphasizing the positive attributes of resources held.

## 2. The resource-based approach of competitive advantage

Resource-based approach, known as the "model of resources and strategic skills" appeared in the United States of America in the 90s. Arguments for this theory argue that subscribe to some theorists of strategic management today is that, on the one hand, numerous studies have failed to demonstrate a relationship between firm performance and industry performance and on the other firm position in the industry depends significantly on its resources.

Deep historical source of this approach, however, is the work of David Ricardo in 1817. The author argued that the supply of land is inelastic and therefore owner of the land resources of higher quality will have a competitive advantage. Similarly, an organization that has better resources than its competitors will have better performance.

According to the resource-based approach, the internal environment of an organization is the primary source of its performance and the strategy is determined by the resources available to it, the history of its development and past behavior. The formulation of policy options is, necessarily, based on an initial analysis of the internal environment of the organization, focused on identifying the different elements that can be used as sources for creating performance and how they contribute to a relative advantage compared to similar organizations operating in the same area.

The theoretical base of studies on the resources of the organization was given by two fundamental assumptions: resource heterogeneity (each company operates its own and unique combination of resources) [9] and resource immobility (some resources of a company, especially the material and human, are difficult or costly to imitate) [12].

Studying the use of resources by the

organization in a holistic perspective of tools of analysis, we find a global interpretation, operating with concepts such as resources, skills, capabilities. These concepts are directly related to the performance of the organization, explained by comparison with the performance of competitors, the result being summarized in a position relative to them.

Elements of the internal environment that, according to resource-based approach of competitive advantage can be used as sources for creating performance are resources, competencies and capabilities.

As elements of the organization, resources can be tangible, naming them, in this case, "capital" (financial, human, physical and organizational) and intangible (brand name, company reputation, product reputation, ties in business, organizational culture). Different types of resources can be classified according to their content (human, financial, physical, etc.), or according to their functional use within the organization (production, marketing, personnel, etc.). Theorists concerned with the strategic management issues complete categories of resources commonly found in economic literature, introducing the following concepts:

- organizational resources (as an attribute of a group of individuals, including the organization, cultural value system, coordination and control systems of an organization);
- limit-resources (necessary for organizations to meet the minimum requirements of economic survival);
- unique resources (which provide a competitive advantage that is difficult to obtain by other competitors).

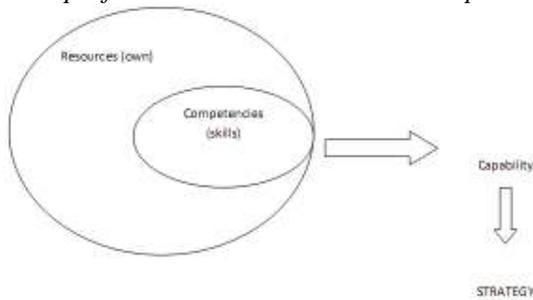
Studying the reference works on resource-based approach of competitive advantage and firm, we find a relative confusion in defining the concepts of "resources", "skills" or "capabilities" that still persists in management literature and that there is not, to today, an unanimity of authors regarding their definition. Thus, the concept of competencies concerns at large activities and processes that an organization uses its resources in an effective manner, taking advantage from their full potential. In Prahalad and Hamel's vision, in diversified firms case, core competencies can be identified, defined as "the collective

experience of the organization, manifested especially in combining various skills associated with the production and technological integration of multiple streams" [10]. In the French literature of management there is a concept close to the meaning of the term of competence – "metier", defined as a combination of skills and abilities to know and to do certain activities met within an enterprise, contributing to a new value created and ensuring business success in a competitive environment. With reference to the concept of capability, some authors consider it to be restricted to achieve coordination of other resources. According to Barney and Hesterly, capability is "a subset of resources that allow the firm to fully exploit other resources" [3], while, in view of Hax and Majluf, resources and capabilities are unique sources of business skills [7]. Despite some efforts to differentiate the concepts mentioned, there is a vague demarcation between them and, therefore, a possibility of overlap, which would justify the position of authors who exclude one or the other terms.

Realizing that the in the mutual reporting concepts of competence, resource and capability there are misunderstandings and ambiguities, Romanian specialist Bogdan Bacanu carried out a clear delineation of terms in the context of strategic management theory, operation designed to keep all three concepts, to give a comprehensible definition in Romanian and establish a relationship between them. According to Bacanu [1], [2], resources define what the organization has available to achieve its stated mission and strategy resulting from this, competencies define the know-how to transform resources into products and its features, mainly relating to combining the available resources it has to create value, while the capability defines the power of company to exploit the existing opportunities and to create an advantage over competitors. Strategic capability requires the existence of organizational resources and the possibility of their exploitation, translating, specifically, through the will to do something for which there are resources and competence.

Briefly, the concepts of resources, skills and capabilities can be summarized as follows (Figure 1):

Figure 1. Internal environmental elements that can be used as sources for creating performance and their relationship



Source: made by author

### 3. Critical organizational resources to create performance and achieve a competitive advantage

In the context of strategic management practice, the demarcation of the three concepts is relatively vague, which is why we operate with the general term "resources". Table 1 presents a classification of the critical organizational resources to create performance and achieve a competitive advantage:

Table 1. A classification of the critical organizational resources

Resource category	Features	Examples
Physical resources	Assets and processes, including their geographical location and spatial	position (location or site), buildings, equipment, materials
Financial resources	Concentration, collection, materializing as an investment	skills related to financial management, risk management
Human resources	Qualitative aspects of human resources (senior managers, which provides an overview of the	leadership, ability to develop and operationalize strategies, ability to generate manage-

	organization and 'front line' employees, with skills essential to the processes that define the identity of the company)	ment structures to ensure stability of operations, skills and professional skills, collective learning
General resources	Elements, mostly intangible, that give specificity to company and have a significant impact on economic performance	patents, copyrights, trademarks brand reputation, the organization's external relations system
Organizational culture	The combined rules, regularities of behavior, philosophy, dominant values, organizational climate and rules resulting in the development of identity with direct consequences in differentiating of the firm	the visible level, expressed by physical products, oral products and behavioral products and the invisible one, expressed by shared values and organizational skills

Source: made by author

As shown in the strategic management literature circumscribed to resources-based approach, the primary source of organizational performance, reflected in a competitive advantage, is represented by the distinctive resources that can be met on a small number of competitors.

### 4. Firm's resources and competitive advantage

The link between resources and

competitive advantage was addressed by Professor Jay B. Barney in his management textbooks and studies. Professor Barney is the creator and promoter of a tool of strategic analysis - the VRIO framework - that focuses on resources associated attributes, the name of this tool for strategic management being an acronym for value, rare, inimitable and organization.

The link between resources and competitive advantage according VRIO framework is presented in Table 2:

Table 2. Resources and competitive advantage

V	R	I	O	Consequence in competition
-	-	-	No	Disadvantage
✓	-	-	↑	Parity
✓	✓	-	↕	Temporary advantage
✓	✓	✓	Yes	Sustainable advantage

Source: Bacanu, B., “Strategic Management in Tourism - Concepts and Case Studies” Polirom, Iasi, 2009, p.79

A resource can be considered valuable (V) if it allows the company a favorable position to opportunities and threats. Economically, having a valuable resource means generating additional profit compared to the situation of not owning that resource. In terms of competition, the value has a positive impact which could translate into improved market share held and, consequently, an increase in profit. Some empirical studies reveal a significant relationship between market share and profit, which implies a similarity of effects in relation to a given resource [5]. To identify a valuable resource, a detailed analysis of the processes of the company is required, reflected in the decomposition of chain of activities, based on either the value chain, Porter or the McKinsey version or a functional approach, based the functional categories inspired by Fayol.

In the VRIO framework of analysis, scarcity of a resource (R) means that it is found in a small number of competitors, being an attribute relatively hard to materialize and maintain. Therefore, if any, rarity is considered a sustainable attribute. Scarcity may be the result of an exclusive arrangement between two partners, like

franchise or the result of a legal regulation, like patent or trademark.

Inimitability (I) involves two aspects: actual inimitability and non-substitutability. A resource is considered inimitable if a competitor cannot take possession of them in a short time or it induces the purchase costs higher than the reference company, while non-substitutability is about a competitor being unable to obtain such benefits from a different combination of resources.

Resource organization (O) refers to the firm's ability to exploit its resources, resources that have the attributes of value, rare and inimitable. This capacity is given by the configuration of organizational structure, efficiency and effectiveness of control, motivation and remuneration policies, mechanisms and budgetary allocation intentions, etc.

## 5. Conclusions

Without disputing the usefulness of the VRIO framework in the analysis of internal environment elements which are responsible for organizational performance, we must emphasize the need to correlate this type of analysis with analysis of the external environment given, for example, need to find external references for estimating the value, scarcity and inimitability of a resource and selection of reference elements from the same market or the same strategic group.

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# Strategic Challenges for Apparel Manufacturing Companies

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## Abstract

*In this paper we highlight environmental challenges faced by the apparel manufacturing companies, thus bringing to the forefront of analyzing a multitude of features and trends that have or will gain, in the future, a significant influence on the industry.*

*Survival and development of companies in the field are generally dependent on the external environment in which they evolve, requiring a clear perception of the changes occurring in it.*

**Keywords:** apparel, TQM, flexibility, TSS, UPS

**J.E.L. Classification:** M21

## 1. Introduction

Apparel industry has an important place within the national industrial system of the developing economies, and the use of an active commercial policy to highly stimulate exports, as a “locomotive” of economic growth, is a factor of the economic growth of these countries.

Nowadays companies, including the apparel manufacturing ones, are required, through the strategic approach taken, to provide the right response to environmental challenges grouped by two strategic axes of analysis: new features of production processes and selecting and focusing on strengths for development [3]. We believe it is necessary that environmental challenges to be highlighted, thus bringing to the forefront of analyzing a multitude of features and trends that have or will gain, in the future, a significant influence on the industry.

## 2. New features of production processes

Regarding the new features of the production processes, a defining feature of

contemporary competitive environment is to impose costs, flexibility and quality assurance as forefront factors of competitiveness.

A. With regard to costs, the main changes are:

A. Increasing costs for research and development of new products, due to the need to identify new products or new functions of existing ones and the requirement of finding development solutions that ensure the effective capitalization of company strengths. This trend is also reflected in the apparel industry, dominant firms winning leading positions in the world hierarchy by combining creative textiles and chemical products, by skillful selection and combination of materials and processing options and creating aggressive new designs, styles and functionalities for products. Research activities, mainly nontechnological, the big textile companies invest considerable sums, give them the ability to constantly innovate in terms of products, to use the most advanced, flexible and efficient processes, aiming to the meeting needs of clients also in constant evolution.

Prevailing industry fragmentation phenomenon has an impact on research, acting as a prohibitive factor - in an industry dominated by SMEs, lack of resources, especially financial ones, is an important issue. It will be supplemented by inconsistent long-term strategies, both in businesses and industry, fragmentation, duplication and discontinuity research efforts, poor translation of research results into products and processes difficulties in protecting research results, etc.

3. The rise of fixed costs due to use of modern production technologies and equipment, of computer systems becoming more efficient and also very expensive.

The production performance apparel production technologies based on modern

technology means computing and information systems are mainly used in appropriate training activities of production, technological innovations enabling:

- three-dimensional design of products and creation of virtual clothing products by applying the two-dimensional patterns on three-dimensional image of real bodies, significantly decreasing the time of approval of products to be manufactured, so that everyone involved to view products and to propose changes without having to create as many samples of production;

- direct extraction of two-dimensional patterns from three-dimensional designed models;

- automatic grading of patterns;

- automatic generation of frames, using multiple processors for settlement and compaction to get the best use of material by compacting parts to remove excess material of patterns;

- electronic submission of product specifications both inside and outside the company, to the subcontractors, distributors and suppliers. Information (including costs, material tables, dimensions, construction details, drawings and multilingual functions) can be accessed anywhere through LAN, WAN, virtual private networks, telephone or through the Internet.

In terms of achieving the production preparation, cutting of parts, technological innovations enable:

- preparing tailored fabrics using computerized machines for controlling and measuring and measuring fabrics;

- automatic spanning and cutting of fabrics.

Basic production processes, assembly by sewing, use production technologies, essentially unchanged for over 100 years. The most significant increases in productivity are achieved through:

- advanced sewing needles;

- sewing equipment with high degree of automation (automatic sewing sleeves, etc.)

- automatic processing apparatus (fusing machines, presses preformed collars, cuffs, pockets, etc.)

- suspended systems (manual, mechanical, electrical, electronic or computerized) to transport individual products or packages.

In the finishing phase of products, technologies based on use of equipment such

as automatic machine embroidery, special buttons reinforced by wrapping, corrugation machines, automatic machines for special finishing (simple or stone washing, printing, etc.) ironing presses, folding machines, etc.

Rising of fixed costs is also the result of the emergence of expenditure that, on certain periods, have the features of fixed costs, such as advertising and promotion costs and product distribution costs. Obtaining performance of clothing industry companies marketing implies a strong marketing activity, due to displacement of ratio of power to buyers (in this business particularly distributors and buyers, less final consumers). This shift of power relation is reflected, among others into the contribution to creating value for the final consumer: the distribution's accounts for a share of 50-75%, while manufacturing's share, on average, is below 20% .

4. ROI reduction, due to increased value for the purpose of actual value and interest to be paid, on the one hand and reducing manufacturing series and the life of products, on the other. Demand features reduce the production batches – although apparel are consumer goods, they are also fashion and style dependent, reflecting the personality of the person who buy them. Diminishing of production batches reduces ROI, so a successful business is often a succession of turnovers at a minimum level of profitability.

5. Adoption by apparel firms, of the price taker position in a saturated, highly competitive market, characterized by a low coefficient of elasticity of demand for income and an volatile demand in volume and structure, unstable under the influence of fashion or change of seasons. In these conditions, ensuring viability of the industry call for a philosophy such as "market price minus total costs is profit worth" and requires modern methods of management and production organization: management by budgets, organizing just-in-time design and production based on "target cost", etc.

B. Challenges regarding flexibility in production are more acutely felt in the clothing sector than in other areas. In the current period, marked by the shift from mass production to customer-oriented production, garments are not only functional but also play a major role in identity and personal expression. Therefore, they are ideal products

for customer focus, their customization according customer's specification offering significant added value.

In the production of clothing, there are two forms of flexibility [1]:

- Static flexibility, reflected in firm's capacity to take an additional order that may occur during the implementation of the provisions of production. Making the most of static flexibility requires the adoption of management policies aimed at the accurate sizing of capacity reserves, resources and working in the various levels of the enterprise and ensuring organizational conditions necessary for their immediate mobilization when necessary;
- Dynamic flexibility, expressing ability of enterprise production system to react to any unforeseen event, based on flexible automation systems, robotics and informatics, organization of production, technical universal equipment capabilities, versatility skills of employees, etc.

Recent technological developments, represented by sophisticated CAD solutions for achieving virtual prototyping, online communication systems between producers, distributors and users, enabling manufacturers to develop successful operations in the production of mass customized high fashion and premium apparel, comparable to production in other sectors such as PCs or cars. In this way, producers are flexible, while maintaining the advantages of series production of large and very large.

Ensuring flexibility in textiles production is based on modern organizational systems: TSS - (Toyota sewing system) and UPS (unit production system). Unlike the classical organization of production batch / packages, featuring downtime up to 80% during production and large stocks of unfinished production TSS is a concept based on methods with fast response.

In TSS environment, operators work in teams organized so that is tracked one product's sewing, movement between machines and operations, and transitions to the next operator, available immediately after processing. Therefore, there aren't unfinished products between phases and operators' work materializes immediately by completing the

product. Thus, a garment with a time of 60 minutes produced by a TSS team can reach the end of the production line after 60 minutes.

Another way to eliminate waste of time and unfinished production stock is using Unitary Production Systems - UPS, which eliminates the need for operator to pack supplies, or arrange to collect them because they are delivered to the point of stitching ergonomically already prepared. Studies have shown that by adopting UPS can change the ratio of time handling / production of 80/20 60/40 or better.

C. Total quality as a feature of the mode of production, assumes that products are developed to meet needs, which involves the enrichment and diversification of offer and also diversification of product functions that would, so that firm will be able to achieve the best possible satisfaction of customers expectations.

The quality of a product or service is a complex notion, in a widely accepted definition representing all the characteristics which give it the ability to meet the needs expressed or implied.

From the traditional quality control aimed at an acceptable quality level evolved the quality management system, understood as a method of administration /management organization that determines a high degree of satisfaction for all parties interested therein.

In order to appreciate the quality orientation of the firm, since they work within a quality management system, were developed ISO 9000 standards, containing a number of requirements for quality management as the referential of focus on quality assessment of the company. Adopting a standard in quality, although it is considered voluntary, has become increasingly "mandatory" for all producers that address their products/ services to markets of the European Union.

Currently, improving quality requires a comprehensive approach - total quality management defined by four concepts:

- visible quality level, which means providing a common definition of quality for all personnel, setting easily measurable criteria for all parties involved in the process;
- measuring quality during production;
- preventing defects - defects should not be considered as acceptable;

- the ultimate goal should be "zero defects".

Quality analysis is an element of overall strategy to exploit with maximum efficiency enterprise resources, quality of products and services, as a factor in boosting sales, reduce costs and increase profitability, turning, also, into a competitive necessity.

As shown in several studies of strategic management TQM can be considered as a source of competitive advantage and therefore a high level of performance, noting the following seven key factors or practices that constitute philosophy support of such management type, as follows:

- involvement of the management team;
- adopting a philosophy of quality;
- increased training oriented to TQM;
- customer orientation;
- continuous improvement of processes;
- management by results;
- adoption of TQM methods.

### **3. Selecting and focusing on strengths for development**

In the current period, the need to find solutions to business development that ensures the best results involves selecting and focusing on strengths. To support this trend, the practice recorded many cases it was easier, less costly and more efficient to develop a strength of a given firm, but to eliminate a malfunction. The main changes in this regard, noticeable in apparel manufacturing sector are:

- Development by multiplying niches of activity, consisting of well-protected market segments that provide high profit margins or bearing innovative vectors. Multiplying niches involves an initial phase of specialization required by the need to target dominance ensuring high profit margins and avoid investments in related fields, followed by a phase of external growth. In the clothing business niches that can be exploited profitably are customized products, enhanced by accessories or embroideries, clothing for atypical dimensional, uniforms, etc.;

- Downstream integration to increase value added – this approach is called for because profitability of dealers, distributors and retailers of clothing is higher than producers'.

### **4. Conclusions**

Elements of competitive game in the clothing industry, survival and development of companies in the field are generally dependent on the external environment in which they evolve, requiring a clear perception of the changes occurring in it. However, the formulation of realistic and feasible policy options for clothing industry companies involves a deeper analysis of the external environment and a focus of attention on the evolving competitive environment in these firms.

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## E-mail Marketing for Customer Orientation

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### Abstract

*When we think about the online commerce market, the first question that arises is, how do the players on this market manage to attract potential customers and convince them to buy online repeatedly. With the development of Internet, the online presence can not be ignored, whether a site is transactional or not. A company without a presence on the Internet is a company with no personality. There are many tools which can be used for acquiring customers and retaining existing ones. This paper aims to address the issue of e-mail as a marketing tool for communicating with Internet users and stimulating them to buy online.*

**Cuvinte cheie:** Internet, online user, e-mail, communication, online store.

**Clasificare J.E.L.:** M31, L81, L86, F10.

### 1. Introduction

Once the competition has intensified, companies have realized they can not overcome relying solely on price and have developed strategies to provide value to customers, in order to differentiate themselves from competitors.

Online retailers are widely using e-mail to communicate permanently with their customers. Thus, they benefit from the advantages offered by e-mail, like low communication costs and the possibility to address to target people, that have asked to receive messages or the possibility to analyze the behavior of those who are receiving the mail. Although e-mail can be successfully used to attract and retain customers, to sell and promote the products, to form loyalty and to offer services to customers, a real

challenge for online retailers is to convince consumers to subscribe. Many are hesitant because of overloading with messages, and many messages are often just ignored.

Newsletters have the merit of attracting and keeping users under the influence of the website's shop. A regularly sent newsletter, at a normal frequency of once or twice a month, brings into memory of the customer the products and services that the company sells and encourages repeated purchase.

Sales on the Internet are increasing as more people have access and become more confident to online transactions, but a web site alone will not guarantee an increase in sales. Sites focus on sales need to have strong online advertising. This generally involves reaching goals like developing the degree of awareness, developing and maintaining brand image and generating visits on the website and initiate online transactions.

Attracting customers is an important factor determining the profitability of an online store. In addition to the right offer, to attract customers is necessary also the use of appropriate tools, such as display advertising, e-mail and search engines.

Using the current online tools, every online company can develop efficient programs to build relationship with customers. E-mail is an important tool for acquiring customers and retaining existing ones, for communicating with users and stimulating to action.

The Internet itself fulfills a function of communication, embodied by electronic mail, which allows the rapid and inexpensive transmission of audio, video and text correspondence. Not only online users communicate with other Internet users, but also companies realize a communication with customers via the Internet.

Electronic mail can be very profitable in

terms of costs, but also as response rate. It can be used to attract and retain consumers, to sell and promote products, to form loyalty, to provide exceptional customer service and for strengthening the brand. Successful e-mail campaigns success are mainly based on trust. Permission and confidentiality is the key to gaining the trust of customers. [5].

According to Marketing Sherpa Email Marketing Benchmark Guide 2008, e-mail is tremendously important to consumers: over 45% of all consumers rate it of higher importance than postal mail or the phone – even amongst seniors and older adults. The medium is not dying out in favor of instant messaging, texting or social networks. Over 70% of all age groups are using email more and more each year. [11].

## 2. E-mail marketing

E-mail marketing options include: [8]

- a regular newsletter by e-mail to keep customers informed about the company and its products;
- a discussion list, probably related to customer support or a group of users;
- e-mail promotions - special offers, contests and discounts to encourage repeat visits to the company's website and convert those visits into sales;
- viral e-mail, to encourage customers to introduce e-mail addresses of friends or colleagues to forward information or entertainment;
- promotions to encourage the renewal of a contract, for example for mobile telephony or insurance.

E-mail marketing campaigns can provide an inexpensive and effective way to address potential customers. The first step is to set campaign objectives. This means setting the target audience, including geographical location, demographic profile and determining the level of personalization of the campaign. Personalized e-mails address to consumers with specific information. Using the name of clients, offering right products at the right time and sending special promotions oriented at the interests of consumers leads to building stronger relationships with those who received e-mails. [3].

Using e-mail offers advantages such as: [4]

- It is cheap; it has no printing costs or shipping costs.
- E-mail is distributed immediately; it does not require moving to a place to be delivered.
- It offers worldwide access.
- Customers are auto-selected; customers requesting deliberately to send them marketing messages are likely to be more profitable.
- It is target-oriented, allows segmentation in order to increase conversion.
- It can be analyzed: can be obtained data on those who opened the mail and clicked on a specific link.
- It can be automated, automatic deliveries.
- Easy transmission through word-of-mouth is a great viral potential.
- The feedback from the public helps create loyalty.

## 3. Building relationships using e-mail

If the goal is building a solid relationship by using e-mail, certain mistakes, such as the following, have to be avoided:

- Sending "spam" to the mailing list.
- Not sending messages for a long time - the opposite of spam. If not keeping in touch with subscribers for a long time, they will tend to forget that company, and this will harm the relationship between customer and the company.
- Sending irrelevant offers - when launching a new product, there may be a tendency to inform all subscribers, although some of them are not interested in that product, or do not need that product.
- Sending e-mails only when selling something. No user wants to be in the mailing list only for selling purposes. The reason they subscribe to the mailing list is because they want something valuable. If they fail to find value, they will unsubscribe immediately.
- To send e-mails hastily. An email with errors, either in content or subject line, such as subscriber name will look unprofessional and create a bad impression.
- E-mail can be considered an excellent marketing environment for the following reasons: [1].

- It is easy to use: With the current tools currently, it is easy for any organization to develop effective e-mail programs to build relationships with customers.
- It is cheap: There is no other marketing medium that is less expensive than e-mail.
- It is interactive: A very important feature is the interactivity. E-mail can be tracked; companies can get exactly data about links accessed from an email and links ignored. It can measure the overall effectiveness and integrate with other systems in order to measure actual behavior (purchases, etc.). In the interactive world, this is equivalent to listening.

The obtained data from the users can be used to adapt a message to an individual recipient. The data is necessary for the organization to show its uniqueness, to prove that it listens to customers and delivers relevant messages over time. The combination of these benefits forms a very powerful marketing tool which enables building long lasting relationships in the online space.

Internet users can be encouraged to read email messages. First, it is essential to stimulate curiosity through an interesting topic of the electronic message and create anticipation in the message subject. The sender of the message must ensure that the message is interesting enough to capture user's attention. It is also recommended customizing the message and using the recipient's name in the message and an indication about the message content.

Consumers are overcrowded with messages that are relevant or less relevant for them. Only permission based marketers will be able to obtain a competitive edge in the online space. Permission based marketing involves a "pull" communication in that the concerned requests for information, subscribing to the newsletter (opt in) and is always able to unsubscribe. Consumers will decide for themselves what information they receive from companies. Marketing based on permission offers advantages for the clients, because the clients have the possibility to establish themselves what information they wish to receive and to benefit from a personalized approach where their interests are taken into account. Marketing based on

permission offers advantages also consisting in a better knowledge of the market and the desires of customers. [7].

Godin S. (2004) analyzes the Internet from a marketing perspective based on permission and defines five stages that any permission-based marketing campaign on the Internet needs to have:

The online marketer offers the potential customer an incentive to join the system voluntarily.

- Using the consumer's attention, the marketer offers a true information program that instructs the user regarding the company's products or services.
- Incentives strengthen the maintenance of given permission.
- Marketer offers additional incentives to achieve greater consumer permission.
- Over time, the online marketer uses the permission to change consumer behavior, making it into a source of profit.

Permission based marketing refers to obtaining customer consent before initiating marketing efforts of databases. The main benefit is to make an exchange: the company collects customer data, in exchange for products and customized offers. 3

According to the Marketing Sherpa Email Marketing Benchmark Guide 2008 [11], the amount of data collected during e-mail list sign up is still fairly basic. Most companies only collect the basics of name and e-mail address from consumers. Less than 30% of those surveyed ask for more detailed information like contact preferences and delivery preferences.

The first step in a successful e-mail marketing campaign is forming a list of people interested in the products or services that the company has to offer. It is recommended to offer visitors a free registration in return for their contact information. An own list is better than buying other lists of e-mail. The latter, in addition to being expensive has the disadvantage that the response rate is generally low.

High quality addresses usually guarantee high click rates, positive feedback and strong contact with the customer, contact that is reflected in a profitable customer relationship. [2].

In a long term strategy is not only important to gain subscribers to the newsletter, but rather to obtain their

permission, their desire to gain information and their interest for a long term. In this age of overloaded information, a person's willingness to allow voluntarily to be sent electronic messages should not be underestimated.

There are a plenty of reasons why users may choose to opt-out from a mailing list, in order to stop receiving commercial e-mails. The main reasons are: messages are not addressed to their needs, users are overload with mail messages, and users are sent unsolicited communications (spam).

The Marketing Sherpa Email Marketing Benchmark Guide reports that the first reason that consumers opted out of email lists was that the e-mails received were not pertinent to them (58%). The second most popular reason was that the sender sent too many emails (44%). Less than a third of those surveyed opted out over too many e-mails in general or because their situation changed or they are using less e-mail in favor of other modes of communication like the social media [11].

To obtain e-mail addresses, a trader can create its own mailing list or purchase it. While purchasing a list of e-mails may seem a quick way to reach large numbers of people, practically there is no way to check the quality of the purchased list.

The real challenge comes from attracting a large number of visitors to subscribe, given that Internet users protect their e-mail addresses. Only by gaining their trust, they will provide their e-mail addresses. The company must explain why it requires this data, for example, to send them special offers, inform them about promotions, and also to ensure that it will not disclose information obtained to third parties. [9].

The vast majority of consumers wants to have control of their online experience and do not want their behavior to be monitored in cyberspace. Therefore, in the communication process with permission, the relationship the company has with customers plays an essential role. If it is built on long-term and based on trust, it gets a greater importance as the online consumer experience is richer. Thus, the user is willing to provide more personal information to companies that he trusts [6].

#### 4. Conclusions

Online retailers are using e-mail to communicate with their customers. This is an unexpensive way to keep them in contact with the company and its products. Online retailers realized that e-mail can be successfully used to communicate with customers, to form loyalty and to develop a strong customer – company relationship. Despite this advantages, it is a real challenge for online traders to find the right potential customers and to convince them to subscribe for further e-mail communication. Own mailing lists bring the best potential customers. Attracting and retaining customers through e-mail is possible only by gaining their trust, by letting the users to have control of their online experience and by not overflowing them with messages and irrelevant information. In this relationship through e-mail, permission plays an important role.

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## Factors for Creating Online Customer Loyalty

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### Abstract

*Only those companies which succeed in building lasting relationships with online customers are those who customers are confident in and transact online securely. Furthermore, successful companies are those who pay attention to customer satisfaction, who are trying to understand customer needs and expectations and to fulfill them properly. Only those online store managers that focus more on gaining customer loyalty, than to customer acquisition succeed in the online business medium. Customer loyalty is generated by many factors, which include satisfaction, service quality, customer expectations and complaints of the customer. Companies operating online need to take into account these factors to ensure that online customers are loyal and relationships with them are developed.*

**Cuvinte cheie:** online user, satisfaction, relationship, loyalty, expectations.

**Clasificare J.E.L.:** M31, L81, L86, F10.

### 1. Introduction

Customer loyalty can be defined as all measures of a company, which aim to direct behavioral intentions of current customers, but also those of the prospectives, to develop a strong and lasting relationship with them. Customer loyalty can be seen in terms of a real behavior, resulted in repeated purchase, or in making additional purchases and in the sense of intentional behavior, referring to the intention to repurchase or intention to make additional purchases.

The first step in managing an online business based on loyalty is to find and

attract the right customers, those who are profitable for the company and that those whose loyalty can be gained and preserved.

Companies based on loyalty should guide herself after the following rules: [9]

- Some customers are inherently predictable and loyal and simply prefer stable relationships for long term.
- Some customers are more profitable than others, spend more money, require less assistance.
- Some customers will perceive products and services of a company being more valuable than those of competitors. No company can be perfect for all consumers. Strengths of a company will better suit the needs of certain consumers.

To increase customer satisfaction and loyalty, companies must continuously analyze customer expectations and exceed them. So they must have a customer oriented approach to develop and maintain long term profitable relationships with them. A company that is focused on customers will be able not only to meet customer expectations but also to anticipate their behavior, being able to obtain a higher level of customer satisfaction.

### 2. Loyalty and its determinant elements

A client of a company can easily become a client of competitors. Buyers no longer have that kind of loyalty as in the past. Products are available from several companies and the choices they have are multiple. Where the customer is loyal, means that its loyalty was created by service and customer assistance provided by the company, rather than loyalty to be obtained through the product itself. [10]

D. Tapscott [11] brings into question the

so-called "Net Generation", a generation that makes its presence felt and thanks to it, relationship marketing gets a different meaning. The rise of "Generation N" undermines brand loyalty, because they want more options and also have more options to choose the products and brands.

The N generation wants personalization of products according to individual desires, which implies a permanent change of behavior, which also weakens the significance of brand loyalty. This generation is always looking for something new, new experiences, with consequences for loyalty to the brand.

Retention is generated by many factors, which include satisfaction, service quality and confidence of the customer. This article aims to treat concepts of satisfaction, customer expectations and services provided for customers.

### **3. Satisfaction and its measurement**

It is often argued that those customers who have a higher level of satisfaction will shop online again from the same store and even form emotional bonds to the store online. Emotions serve users as information on fulfilling their expectations: if surfers are excited, this is an indication that the expectations of visitors of the online store have been met. In evaluating satisfaction with the organization's online store, visitors are less reliant on their emotions.

According to McGaughey [7], "today's consumers not only expect a high level of service, but they require such services for their benefit." Customer satisfaction is achieved when a company can meet customer needs.

Because a company's customers are different, their level of satisfaction vary, and the extent they are satisfied after the same situations differ from one customer to another. It may be impossible to know what satisfies each customer. Achieving high levels of customer satisfaction by short-term measures is important, but such satisfaction is vulnerable and must be accompanied by a greater relationship for long term, with the company. Customer satisfaction is an extremely important step in developing a solid relationship with customers, but only satisfaction will not lead to the formation and

maintaining this relationship. [1]

Customer satisfaction is a fundamental concept of marketing which claims that customer satisfaction is the key to retain customers. Recent research on the online medium mentions satisfaction as a fundamental element in building customer loyalty. In an empirical study, Shankar (2003) [8] approaches the topic of customer satisfaction in both the online and offline medium. The author concludes that overall satisfaction helps to create loyalty, but that the relationship between satisfaction and loyalty is stronger online than offline.

Formation of satisfaction in the online environment relies on a greater trust than in the offline environment. A satisfied user is one who will return to the company's online store, will generate traffic and make acquisitions, but also one that will promote the store through viral marketing, by communicating with other visitors the perceived values.

Monitoring customer satisfaction brings valuable information on how merchants are perceived, on products and services and allows managing the online business according to customer expectations. Some companies operating online use questionnaires to assess the degree of satisfaction, which are sent after providing the service. Generally, in the online medium it can be determined the level of customer satisfaction through a focus group, questionnaire, surveys or through suggestions customer post on site. The last is still a passive way in which only complaints are likely to be received.

### **4. Customer expectations**

Customer expectations are based on previous experiences in similar situations, on what promises advertising or other forms of communication or on what the customer believes that should happen. Online, customers have higher expectations. They want and expect higher quality services, convenience, fast service, competitive prices and a varied offer of products. Although not expected, they want to be in control, transactions to be secure and that their data to be safe. Having higher expectations, this can be harder to fulfill.

Managing customer expectations in the

online environment becomes more challenging due to high expectations. A company must: [4]

- Understand customer expectations regarding service delivery and the difference between expectations and the actual customer service delivery
- Ensure that the promises made regarding the privacy policy, ensure security on delivery, price and assistance on time
- Deliver customer service through a user-friendly site, offering competitive prices and based on excellent service

Some researches demonstrate that it is not sufficient to provide only low prices and fast delivery of products in order to attract and retain customers. In this process also contribute issues like access to a wide range of goods and services, transaction security, aesthetics of the website, the available amount of information and credibility.

## 5. Services provided and complaints

In the virtual market, the power structure of participants changes. Structures of this market allow customers to compare products and prices of different suppliers without too much effort. Online stores have to offer high quality products at lower prices than for offline offers. The customer has the possibility, that only by one click, to change the store, to move to competition. Often the reason is not the price charged by that store, but the lack of services for the client. Because some online stores offer bad services and because of the lack of communication between the client and company, confidence in electronic commerce is still low.

Once the competition has increased, companies have realized that they cannot win relying solely on price and have developed strategies to provide value to customers, in order to differentiate themselves from competitors.

Quality services for customers offer advantages such as: [5]

- differentiation from competitors;
- improving the image in the eyes of customers;
- reducing sensitivity to price;
- increasing satisfaction and loyalty;

- strengthen the reputation;
- reducing costs.

Those companies that already have experience in electronic commerce realize that not only the simple online presence attracts success in this environment, but lower price, and especially the quality of online customer service. In the online environment, customers expect quality services at are at least so good, but preferably more, compared to customer service in offline environment.

The Internet has opened a new way for companies to interact with their customers. Customers want a consistent personalized experience, which means they are served effectively, either by Internet or one conventional means of communication such as phone. Companies that neglect to provide good customer service, online or offline do not take into account that no site, no matter how well structured it is and how aesthetic it looks is a substitute for promises and unfulfilled expectations.

Only those companies who decide to build loyal customers by providing quality services, whenever they are contacted by clients will be able to survive in the online environment. [2]

An effective program to solve customer complaints is essential to the success of a business and is a vital component to form powerful brands. Through the complaints, customers communicate directly with the company, suggesting the direction for improvement. Through continuous improvement of business activity, one can improve customer retention rate. If customers do not feel a continuous quality improvement of services in their favor, they will leave the company.

Customer complaints have a quite big impact. If a customer will tell to eight to ten people about a positive experience from the sale, he will tell a number of 16 to 18 people about a negative experience encountered on sales. [3]

When a company receives a complaint, it must do all that is possible to resolve the claim and to minimize customer concerns. Most customers do never claim. However, if a customer does not complain, it does not mean that he is also satisfied. A company should be concerned about customers claiming different problems, and especially

about those who do not communicate with the company.

Therefore, it becomes extremely important to get feedback from customers. When customers make a complaint, customers expect that the complaint is solved seriously, that they are in connection with the person who can quickly resolve the complaint, they receive an explanation about the cause of the problem and they are informed about progress in resolving the complaint. If the problem could not be resolved on time, they should be ensured that that situation does not happen again. [6]

An online trader must be thankful that the complaint has been expressed by the client and he was able to help the customer. Most of the times, however customers are not complaining, and they change to another trader and will advise friends to avoid the trader where they had problems. Such a claim can be seen by merchants as an opportunity to interact with clients.

## 6. Conclusions

Once the competition has increased, online companies have realized that they cannot win relying solely on price and have developed strategies to provide value to customers, in order to differentiate themselves from competitors. Those companies that already have experience in electronic commerce not only realize that the existence of a website attracts success in this environment, but also the quality of online customer service.

Online managers are turning to creating customer relationships that form over time, even if in the first phase the profit from them is reduced. Moreover, focusing especially on customer acquisition and the high cost of customer acquisition make many relationships with customers to be unprofitable during the first year.

A successful online company knows how to gain the loyalty of its customers. Loyalty in the online medium may be easier to be achieved than in the offline medium, since there is trust, good service quality and customer expectations are predicted and taken into consideration.

On the e-commerce market, attracting and retaining more customers is more and more important and contributes to the success of an

online store. Unfortunately, the orientation of attention of online retailers is moving mainly on attracting and acquiring new customers and not on gaining their loyalty.

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# Typology and Characteristics of Strategic Planning

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## Abstract

*The process of strategic planning has been addressed by many authors in the international specialty literature, aspects as planning's typology, stages or advantages for companies having been analysed and described in various management - marketing scientific articles or books.*

*The present paper tries to define the concepts of strategic planning, long-term planning, and marketing planning, by highlighting their content and the differences between them, in terms of time or level of implementing. At the same time, this study reveals the results of international studies or conceptual approaches, which support these distinctive characteristics, in order to clarify any possible confusion regarding these tools.*

*The paper ends by mentioning the favourable consequences that a company enhance due to developing a strategic planning process.*

**Keywords:** strategic planning, long-term planning, marketing planning, corporate planning

**J.E.L. Classification:** M31

## 1. Introduction

The process of strategic planning has been addressed by many authors in the international specialty literature, as well as in the Romanian one. Aspects as planning's typology, stages or advantages for companies have been analysed and described in management - marketing scientific papers.

According to Carter, strategic planning exists since the most ancient times, but as military strategy. It entered into the economic sphere in the 1920s, along with the development of the first strategic planning methodology in the commercial field,

elaborated by the Harvard Business School.[4]

In the 1950s, the strategic planning shifted towards the risk management and increasing the market share. It became so important that almost all large companies had their own strategic planning department. If in the 80's, the strategic planning was in decline, being at one point considered even redundant. But in the late 90's that concept was given again due attention.

## 2. Defining strategic planning

Planning is a process that involves several steps [12]. Firstly, the company defines its purpose and more precisely it identifies the target customers' needs and the necessary technology for meeting them. The second step focuses on determining key areas: market research, innovation, productivity, physical and financial resources, profitability, manager's performance and development, performance and attitude of non-managerial staff. The third phase includes identifying means for measuring results, while within the fourth stage the constraints and the limits are met or exceeded (legal or ethical issues).

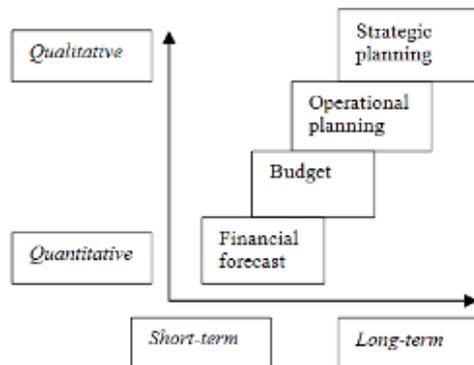
Piercy suggests a multidimensional model of planning, encompassing three dimensions: analytical, behavioural and organizational [6]. So, according to the first dimension, the analytical instruments, techniques and models are important because they provide the necessary framework to address the results and identify and solve the problems. While the planning systems have the advantage of a common systematic approach, in order to be effective, they must address the behavioural and organizational issues.

The behavioural dimension focuses on human resources within the planning process. Plans are successful due to the support, participation, motivation and commitment of human resources.

According to organizational dimension, planning takes place within a context of a particular organization. Thus, it will be influenced by organizational factors such as culture and management style.

Lasher takes into consideration four types of planning: (1) strategic planning, (2) operational planning, (3) budgeting and (4) forecast. [1]

Figure 1. Planning's typology



Source: Analoui, F, Karami, A., *Strategic Management in Small and Medium Enterprises*, Thomson Learning, London, 2003, p. 155

Strategic planning creates strategic plans, which rather explain the general ideas and concepts, being developed on long term.

Operational planning specifies the necessary actions to achieve the objectives and it determines the modalities of business daily running.

Budgeting involves allocating resources to specific functions and then helps to measure the activities, while the forecast estimates the short-term financial results.

The two concepts of strategic and operational planning have been also discussed in the specialty literature in Romania. Thereby, strategic planning sets the direction and objectives, while operational planning refers to the daily decisions specific to lower levels of the organization. Strategic planning is oriented to make good things (necessary activities - effectively), and operational planning intends to make things better (by necessary means - efficiency) [5].

Therefore, strategic planning is a management tool, and like any tool of this type, it is used for one purpose: to help the

company to operate, to ensure that the employees are gathering their energy and work together to achieve the same ideal, to set and adjust the company's action direction in response to a changing business environment.

In fact, the new concept of market-oriented strategic planning that was proposed by Kotler represents “the management process of designing and maintaining a viable relationship of correspondence between the objectives, skills and resources of the organization and its changing market opportunities. Strategic planning’s goal is to shape the company's economic activities and products so as to achieve the established profits and growth rates”. [9]

The analysis of this definition ensures key elements that cover the meaning and success of strategic planning process.

The process is strategic because it involves finding the best solutions to the circumstances of the company’s business environment, whether they are known in advance or not. Strategic planning requires clear knowledge of company’s objectives, of its resources, but it assumes also a responsible response from the company’s managerial staff, in the context of such an unstable marketing environment. In addition, the process refers to the planning function, as it involves setting deliberately certain objectives – linked to a desired situation in the near or distant future – and develops ways of achieving these objectives.

Strategic planning process raises multiple questions, which helps the professionals to gather and incorporate information about the current situation and predict the business environment in which the company will operate in the future.

Finally, the process is related to fundamental decisions and actions because choices must be made in such order, to meet the above series of questions.

Strategic planning involves a set of decisions about the tasks to be undertaken and carried out successfully, the reasons behind these responsibilities and the modalities of action. As sometimes is difficult or even impossible to organize all the necessary activities due to various obstacles, the strategic planning can help the organization to prioritize the decisions and to

adopt those that are closely related to successful consequences.

The most important consequence of strategic planning is to achieve the desired profit, while the customers declare themselves fully satisfied with the company's products or services.

Regarding the strategic planning's stages, it appears that this process includes:

- mission, vision and corporate objectives;
- assumptions underlying the plan;
- strategic issues arising from the appraisal of organization, marketing environment and competitor analysis;
- evaluation of a profit margin;
- strategies drawn from the above mentioned elements, including creative thinking about how to exploit the opportunities and gain competitive advantages;
- detailed analysis of risk factors;
- financial results. [8]

### **3. Strategic planning versus long-term planning**

Taking into consideration the time of implementing the plan within a company, some authors consider that a tactical plan is established for one year, and the strategic plan is established for an interval of time longer than one year. [3]

There are also specialists who say that there is a difference between strategic plan and long-term plan, in terms of the marketing environment, which those two processes assume. [13]

The concept of long-term planning appeared in the late fifties and early sixties, when the economies of various countries were relatively stable. Therefore, the long-term planning is generally considered that is developing a plan for achieving a goal or set of goals over a period of several years, indicating that current information about future conditions are sufficiently safe to ensure the quality of the plan even over the time of its implementation.

Unlike long-term planning that is useful in the context of a stable environment, the strategic one takes into account that the organization must respond to a dynamic marketing environment.

In the non-profit sector there is a common view according to which marketing environment is changing, sometimes in unpredictable ways. Thus, strategic planning emphasizes the importance of taking decisions that will ensure the organization's ability to respond successfully to changes in marketing environment.

Two other differences exist in theory between long-term planning and the strategic one [13]. First of all, strategic planning is done at the highest level of organization, while long-term planning is carried out bottom up and it is rather a set of plans specific to individual units. Second of all, strategic planning bears the mark of quality and assures the company a clear vision, while long-term planning is driven by numbers.

In addition, the specialists have tried to identify whether in practice there is a difference between the strategic planning and the long-term one and what it would consist of.

Therefore, a marketing research was undertaken among 65 libraries, 34 being public and 31 belonging to various universities [13]. The study showed no significant difference between the plans named “strategic” and those entitled “long term”. Both fit a pattern that each library interprets in a particular way. In conclusion, in practice, the concepts “long term” and “strategic” seem to be equivalent.

### **4. Levels of strategic planning**

Every company needs a plan for each product that it sells, specific strategies and adequate resources, the development of these plans being called marketing planning. [2]

Instead, strategic marketing planning involves coordinating marketing activities necessary for successful sale of all products of a company, and it can also provide answers to certain questions, such as:

- What is the organization's current situation and what are the steps taken to get here?
- Where does the company intend to get in the future?
- What are the stages that need to be fulfilled for the organization to reach the desired position in the future?
- What are the costs associated with these steps?

- What kind of performance has the company to achieve, in order to conquer the desired position in the future? [14]

In other words, the strategic marketing planning is a complex process of establishing and maintaining the best relationship between objectives, staff training and resources of an enterprise, on the one hand, and marketing mix, compared to market conditions, on the other hand. [7]

However, over time, in order to avoid the confusion in the marketing theory and the use of specialty terms as synonymous words, even if they address distinct issues and express different ideas, many authors have attempted to define both concepts (strategic planning and marketing planning), as clearly as possible.

In this respect, Morse brings multiple arguments to support his point of view, namely that between long-term planning and annual marketing planning there are many differences. [12]

Thus, long-term planning encompass the following data: (1) information about consumers, as age, gender, salary, statistics on consumption or spending, (2) data regarding commercial issues, as channels of distribution, trends and statistics, (3) economic data, like changes in prices, raw materials, legislation, (4) competitive activity, and (5) post-selling performance.

However, the annual marketing planning is basing on: (1) diagnosis of marketing data from the past, (2) product performance versus goals, (3) data related to the product, as sales volume, market share, profit, (4) distribution objectives, (5) strategies and objectives for every group of products, per month, per territory, (6) promotional plans.

A difference between the corporate planning and the strategic marketing one is underlined by Young [15]. Thus, corporate planning process includes the following steps:

- establishing vision, mission and corporate objectives;
- declaring the strategic intent;
- proposing a value for ROI (“return on investment”);
- identifying the target segments of the strategic business unit;
- elaborating business growth plans;
- reducing investment;

- establishing the market position to which the company aspire to get;
- choosing the corporate brand strategy;
- using effectively all the company’s resources.

Instead, strategic marketing planning focus on: marketing objectives, target market segments, intentions for positioning, sales and revenue objectives, desired market share in key markets, products or services portfolio strategy (new products or services, re-launches, withdrawals and associated activities), competitive strategies, entering on new markets, strategic programs and initiatives of a particular importance, high quality plans and related measures, emergency plans, internal and external communication objectives.

Table 1 reveals the three levels of planning within a big corporation.

*Table 1. Planning levels*

<b>Planning level</b>	<b>Management level</b>	<b>Decisions type</b>
<i>Company</i>	Top management	Decisions regarding the activity domain
<i>Strategic business unit</i>	Business management	Decisions regarding product portfolio
<i>Product</i>	Product management	Decisions regarding marketing-mix

*Source: Assael, H., Marketing. Principles & Strategy, Thomson Learning, United States of America, 1990, p. 617*

Moreover, at the company level there is implemented a corporate development strategy and are adopted directives towards strategic business units.

Both the corporate planning and the strategic business unit one are designed for a five years interval of time, while the planning specific to individual product is for one year.

The strategy chosen at the product level include market segmentation and product positioning.

However, one cannot completely separate the strategic marketing planning from corporate planning. In support of this idea comes McDonald, who states that is not possible the planning of marketing activities separately from other functions of the

company, as marketing planning is the instrument by which the company monitors and controls internal and external influences on its own ability to obtain considerable sales, and communicates what it wants to go to completion. [11]

Consequently, marketing planning process should be based firmly on the corporate planning system and the first link between the two concepts is the stage of establishment the company's mission and objectives.

But taking into account the level of development and implementation of the planning process, it can be said that strategic planning takes place at the level of both company and strategic business units, while marketing planning is carried out only at the level of the individual products.

## 5. Conclusions

Strategic planning is a circular process, whose steps include: (a) choosing strategy, (b) establishing the strategic objectives, (c) elaborating specific plans, by mentioning at the same time the tasks, the deadlines and the responsibilities, (d) allocating the resources, and (e) applying the monitoring and control procedures in the case of objectives and resources and for validating the predictions regarding the environment. [14]

Although sometimes the planning's usefulness is challenged [10], considering that “much of corporate planning ... is like a ritual dance to invoke rain, it has absolutely no effect on the weather of the next day”, this process brings many benefits for companies, including the following:

- greater capacity for predicting the development of the external environment's components, and rapid adaptation of resources, which is basing both on complex and accurate analysis, and on the increasing of managers' responsibilities and the staff's professionalism. Planning also enables them to anticipate threats and opportunities and to properly assess the strengths and weaknesses.
- better organization of managers' work, which are facing multiple, difficult and sometimes unpredictable tasks.
- favourable position in the market, as a consequence of the technological innovations implementation and

competitors challenge, knowing the risks and potential financial benefits.

## 6. Acknowledgments

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## Organizational Learning and Learning Organization in Knowledge-Based Economy in Romania

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### Abstract

*Each company's future depends on its transformation into a learning organization, and their success will depend on the effective use of talented people. Organizational learning remains an imperative for developing a knowledge based economy; it is also necessary to affirm the creativity of Romanian organizations as the main source of competitiveness and international identity. The learning ability of the organization's members must be rediscovered and revived. It is necessary for learning to become the background for change.*

**Key words:** organizational learning, learning organisation, knowledge management, organizational culture

**J.E.L. Classification:** M16

### 1. Introduction

Although, initially, the terms *organizational learning* and *learning organization* were interchangeable, gradually, since the mid 90's, the two concepts separated into two trends.

Organizational learning is the descriptive trend, oriented on the process of learning in organizations. The roots of this trend are in social and cognitive psychology and have a strong academic orientation. Basic question is: How does a learning organization? and in these research publications Argyris and Schon's (1978, 1996) are widely mentioned. [1]. On the other hand, the *learning organization* is a prescriptive trend that focuses on the characteristics of the organization that facilitates learning and aims to create a certain type of organization. We can say that this trend has a strong practical orientation and research are made predominantly of practitioners: Drew and

Smith (1995), Benoit and Mackenzie (1994), Moilanen (2001 - quoted by Sun and Scott, 2003), and Senge's work (1990) is the foundation of these approaches.

The concept of *learning organization* has a more recent history than the *organizational learning*. It was known by the late '80s, through the European scientific world contribution, including British writers Garratt (1988) and Pedler (1981). Then, in 1990, Senge's work is one that has attracted particular interest, perhaps because organizations and consultants were seeking new ideas to replace the concept of *corporate excellence* (Peters and Waterman, 1982). [2]

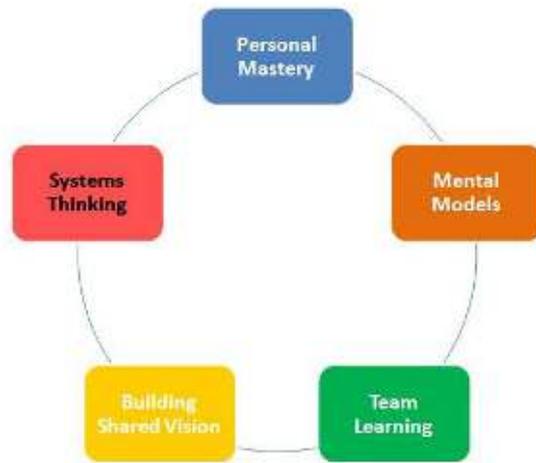
Although Senge's success was substantially in Europe, his view was not fully accepted by the academic community in North America and, thus, was more at issue discussed and extended in Europe (consider some authors such as Swieringa and Wierdsma - 1992, Burgoyne - 1994; Peam - 1995; Probst and Buchel - 1997, etc.). Between the few American scientists who have addressed this concept we mention Dixon (1994) and Torbert (1994), largely influenced by European ideas.

The concept of *learning organization* (or knowledge-based organization), was described by Peter Senge, in his "The Fifth Discipline", in 1990. [3] For the author, learning organizations are organizations where people continually expand their capacity to create the results they truly desire, where new and expansive patterns of thinking are nurtured, where collective aspiration is set free, and where people are continually learning how to learn together." Mike Pedler suggested another version of the same concept – learning organisation "is a company that teaches projection, a vision of what might be possible." A learning organization expands its capacity to create its future, not only willing to survive. Learning to survive, often seen as adaptive learning,

important and necessary, couples with generative learning that develops substantially the ability to create ”.

Senge (1992) described the core of a learning organisation’s work as based upon five learning disciplines which represented lifelong programs of both personal and organisational learning and practice.

Figure. 5. „Five learning disciplines”  
(according to P. Senge)



These include: [4]

- *Personal Mastery* — individuals learn to expand their own personal capacity to create results that they most desire. Employees also create an organisational environment that encourages all fellow employees to develop themselves toward the goals and purposes that they desire.

- *Mental Models* — this involves each individual reflecting upon, continually clarifying, and improving his or her internal pictures of the world, and seeing how they shape personal actions and decisions.

- *Shared Vision* — this involves individuals building a sense of commitment within particular workgroups, developing shared images of common and desirable futures, and the principles and guiding practices to support the journey to such futures.

- *Team Learning* — this involves relevant thinking skills that enable groups of people to develop intelligence and an ability that is greater than the sum of individual members' talents.

- *Systems Thinking* — this involves a way of thinking about, and a language for describing and understanding forces and

interrelationships that shape the behaviour of systems. This discipline helps managers and employees alike to see how to change systems more effectively, and to act more in tune with the larger processes of the natural and economic world.

Garvin (2000) defined the learning organization as a qualified organization for the creation, acquisition, interpretation, transfer and acquisition of knowledge, which deliberate change its behaviour to reflect new knowledge and insights.

As individuals learn through different means or in different styles, so it is happening with the organizations. Up to a certain level, these differences are explained according to the environment in which the organization operates. For example, *why* and *how* organizations learn in external stable environments, with well-defined products, such as matches and toothpicks, will be different from what happens in *volatile* industries, involving new products and evolving technologies: *hardware-products* and *software* type. The differences between organizations in the learning process can also be a result of differences in history, culture, organization size or age. The new organizations appeared on the market learn differently from larger ones.

Organizational learning style suggests how organizations learn and it is defined by the learning activities that are taking place (Di Bella and Nevis, 1998). A set of learning activities belonging to an organization reflects its style of learning. Learning style can not, however, indicate how well the organization learn and can not appreciate the value of the learned but instead may provide clues about what *is learned* and *how learning takes place*. As a result, a complex organization applies different learning practices which are themselves, different learning styles. These practices and learning styles form the basics or the background of the organization *learning portfolio*. [2]

Learning styles is an ability that the organization has acquired. To use this ability to obtain competitive advantage, it is necessary for organization members to identify, as accurately, what this ability consists in. Research shows that some organizations have a dominant learning style, while many others use a variety of styles, each providing a particular style of learning

capacity. Organizations with a portfolio of learning styles and multiple skills are able to demonstrate a greater ability to adapt to change than those based on one single learning style. [5]

## **2. Organisational learning (OL) and knowledge management (KM)**

Because of the fast development and growth of the organizations, the information technology and information capital have become significant assets. Managing knowledge is important because knowledge is one of the most strategic weapons that can lead to sustained increase in profits (Choi & Lee, 2002). [6]

Organizations are seen as learning through processes that create new knowledge or modify existing knowledge (Phanng, 2008). From the knowledge-based perspective, Bates (1998) argued that knowledge is the basis of learning. An organization can not compete with others in this changeable environment for the lack of adequate knowledge and renewal capability. Knowledge or information is now perceived as the most significant strategic resource in organizations, and its management is regarded as critical to organizational success (Ipe, 2003). The development and growth of organizations have made information technology and information capital significant assets in organizations. Managing knowledge is important because knowledge is one of the most strategic weapons that can lead to sustained increase in profits (Choi & Lee, 2002).

Facing such a turbulent environment, business must continue with learning in order to maintain its competitiveness. As we argued before, according to (Senge, 1990) *learning* was the only sustainable competitive advantage. He regarded KM as a business process, through which firms generate and implement their institutional or collective knowledge, including organisational learning, knowledge production and knowledge distribution. Organisational learning is the process through which a firm obtains information or knowledge.

In organizations which rely most on tacit knowledge more than explicit knowledge, the approach that works best is the personal

transfer and the information technology can only support this process, not to replace it.

Learning processes must become more deeply, anticipative and participatory, to ensure the transition from specialist to adaptable generalist; to put the focus on innovative learning, to ensure autonomy of the individual (as a key element of personal fulfilment) and its organic integration within the society (as a key element of human relations)

Any new knowledge, especially in a training organization, is both a product of past activities and a source of knowledge on a future activity. The ability to organize activities which ends with the generation of new knowledge is valuable but the knowledge has a low utility if employees are unable to apply them practically. Experience, interpretation and context in which information becomes knowledge are difficult to replicate and, in consequence, the talent, dexterity and / or skill of each individual are unique and can not be acquired in an identical manner by others.

It becomes increasingly clear that if there is a community of interests, people who have achieved the same goals or share the same values will recognize how advantageous it is to put together everything they know. Of the same importance is for everyone to show off what they know with relevance in the workplace.

## **3. The role of organisational culture (OC) in support of organisational learning (OL)**

Organisational culture means the shared understanding or values between the employees within an organisation, which finally will determine how things work in the organization. Osland, Kolb, and Rubin (2000) defined OC as a pattern of shared values and beliefs that produce certain norms of behaviour. Andrew and Yate (2002) argue that OC is an aggregation of shared values, beliefs, and understandings among members. When Tucker (2001) describes OC the focus is underlining the effect in terms of organisational change: OC represents the company's values, traditions, priorities and paradigms and its universal existence within organization will affect the implementation of organizational change.

Dodgson (1993) provides a comprehensive definition of organisational learning: OL involves the ways firms build, supplement and organize knowledge and routines around their activities and within their culture, and adapt and develop organizational efficiency by improving the use of the broad skills of their workforces. So, the OL is seen as a dynamic process based on knowledge, and also implies moving among the different levels of action, going from the individual to the group level, and then to the organizational level and back again.

A culture encouraging change is a critical feature of OL. In order to face such a complex environmental situations, organization needs more stronger adaptive culture to encourage the mutual cooperation and earning among members (Daft, 2001). Sometimes the failures in organisational learning may be caused by the lack of communication among the organization's different cultures. Organisational learning can be the catalyst for implementing an organizational learning culture and in return , the learning culture would systematically improve organisational learning. Brian and Pattarawan (2003) suggested that organisational culture is positively related to organisational learning.

#### **4. Organizational learning and learning organization in knowledge-based economy in Romania**

Romanian organizational environment is no exception from the global trend of contemporary orientation to knowledge but, due to the lack of strategic options, it happened unsystematic, especially locating the informal plan. Large organizations are more attached to the hierarchical configuration and functionality, even in case of the transition to computer assistance. Instead, however, within the SMEs and non-governmental organizations, professional management practices and knowledge are already present, but in more experimental, reversible, forms.

Organizational learning remains an imperative for developing a knowledge based economy; it is necessary to assert Romanian creativity as the main source of competitiveness and international identity.

In Romania, many organizations are considering the *change, the development*, but can not decide the *direction* of change or development. Ensuring feasibility of organizational learning projects in the Romanian context requires both strategic computerization effort and educational support, but also a proper management.

It takes another way to see the leadership in the context of business environment in Romania and to get change in this proper context. A linear thinking, top down, will lead to errors because it will lose to all causes of unwanted effects. The problems are seen in a different view/perspective by those facing every day with it and there is another perception to the next level.

Often, managers resistance to ideas of subordinates reflects intolerance of contrary opinion, difficulties in accepting the truth or simply the fear of coming up with a better solution. In theory, this concept of organisational learning is very attractive. But how many organizations actually put it into practice? What are the obstacles that prevent us put it into practice? How can we evaluate the learning within the organization?

Our current vision and the manner in which we understand things are not consistent with the reality of the environment or with our system of values that define this environment.

According to (Filip L, Dragomirescu H., 2001) some measures appear to be vital, starting from the national level:

- (1) training of professionals in knowledge related areas and its management,
- (2) official recognition of new professions and occupations and knowledge-based organizations,
- (3) training of trainers for these competence profiles.

Developing organizational learning, along with its foundation on knowledge can be organized/achieved within the following generic scenarios (according to Filip Dragomirescu, 2001): [7]

1. *The scenario of emergent development* – is one scenario in which the orientation of the organizations towards knowledge is produced under its own essential inevitability. A trend in such a scenario is likely to occur under the conditions of inaction or delays in concentrating efforts to

support the country's progress towards the knowledge society.

2. *The scenario of strategic development* - it is based on projects aimed at facilitating the establishment of the knowledge appropriate changes in existing organizations and creating new ones. The result of applying this scenario is also a non-hierarchical configuration, but in a form represented by the pattern centred on organization memory; in this type of organisation the synergistic effects would prevail, by strengthening organizations integrating elements (memory, network infrastructure, intelligent solutions for tutoring groups) to support partnership and creative behaviours.

The second scenario is superior to the first, both in terms of *approach* and the *expected results*.

## 5. Conclusions

Each company's future depends on its transformation into a learning organization, and their success will depend on the effective use of talented people. The organisations that will not create a generative learning culture, will not adapt fast enough, will not face the challenges of the environment in which they operate.

Therefore, the learning and improvement have the goal the orientation to innovation, towards different and creative solutions and preparation of the responses to different situations. We face complex problems are as effects of several causes. People must learn to solve the problems by their own and they have to be aware that in their ability to learn, to develop unique and individual capacities are kept many answers. We are heading for an era of human freedom, responsibility and intelligence. The learning ability of the organization's members must be rediscovered and revived. It is necessary for *learning* to become a background for change.

Organizational learning remains an imperative for developing a knowledge based economy; it is also necessary to affirm the creativity of Romanian organizations as the main source of competitiveness and international identity.

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# Business Benefits, Social Responsibility and Sustainable Development in SME Trough Implementing and Combining ISO 14000 with ISO 26000

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## Abstract

*The negative effects of the global crisis can be seen on SME's because of their size and their difficulty to access finance. SME's need to be aware of the impact that their activities have on the environment which will turn into a great opportunity to explore the economic advantages that emerges from implementing an environmental management system. If an SME has already implemented an ISO 14001 environmental management system, the next natural step would be to turn its attention towards this new and long awaited ISO standard which is ISO 26000.*

**Key words:** *competitive advantages, risks of environmental accidents, EMS, SME, ISO 26000, ISO 14000, healthy ecosystems, social equity, good SME management*

JEL M41

## 1. INTRODUCTION

Small and medium size enterprises, even in this time of crisis, represent more than 90 per cent of all enterprises and they operate in a constant changing environment. From the viewpoint of sustainable development, SME's play a fundamental part in redirecting the economy to more sustainable patterns of production and consumption.

The most concerning problems that small and medium size enterprises are facing are the access to finance, witch in this times of global crisis represents the greatest threat to their future, not to mention that finding customers is always a challenge for this type of enterprises, the competition, the costs of production or labour, the availability of

highly trained staff or experienced managers, and last but not least the regulations.

SME's need to be aware of the impact that their activities have on the environment which will turn into a great opportunity to explore the economic advantages that emerges from implementing an environmental management system.

## 2. SME'S AND THE ENVIRONMENT

Across Europe, small and medium size enterprises, category in which we include also micro firms, represent about 95 per cent of all type of enterprises. Along with their large number comes also a dose of optimism because on some surveys more than half of them anticipate growth.

Even if they are interacting in this constantly changing environment on all aspects their capacity to adapt quickly to new situations is diminishing. The economic situation that we are facing requires a great effort to adapt in order to fell efficient and competitive, effort that is not encountered by SME's which are not willing to invest in research and development. A consistent part of SME's do not spend money on innovation and they don't allocate any of their revenues on research and development. This situation may occur also because the major part of the small and medium firms cut their investments along with the coming crisis.

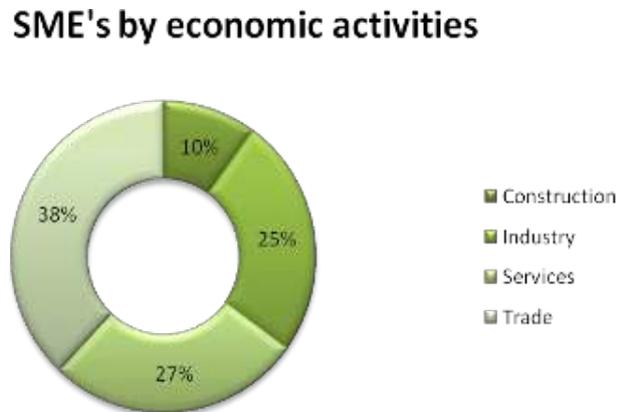
When it comes to environment this is a problem which does not concern only a country being in fact a global action with a firm objective of environmental protection.

If we turn to SME's their large representation in the economy generates also a great impact on the environment. This impact includes among others: air pollution,

the use of natural resources, the use of energy, noise, odor, dust, disposal of wastes

and many other.

Figure 1 - Small and medium size enterprises described by their type of activities



Source: projection made by authors

In all of this areas SME's have a significant impact on the environment from waste, discharges, emissions to consumption of raw materials, consumption of water, consumption of energy, risks of environmental accidents, effects on biodiversity and others.

### 3. COMBINING ISO 14001 WITH ISO 14006

In order to implement an environment management system (EMS) SME's needs to take into account booth their direct and indirect environmental aspects. The implementation process defines and establishes a strategy to develop all the process of implementation.

Aside with the implementation of ISO 14001 SME's can also consider the implementation of the new ISO 14006 representing guideline for incorporating ecodesign, incorporating ecodesign into any environmental, quality or similar management system.

All products or services of SME's have an impact on the environment during all stages of their lifecycle, from extraction of resources to end-of-life. The main objective of ecodesign is to integrate certain environmental aspects into the design and development of products and services order to reduce their environmental impacts and

continually improve their environmental performance throughout their lifecycle.

SME's witch decides to implement this new ISO standard will find themselves offering cleaner products and services and a greener planet.

The implementation of ISO 14001 and ISO14006 reduces costs and attracts financing and investments increases revenues by converting waste and they are reducing the use of materials through improved and timely follow-up materials and reporting systems.

The advantages of ISO 14006 is that it is applicable to SME's and it is suitable for SME's that alrely have implemented an ISO 14001 environment management system.

Another advantage of this ISO 14006 standard is that it does not establish by itself any specific performance criteria and was not created for certification purpose. The management of the SME can apply this particular standard to those aspects inside the SME that they control and has a big influence on.

### 4. GETTING AHEAD OF OTHES BY IMPLEMENTING ISO 26000

SME'S must be aware of the need for and benefits of socially responsible behavior. The main purpose of social responsibility is to contribute to sustainable development.

The performance of an competitive SME in relation to its impact on the environment and the society in which it operates has become a critical part of measuring its overall performance and its ability to continue operating effectively. It represents a reflection of the growing recognizing of the need of healthy ecosystems, social equity and good SME management. If we think in long term, all SME's activities depend on the health of the world's ecosystems.

If an SME has already implemented an ISO 14001 environmental management system, the next natural step would be to turn its attention towards this new and long awaited ISO standard which is ISO 26000.

This ISO 26000 helps SME's around the world to contribute to sustainable development. It is meant to encourage SME's to go beyond all legal compliance, knowing that compliance with the law is a fundamental obligation of any SME and a main part of their social responsibility.

ISO 26000 is intended to promote common understanding in terms of social responsibility, and last but not least to

complement other instruments and initiatives for social responsibility, not to replace them.

Getting ahead of others by implementing ISO 26000 gives SME competitive advantages, not to mention the ability of hiring and retaining workers, customers and clients. Through this process SME's develop their relationship with companies, government, the media, suppliers, customers and the community in which this SME's operates.

Another benefit that comes along with the implementation of this standard is rising the employee morale, commitment and productivity things that mean a lot to a SME further on it means everything to a micro-firm.

Making ISO 26000 a guideline document, it offers a concise opportunity for managers to look at the principles and the objectives of social responsibility and to look how they may apply these principles in their SME.

We must say that ISO 26000 is not a management system standard and is not intended or appropriate for certification purposes This ISO 26000 does not contain requirements.

*Figure 2 – Social responsibility main subjects*



*Source: projection made by author*

## 5. CONCLUSIONS

In our times the environmental problem regards not just a particular country, being a global action with the major objective of environmental protection.

SMEs have a great role in redirecting the economy to more sustainable patterns of production and consumption.

Environmental and business benefits along with social responsibility and sustainable development can be achieved by combing and implementing this two ISO standard making the SME more competitive,

increasing its reputation, improving public policy making in relation with the environment, improving the information used for the evaluation of environmental performance. SME's can reduce costs of maintenance, repair and operations, can reduce costs associated with waste and losses of material. SME's also can increase revenues by converting waste and they can reduce the use of materials.

Developing the relation between ISO 14000 and ISO 26000 will increase credibility of SME's and will give them a greater security on the management of environmental issues along with social responsibility awareness and a real sustainable development.

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# Human Resource Management and Corporate Social Responsibility

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## Abstract

*The current context of economic development, the transformations that are subject to national and international organizations impose their traditional attitude change in relation to results and performance of current activity. In this context, the Corporate Social Responsibility (CSR) aims to achieve economic success in an ethical manner with respect for people, communities and environment.*

*This article analyses the concept of Corporate Social Responsibility in relation to Human Resources (HR) Management, respectively the issues relating to human resources that an organization must consider when designing their corporate social responsibility strategies.*

**Key Words:** Corporate Social Responsibility, Human Resources Management, Human Resources Development

**JEL classification:** O15

## 1. Introduction

Human Resources Management in the context of human thinking was individualized as a well determined field within general management theories and practices it influences in entire organization becoming; it comprise total conceptions, methods, procedures, projection and solutioning objectives and tasks of all leadership issues at organization level as system in all activity fields and on all company hierarchy levels. Human resources management, G.A. Cole regards managers' activity of those with responsibility of achieving policies and strategies in the field of assuring, recruitment, selecting, training, socialization and estimating organization personnel [5]. They have double professional

preoccupation for both employees and for organization leadership, advising the two organization structures—employees and leadership—to administrate as carefully and efficiently the most active, valuable, innovating- creative resource, people who, acting individually and group, accomplish organization existential objectives. One must not omit the fact that organizations mean people in their diversity and unity as well, they are “groups of groups”, G. Lapassade between whom there are interpersonal complex relationships focused on mutual pursues. Human resources management is related to both theoretical, conceptual values of management and to personnel practice, incapacities integration and altitudinal, attitudinal and behavioral of employees evaluation.

Realities of knowledge society, post-bureaucratic organization - “expressive organization”, “democratic organization” [1], “intelligent organization”, “learning organization”, “relational organization” resulted in the development of a new organization culture, dense, borderless with record communication time. Such organization structures demand new needs, first of all the inter-human relationships need – between lead and leading since existence milieu and existence is another one. Interest partners, who do no limit only to employees—are preoccupied that their relational system, of business, beyond pressure for profit gaining, get accomplished in a responsible manner, in transparent standards and within an existential or relationships with community structures they serve in organization full responsibility.

New post-industrial realities develop new paradigms, among which Corporate Social Responsibility (CSR) within which values of company culture become dominant in organization manifestation area, values hey have to believe in and act in entire responsible becoming of its business, in

business strategies as well as in company daily activity.

## 2.The concept of Corporate Social Responsibility (CSR)

Multivalent concept CSR has a time becoming synthesized and evaluated after 1960, as consequence of new post-industrial changes and also as a sustainable development. CSR regards voluntary managers' selection activity of actions and activities system meant to protect and assure society welfare as well as of organization and employees. Comprehended as that conception which regards companies' voluntary contribution to modern society development, CSR serves to sustainable development through promoting desirable corporatist behavior. It is deliberately assumed engagement, beyond legal or imposed by economic restrictions, to pursue objectives in the long run regarding society becoming [12].

By issues amplexness and depth CSR engages modern post-industrial society in its integrality: international institutions-principles-recommendations; national institutions-regulations normative, legislative; local institutions—decisions; companies-resources; communities-development needs. Thus, UNO, EU, OECD are only the most important international structures that involved in conceiving and elaborating both defining frame and indicators defining and allow estimating CSR. Practically, this economic and social relationship, (CSR) structures issues into two conceptions: 1. CSR perceived as company moral obligation or duty; 2. CSR perceived as deliberate initiative, voluntarily assumed by company in view of heir existential economic and social objectives.

Theoretical confrontations are present through their step to activity of elucidating of real and proper CSR for actual world. O.Falk and S. Hebllich [6] hold that “CSR must be understood as a voluntary corporatist engagement I order to surpass implicit and explicit obligations imposed to a company by society expectations regarding to conventional corporatist behavior.”From this standpoint, there also are P. Kotler et Lee [9] who define CSR as being main activities carried out by corporation to support social

causes and to accomplish responsibilities engagements assumed, that CSR has an Omni-comprising, global contents resulted also from accepts given by UN through global principles provided for companies strategies, for their actions, known as NU Global Compact (comprising four domains and ten principles). Developing these recommendations, A.B.Carroll [3] draws attention upon the fact hat CSR regard the entire scores of social order face to society-legal economic, legal, ethic and charitable responsibilities elaborating social corporatist responsibilities pyramid (Fig.1).

Pyramid base is given by economic responsibilities, followed by the legal ones, ethic and on peak there are the charitable. Dimensions do not exclude. Neither are they treated as proper structures of social responsibilities, because whatever company action is based simultaneously upon the four of responsibility structure précising that a certain dimension out of the four ones become predominant in a certain given context without excluding the other ones.

*Fig. 1. The Pyramid of Corporate Social Responsibility*



*Source: A.B.Carroll, 1991, p.42*

Expert literature reveals, chronologically three approaches of social responsibility [11]:

- CSR as obligation only face to shareholders, a narrow approach the only responsibility is profit growth, their maximizing as central preoccupation of companies, and social responsibility is in Government competence and preoccupation [7]; is narrow CSR since business system is “closed, microeconomic outdated vision;
- CSR as obligation face to stakeholder, therefore not only of shareholders but

face to all stakeholder even though such stakes are divergent of influent social groups-CSR dominant dimension [8];

- CSR as obligation of company for society in its totality, extended perspective of CSR; company is responsible to society in its integrality, in its quality of component of existential milieu; organization acts functions through public consensus, motive determining it to serve deliberately social needs of society; CSR is a strategic response to the new, actual internal and external needs that are extended to organization level; companies according to this vision extended CSR promotes social welfare as a response to a social need, that because they are actually open business systems where there is a well determined balance between organization economic and social performances.

CSR, according to Ed. W. Younkins [13], involves engagement in market open competition with no illicit means, but in respect of employee's and engagements assumed to them rights, to partners providers and clients, supposes a suggested debt organization, as social existence has for all parts involved into its actions and activities, to human community, therefore face to people.

CSR, E.Cohen [4] shows, must be comprehended as a business strategy viewed on ethic principles, on structured management elements, which takes into account in decision making process social and environmental aspects besides the economic ones and which attempts to positively influence all parts involved to constitute a voluntary approach going beyond conforming to regulations and legislation, regards beyond final purpose. – profit maximization – gives also attention and satisfies other public categories, minimizing their negative impact upon environment, on society in general, those stakeholders who have positive interest in this (shareholders, employees, clients, providers, distributors, public bodies, local communities, etc.), pursuing maintenance and development of solutions in the long run and mutually advantageous.

### 3.Human resources management and CSR

Human resources management, in context of knowledge based society development has as target for its entire step fact that organizations are people, they also are fundamental argument to promoting CSR, brought into relief also by N.E. Bowie and F. Duska [2]. By their quality of society institutional members, are citizens, people, and they have civic duties and responsibilities. Organizations benefit of totality of society existential values, therefore, they have certain gratefulness duties for these, that allow them he exist and function, to materialize their existing objectives and tasks and businesses to develop according to stakeholders' existential needs.

Out of such prerogatives, human resources management are both conceptually and practically optimally responds and have preoccupations for social corporatist responsibilities in the sense that it has fundamental preoccupation covering with expertly personnel all organization professional activities under required efficiency, competitiveness and performance conditions. Investment in people remains the certain path by which whatever company competitiveness, as well as future are assured; interest being that such investment, the most active, innovative and creative one should act as performing as possible. Personnel need and satisfying it is an ample, simple to accomplish conscientious process and which is accomplished, as A. Tabachiu shows [14], according to knowing organization actual development stage, it's becoming directions careful and responsible analysis of and professions and their practicing scientific development level, respect of psychological requirements regarding profession practicing, human and social-human, relational qualities and organization socialization and integration degree of promoted organization culture norms and values, etc.

Or people with highest influence upon company and who also are most influenced by them are employees, without diminishing the other organization structures. Organization functioning depends on them, they are actively, devotedly, motivated involved, able and competent. By common

activities, they assure company's social responsibility becoming [4] in conceiving and elaborating social responsibility strategies, organization should give a special attention to position content, working place offered to employees, respectively, therefore to human capital, to qualitative accomplishment of its existential objectives and tasks to assuring working conditions, climate and atmosphere proper to creativity and innovation, of a motivational system and also for evaluation and corresponding evaluation and appreciation of social and economic development stage. Employees' involvement is a result of responsible working place, and it belongs to organization management.

CSR has its becoming, therefore here, in working place creating where responsibility must be on first place, and organization assumes its responsibility for the impact on employees and their families, on community. Treated as complex personalities, employees will behave correspondingly in their entire relational system-active in production in organization culture, in community, in voluntary activities, in environment protection both in and out of organization.

Corporate social responsibility at working place has a rich content at the size of human individual richness and complexity, of its nature [5], and regards on assemble of issues such as:

- Employees' rights: Company is responsible when employees' rights are known, respected/applied, fight protected by international conventions, national legislations and local decisions.
- Employees' payment: incomes able to provide decent living and reflect local level cost of common goods. This, naturally, is larger than minimum wages per economy imposed by normative acts; payments, rewards to belong to organization capacity, to company management to correlate incomes with outcome obtained by work carried out;
- Employees' welfare: is a CSR dimension comprising: certainty at working place; assurance at working place, healthy working milieu, protected against risks, drugs, harassments, tobacco and alcohol noxious influence; sanitary training of personnel; offer of benefits of social care delivery and aid; balance between professional and private life, etc.;

- Personnel recruitment: CSR represents an actual recruitment and selecting personnel. Organization which is responsible of its becoming and development, is responsible above all, also socially, improving attracting, maintaining and developing capacity for talented personnel by providing equal opportunities in recruiting and selection to all human individuals, irrespective origin, race, religion, sex, age, etc;
- Employees formation and development: settling down preparing strategies and policies, training forms-organization and self preparing-to respond at larger extent to social and economic needs of companies; assurance of ethical programs in context of working place responsibilities, in organizations based on authentic and resistant values able to create mentality focused on responsibility, ad dominant of expected behavior;
- Communication with employees, intra-organization dialogue: though it is a jeopardizing action communication with employees is a human, necessary behavior and it belongs to organization obligations to employees as to their expectation, organization contents, of employees and managers in relation with projected objectives and tasks; dialogue is a well-structured activity, to obtain certain information from employees, it is not confused with “sterile, friendly or gossiping”; organization is not necessarily democracy: managers decide, but after dialogue with employees, their decisions can be in knowledge of cause and not adopted based on suppositions; dialogue needs attention and capacity of comprehension, considering employees' opinions, aspirations, preoccupations, company success belongs to;
- Employees' involvement is related to organization existence and functioning. We know organizations are people and people are organizations, heir mirror; Company existence and permanent becoming depend on them. Engagement, Involving belongs to organization management and is an actual form of its motivation in performing accomplishment of tasks, of organization viability. Process involves employees' participation in planning and implementing organization projects, to participate with innovating solutions at company's success, in career development programs. Employees' involvement, E. Cohen [4] shows, supposes

that organization has capacity do discover, to awake interest of personal in activity success, motivate interest, evaluated and promoted; to put into value creative energies of each human individual of company, inspiring employees to make use their passion, creativity, talent, attitudinal and behavioral states, personality characteristic in favor of working place development; to recognize, evaluate and praise each component efforts, contributions to company successes.

- CSR success is possible if objective materialization is provide by human resource management processes and if some imperatives of post industrial becoming:
- Comprehending society as a social complex, where organization is a factor, an agent, its active actor, whose positive impact is assured by awareness of the place occupied in its structure;
- Existence of global reality characterized by manifesting a rich relational network, partnerships, strategically and tactical value alliances for surpassing possible malfunctions. It is about, first of all intra-organization relationships between company's components, then partnership interrelations-providers, beneficiaries, distributors, client, government and local bodies or non-governmental ones, etc, précing that only company employees can materialize conceptions and social preoccupations, of business, in their daily activities;
- Life quality development, aspect surpassing restrictive sense of business - profit gaining, its maximization – regard in toward a sustainable development and community welfare providing, o people and environment-process attracting other structures, too, beside those in business milieu, but which solidarism with development projects community future. Company issue complex with social and environmental ones integrated into organization' general strategic plans where CSR becomes business dimension meaning that each company component should take into account in his activity by social and environmental impact of its own action step.

#### 4. Conclusions

Concept of CSR, L. Oprea [12] shows appears in our country by means of multi-

national companies and early imposed as a “vogue” and not as a result of awareness of all stakeholders need. Though it appeared at the end of World War II, CSR becomes a sustainable development dimension, as a consequence of social and economic analyses carried out after 1990. In our country, it is elaborated Strategy of Promoting of Social Responsibility and approved by Romania Government on 14 September, 2011. Strategy pursues organizations responsabilization with needs of environment development and protection, of local communities for economic growth and sustainable Romania development. They are opinions [14] holding in Romania companies to respect CSR's four dimensions— employees, community-society, environment, and clients - consumers. “We start getting civilized”, Fl. Glinta holds [14]. EurActiv.ro makes a synthesis of CSR contribution of some Romanian companies RomPetrol, Groupe Societe Generale, Danone, Coca-Cola – as well as Romania's Trade and Industry Chamber, by coordinating a network of 42 advising offices for promoting CSR of company.

Unfortunately in the last three years against economic recession background many companies cut off completely CSR budget or reduced it very much. However, there are also companies that developed on-line platforms in order to make their initiatives regarding involvement into society known; for example, **Petrom** with “Andrei Country”, RomPetrol with “Together for everyone”, Raiffaissen with “Raiffaissen Communities “ or URBB Tuborg with ‘Green Umbrella”, platforms well received by stockholders [14].

In practice many CSR are spontaneous, accidental. Some companies look at what do the others do trying then to copy. However there also are companies that choose domains upon which they concentrate according to marketing /PR value they could obtain Multinational companies get indications from their central headquarters on domains they must get involved into. For example, for banking industry there are domains with involvement domains valid everywhere in the world Culture, education and financial inclusion, digital security, struggle against corruption, chance diversity and equality, etc. Certainly, ideally companies in Romania will

also reach sooner or later to establish domains to concentrate upon consequently to real dialogues with public interested (stakeholders) and consequent to analysis of importance the worries and expectations they have.

Domains many CSR programs they concentrate upon in Romania are environment protection. On one hand companies, similar with the rest of public opinion, recognize that threats related to environment are real and it is a global issue they cannot ignore. Don't they improve their impact with environment now, they will be forced by law to do it later. On the other hand, environment is, from all CSR specific themes, the worry toughing the most numerous public. It touches cosmopolite categories, with big incomes, categories that, in general are nor sensitive to other social themes. That is why, an environment program offers the biggest potential benefits in image level.

As regards human resources, companies in Romania integrate responsibility for employees in their CSR programs through their training and continuous learning programs, security and occupational health ones, programs of diversity and work inclusion, corporative voluntaries, salary donation etc. programs.

A big problem in Romania is the lack of CSR reporting; it means there is a lack of transparence regarding budgets invested in social programs, the domains investments have been made in and the decisional process they came at respective domains through. Consequently, a company cannot assume the merits in CSR domain until he writes a public report (similar with annual financial report). There are elaborated universal standards such as Global Reporting Initiative Framework (GRI) and ISO 26000. Not in the last line, in order to obtain realistic maximum level of “accountability”, reports are audited by third parts. In certain countries, such as the United Kingdom, public companies (listed in stock exchange) are obliged by law to report regarding their economic, social and environmental impact.

Differently, in Romania companies reporting are very few, and those correctly reporting (conform to international standards) are as many as non-existent. In such conditions deficit domains are hard to

identify. Similarly, many times it is difficult to draw a line between a CSR initiative and a PR company

In a globalizes world economy where corporations became ever more powerful, raising the problem of responsibility assuming, companies give ever more importance to social corporatist responsibility. While some analysts qualified CSR as being ‘an exercise of public relations, many companies consider there are powerful commercial reasons to develop CSR strategy from the relations with external interested partners, to employees engagement. Moreover, increased interest of companies manifested in external checkup of CSR practices indicates that CSR domain is taken in seriously with a real engagement in offering real significance to the concept.

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## Present Day Recession Effects on Human Resources

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### Abstract

*Specific characteristic for recession situation are: instability, anxiety, unpredictable attitude and behavior accentuation of knowledge, cognitive filters and erroneous interpretation of social, economic or existential realities.*

*In this paper, for knowing this recession from the perspective of human resources, I started from determining some objectives such as: Knowledge of present recession peculiarities, of its area and depth, learning recession effects, its impact upon human resources, identifying solutions for overcoming these malfunctioning.*

**Key Words:** Human Resources Management, Human Resources Development, Economic Recession

**JEL classification:** M54

### 1. Introduction

Understanding recession as a malfunctioning, we shall also notice this phenomenon actuality, especially when we relate in on economic, social or political or plan or to its area: local, international or global, generalized. Specific characteristic for recession situation are: instability, anxiety, unpredictable attitude and behavior accentuation of knowledge, cognitive filters and erroneous interpretation of social, economic or existential realities. For knowing this recession from the perspective of human resources I started from determining some objectives such as: Knowledge of present recession peculiarities, of its area and depth, learning recession effects, its impact upon human resources, identifying solutions for overcoming these malfunctioning. As working hypothesis I established: whether recession created malfunctions belong to human and his

activities, then overcoming them should be done by solutions initiated and implemented by humans. As working methods for deciphering such a malfunction complex all our existence levels I made use of: the study of specialty literature regarding recession phenomenon in global, zone, and local plans, knowledge of some realities in Iasi zone through direct investigations – study of official documents, interviewing and questioning subjects various role statuses in organization – managers, workers in executive sectors.

According to those communicated by National Bureau of Economic Research (NBER), recession, in defining sense, is “a significant decrease of economic activity for several months reflected in GDP, of individual incomes, diminishing occupation level diminishing industrial production and consumption, with effects upon every human existence dimensions [9]. In specialty literature it is reflected the fact that malfunctioning of this kind, economic recessions have a financial, social and political determination. As financial recession is a facet, a form of economic recession as a consequence of increasing mistrust in financial system, hence also natural consequences: decrease of stock exchange transactions, affecting activities of various compartments or departments.

Through its disastrous effects nowadays recession drew experts’ attention so that it is only natural Alan Greenspan [4] held that “it is an actual Tsunami which appears once a century” whose waves propagated to almost all real economy sectors, to real economy on every globe meridians. Irrespective it is private or public domain. Malfunctions created in the financial sector of private companies negatively restricted over public finance, imposing new restrictions and new impoverishing rules in financial transactions.

## 2. Recession effects at human resources level

In general plan recession impact, its effects let not be expected, they were felt in every levels of economic, social, and individual levels because exports, investments, foreign capital inputs, demands for inner large consumption goods, general and individual earnings etc., all were diminished.

Referring to existential life in Romania, effects have been felt above all in macroeconomic system inadequate development, process felt in our society's all dimensions: budgetary deficit reaches cca.5% of GDP, economic growth was based of inner consumption as well as on base of some investments raised by foreign capital, with a low inner saving leading to increase of external indebting –21.5 billion in 2004 , 74.0 billion in 2008 of which public unguaranteed debt in the short run increased by 75 times, amplifying vulnerability high degree in assuring external deficit financing. Romanian exports drastically decrease also as a consequence of the fact that exported produces – metallurgy, petro-chemistry, complex equipments (cars) registered no more demands; investments decrease, and national currency registers depreciation of 10.4% in 2008 and with still 6.4% in 2009, etc.[10]

Effects let not be expected in human resources level either, if we have in view that man, human individual stays at the base of every existential, social and human processes, so that malfunctions impact – malfunctions owed to man - were highly felt in this level. Firstly by stopping its activities crediting, continuing with drastic phenomena such as unemployment growth, wealth decrease, of population material state, implicitly of the consumption and its increasing poverty.

In such a situation it is important that a company's personnel should be treated very carefully, be priced because it is the inestimable wealth of an organization, if either they keep it or make it available. A company's personnel is the one representing most frequently the organization, its products or services accomplished; at least out of this reason company's people should be treated as well as at clients' level.

In conditions of personnel maintaining, employers, in order to support productivity increase to the expectance level are determined to promote a direct and permanent dialogue with employees, to create them a certain assurance regarding working place certainty, to combat rumors, false information, not to renounce to performing personnel or investments and company's perspectives. In conditions or wage diminishing they should find alternative, supplementary forms of motivating the personnel under the form of bonuses, commissions, to make employees responsible by consulting them in management act, in decisions making regarding company well going. In such conditions employee feels integrated and important within the group, he refinds his norms, principles and company directions and policies - a feeling which increases his own attachment to organization and to his like.

Even in conditions of more definite solutions - employees disponibilization /firing, diminishing working time etc. - the measure imposed by labor market, they should have in view these were done grounded on certain criteria, the same it was done at employing, respectively by taking into account abilities, experience and career aspirations personality traits, manner of self-evaluation etc. In these conditions, too, managers' attention should focus on keeping employees with increased working profitability, to key personnel involved into working processes efficient making.

It is according to Maastricht Treaty (1991, art. 136), recognized as EU treaty. “(EU) communities and member states (...) should have as objectives to promote labor force occupation, combining life and work conditions, proper social protection, dialogue between management and work, human resources development, having in view high and sustained labor force and combat of exclusion.” [5]

Concrete realities within business milieu confirm the fact that recession first affected are people in their existence complexity bear under one form or another the effects of such economic, financial, social psycho-human and political malfunctions due to either state or its institutions that become incapable face to catastrophic, unprecedented phenomena,

or to owners for their incapacity to maintain working processes at competitive level, in order to naturally reward as deserved employees' work. In fact the general picture of recession effects viewed through prism of human dimension shows us a *duplicate state*: increase of disponibilized from one stage to another and an extended unemployment, remaining, sending an active, important autochthonous population to hit the road outside a working place while in many companies many owners appeal for continuing working processes specific in foreign labor force – Asians, Africans etc. European Commission has launched the campaign: “do you know what social Europe can do for you?” by which it established some fundamental values, some rights regarding labor among which: labor force mobility, combat of social exclusion, professional formation and adaptability to working place etc., right that if promoted, they would make human individuals' life more bearable, including in condition of restrictive measures, like those of recession are [12].

Facts confirm the existence of a contradictory picture regarding positive administration of human resources in such moments As Ioana Manaila—President of experts in human resources holds: “All structures, public and patronage, make a profit of recession in order to commit lawless acts” [8]. Disrespect of chance equality between men and women as well as for persons surpassing 40-45 years of age, for simple motive that generation – the second one is not as efficient and productive as persons belonging to anterior generations; generally women are selected for execution activities those of managing being improper for them; the “age criterion” became an absolute milestone to post “forbidden” sign for employment, age becoming in fact the annulling criterion of engagement for persons belonging to second and third generations, and mainly for those in the third generation there were not found socializing forms able to change psycho-social and existential climate for such people, too.

- Young people are employed, as age and also within profession, nothing wrong, but to the detriment of those ones with experience, mainly in multinational companies, a category without necessary

experience, easily maneuverable, with minimal wages, easy to control and fired when necessary. Or when they try to request their rights;

- Disrespect of the rights regarding employees' recovering physical and psycho-human state, mainly the rest rights, besides the abusive lengthening of working day. The rest vacancy is not given in its totality but moreover it is given divided in stages and during “dead seasons”, non-benefitting and recovery value of human state;
- Diminishing activities specific for assuring with human resources, of recruiting and selecting programs of professional formatting and developing, of training in becoming - in career with direct impact in non-accomplishment of performance indicators, in full evaluation of employees' capacities, and their un-motivating.

To these working place insecurity, timely earnings established payment, practicing ever newer taxes and imposes strain is added: it diminishes their earnings and are factors that increase the demotivating feeling as performing outcome as possible, insincere attachment to organization, diminishing human individual statute and role within working group, respectively in company. Managers in either public domain or in private one omit that their careless, indifferent treatment of employees, manifested during recession is with effects in the long run, unless irrecoverable. By its consequences, taking into account the only dimension that human resources remain organization only dimension capable to offer sustainability, viability to company irrespective its situation.

Present economic and financial recession negative impact was felt synthetically first by profound organization need of solvability of ever diminished material possibilities of companies that had contracted loans to pay their debts, the recession fell disastrously upon people, on human resources, the one producing plus-value.

Out of this last perspective affecting human resources - based on our investigations, anti-crisis measures had, essentially a *reductionist* contents - reducing expenditures, the costs in all chapters to assure conditions necessary to existence, to

companies survival, and in some cases solutions regarded either their bankruptcy or drastic diminishing of basic activities volume, specific ones with direct impact on human resources, through personnel disponibilization and substantial reduction of those maintained earnings.

### 3. Investigation results

At the level of Iasi county, according to National Office of Trade Register (ONRC) in 2011 the number of companies wiped out from Trade Register is over 500, and those with suspended activity is 260; wages level decreases with 8.1% in 2010 face to 2009, and employees earnings are with 7.6% lower face to earnings achieved at national level; in 2011 wages in services are with 12.0% smaller than in 2010 [6]. Therefore, present recession negative effects hit frontally man, organization most active and innovative resource – reduction of working places, firings, diminished wages, social insecurity etc.

Research I initiated comprised 18 (18.9%) organizations in industry, constructions, services, trade, and tourism with 192 subjects of which 36 (18.8%) managers and 156 (81.2%) execution personnel.

Present economic and social life dynamics, economic activity international, interdependent characteristic as consequent to globalization and post-industrial changes, our presence in EU, foreign investors' participation and national economic activity as well as the newness for most human individuals of the phenomena recession has created, a phenomenon which by its content surprised population largest part resulted in appearance of apart conduct more or less manifested in both managers and executive personnel. So, e.g. as for knowing recession contents, 48% of the managers and 36% of executives are of opinion that it represents an inactivity state in organization, work performance lack with direct implications in individual and organization plan. This aspect reflects managers' preparation lack and of the organization personnel as regards the content and negative, catastrophic effects of such a phenomenon with possible malfunctioning in economic, social and political plan, and also managers' capacity in recession positive administrating. As to recession effects,

research subjects' opinions are structured on two dimensions The former one regards effects felt in personal level of human individual: 9 (25%) managers answer positive, therefore they felt this phenomenon effects in individual level while the number of executives reaches 145 (93%). The latter dimension regards the feeling these effects in organization all 36 (100% managers and 153((8%) executives perceive.

From managers' perspective, recession negative impact was felt in organization level, mainly by: restraining production activities, restraint access to credits and very high costs when done, decreasing exports, mainly to states within Euro zone; decreasing consumption/internal market demands, social effects, working place and earnings insecurity, performance, productivity, and earnings galloping diminishing, some services externalization, some outsourcing services.

In the level of most active organization resources, of executives, *recession negative impact* was perceived mainly by restructuring, reducing or loading/developing working places, reduction of working week/day with direct effects in earnings freezing or diminishing, in employees disponibilization, early retiring of an employee category, working place insecurity, funds for human resources specific activities, especially for their professional training, and becoming in career.

My investigation also confirms some opinions regarding positive effects, present recession opportunities that may be synthesized in this way: 58 (30.2%) of subjects hold that there are also perceived positive effects: thus: 33% of managers and 29.5% of executives hold that present recession determined organizations to proceed to a more careful selecting and grounded on certain criteria of distinct work results of employees with appreciable degree of integration and socialization, facilitated those of other employing modalities—contract for limited periods, part-time contracts, externalization of some activities, generally for entertaining and not only, as well as of some well-determined activities of those for achieving some products/services; changing the mentality regarding self-evaluation as well as its achieving modalities, accentuating working place security in

relation with wages level, change of employees attitude states regarding their attachment to organization, noticing those with false attachment.

I therefore attempt to draw attention that in human resources level perception of present recession covers two dimensions: a *positive* one - maintenance of best and most valuable employees and working place security for them, promotion from inside, based on certain value criteria; finding out alternative of motivating employees; involving employees in the making decisions act regarding organization survival and profitable becoming, by enforcing employee's role-status in his working group, in organization etc. The *negative* effect of recession impact perceived human resources level regards: firing, renouncing to certain employees attached to organization—phenomenon resulting in, employment freezing, in blocking positions, working time reduction (weeks and certain days), adverse, nonfunctional inter - organization, interpersonal communication directional with implications in settling down the mistrust among people, in managers, fright or scare to lose working place, diminishing feeling for working mates, fellows and organization, affecting psycho-social, ambient climate and working motivation of the personnel, etc. Present recession, therefore affected human individual in its whole existential structure, in bio-psycho-social totality and the wave recession propagated has provoked malfunctioning of human communities and occupation organization structures in all activity domains and sectors.

As to present recession effects administering from present research it results that measures of attenuating its negative effects were taken. Thus, all the 192 subjects in my sample for investigation hold such measure have been taken, though they regarded, as one could see, the restricting human resources development, mainly regarding personnel continuous training and development for career becoming, as well as direct measures for human resources, within the scale of stopping or diminishing new taxes and imposes, etc. It is also disputable for sample largest part the justice of such measures, their destructing and dehumanizing consequences 88 (45.8%) of subjects hold that such measures have not

been so severely and stringently imposed. 78 (40.6%) are of opinion for their imperative characteristic, that necessity imposed, and most executives, 86 (55%) think such measures are not imposed - an opinion also supported by 5.6% of managers.

Self estimating their attitude and conduct states face to recession negative phenomena, subjects expressed opinions on a value scale with grades from +5 to -5 (+ positive estimations, and - negative ones), it results that, generally, personnel administered well this personality dimension in both individual and organization level: in 62.5 grades had positive values, and out of them cca.29% estimated this dimension in recession situations with superior grades, respectively, +5. This means that most employees comprehended relatively correctly the manifestation of malfunctioning present recession created. (62.5% promoting a normal, decent working and organization conduct, 37.5% were estimated with decreases of working tonus, engagement and performance, expected coherence and efficacy, 52.8% of them have values between -4 and -5, therefore, high degree of affecting attitude and conduct states.

Research also reflects that such attitude and conduct states encountered in employees are natural consequences of the wrong way organization communication, interpersonal relation system in inner plan have been administered 86.1% of managers hold they promoted a careful, permanent and sincere communication with employees, and 13.9% claimed not being satisfied with management achieved in this domain. In executive level inter-organization communication has a complete another perception. 21.2% of subjects claimed an engaging, well-shaped on finding and implementing solutions able to make recession effects bearable communication was promoted. 58.9% internal communication they hold, wasn't accomplished at the size of recession created phenomena, under expected level and necessities, and especially “it was and not very much an intra - organization communication.” And 19.9% organization communication was absent.

Faced with such realities employees attitude and conduct states surrendered, escaped from under reason control: 6.8% hold that in company there were vindictive

manifestations, such as refuse to work, decrease of working intensity and performance, works deserted etc.; 93.2% hold that they manifested maximum caution, comprehension, promoting decent conduct with efforts not to surrender as attitude, but notwithstanding tasks have not been accomplished in normal performing parameters. Attenuating actual recession negative impact from human resources perspective, is an achievable, possible, viewed by 79% subjects of total sample, by first adopting measures able to provide organization survival as well as its moral existence, measures belonging above all to qualitative, focused on man, adaptable management practicing by promoting concrete measures in organization plan such as: intense internal communication in all levels and oriented towards employee; searching and promoting personnel motivation by non-financial variants for promoting personnel motivation, able to assure careful responsabilizing and evaluation of human resources within working and creating process; conceiving and implementing some modern and training programs with small expenditure, making use of internal strategies that would stimulate employees' trust in managers, in organization; intensifying activities for promoting responsible organization culture, by bringing much more in value the norms and principles regarding work quality, personnel engagement and attachment to company.

#### 4. Conclusions

Therefore, recession phenomena produce instability, anxiety, uncertainty as well as lack of outlook, fright, and scare for our existence with direct consequence upon attitude and conduct states that can no more be controlled: modify man's cognitive, knowledge system, comprehension and action, inter-human and inter-organization relations etc. Administering these phenomena as it results from my investigations belongs to man, on promoting a focused on man, on employee management, as they are whatever organization fundamental resource, in evaluating his creative and innovative potency.

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# Romanian Customer Perception and Behavior in the Current Economic Conditions

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## Abstract

*Romanian retail continues to grow both in terms of penetration, and in terms of number of players. No headway buyer and simple familiarity with the store brand is not enough when it comes to choosing shopping site. This maturation creates high expectations, that retailers must consider if they want to differentiate themselves from competitors. Given the constant changes that occur in the Romanian economy in the world is natural for consumers to change behavior. Those who suffer most from the crisis are those who do not want to change, to adapt. Consumers are able to cope in this difficult economic environment with a small salary, manage to buy from shops to get their money until the next salary makes things themselves without being forced to buy them in stores.*

**Keywords:** consumer behavior, market strategies

**JEL Classification:** D12

## 1. Introduction

Retail market shows signs of recovery, a trend that is seen in increased frequency of access for most formats of stores in 2011, compared to 2010. Modern retail continues to strengthen its position attracted most shopping budgets.

Also, frequency of visiting supermarkets and hypermarkets has increased slightly, while the traditional trade has struggled to remain even in the previous years.

In terms of buying behavior for two main categories - food and non-food - almost do not notice any change. Fresh foods such as fruits and vegetables, meat or dairy, continues to have the largest share in the

shopping cart and default to capture most of the budget (66%).

## 2. Consumer research

As every year, analysts Nielsen study done in over 50 countries including Romania on buyer behavior.

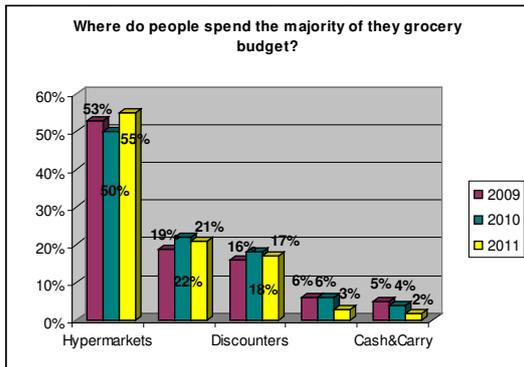
ShopperTrends unveils the important factors for developing retailer brands. By asking what consumers do, know and think about retailers, we find out what are the influencers in choosing the stores. The study was conducted during October-November 2011 on a sample of 1,200 participants, 300 of Bucharest, 100 participants from each of the following cities: Iasi, Cluj Napoca, Timisoara, Constanta, Brasov, Ploiesti and 60 participants in each each of the following cities: Arad, Targu Mures, Rm.Valcea, Piatra Neamt, Targoviste. The application of the survey was face to face interview. The sample is nationally representative for large and medium cities including persons between 18 and 65, people who do regular shopping.

After two years of steady decline in consumer confidence and passed, Romanians have been a first rebound can be explained by a positive outlook for personal income and their ability to purchase various goods. In November 2011, the average wage increased by 8% the previous year, while revenue growth rate increased 5 times, from 1.3% to 8.7%.

However, national Romanian consumers are uneasy with the other Europeans, only a quarter of them having a positive perception of their financial status.

Revenues were up superimposed higher prices in shops. From the survey, more than four in five customers said that prices in Romania are increasing their share is higher than a year ago. Of these, more than half simply buy based products.

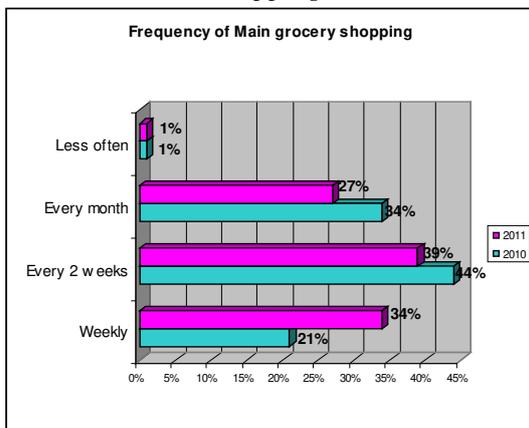
Figure 1. Where do people spend the majority of their grocery budget?



Source: Nielsen. Shopper trends 2012.

As in previous years, Romanians prefer to do their shopping in hypermarkets, 55% of respondents saying they prefer this type of stores. Are supermarkets, attracting 21% of their income, compared with 22% a year ago and discounters, who lost her importance-17% in 2011 compared to 18% in 2010. Regardless of where they source, Romanians quality private brands associated with the store. Thus, approximately three out of four respondents agree that the best stores have the best private brands.

Figure 2. Frequency of Main grocery shopping



Source: Nielsen. Shopper trends 2012.

34% of shoppers go shopping every week, against 21% a year ago, indicating a slight market growth. However, frequency of intermediate purchases remained the same. The phenomenon can be explained by the availability of people to spend a large amount of budget shopping in one occasion, but also by seeking active and continuous promotions, supported by other work and the

increasing number of stores visited in one month.

In terms of buying behavior, 4 of 5 Romanians believe that prices in Romania rose and their main reaction was the waiver, and more expensive products, essential. Against this background, promotions remain an important criterion for purchase, but they are no longer a differentiating factor when choosing the right store. We are talking about a dynamic and mature market, which includes products of first necessity, with a frequency of purchase, thus, quite high. The diversity category was sustained in recent years by launching more and more specialized products that benefit and diverse forms of use, which take place or come in addition to universal products.

Following the purchasing behavior of consumers if the basis for food, specialized manufacturers say they have not thought about long-term usefulness of the product but were oriented to the detriment of small packets to the big weights. Exception is made where the item was on promotion, and then the acquisition price was justified by the reduced package.

Regarding promotions, discounts come best to Romanian, 59% of respondents preferring this type of campaign. In fact, many consumers (3 of 5) know the prices of most products they buy regularly. Although special offers and promotions remains a strong influence in the acquisition, they are no longer representative differentiation factor between stores, because of their abundance in the market.

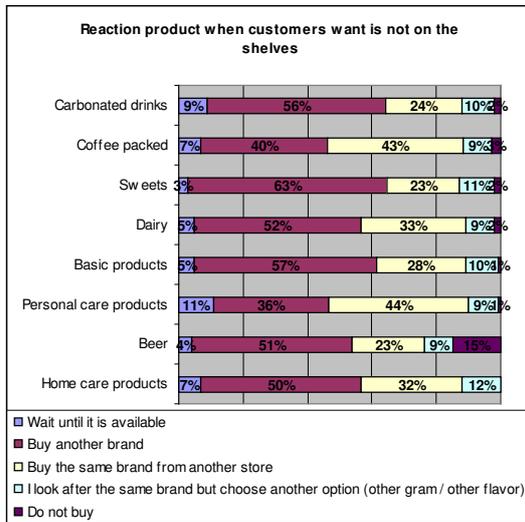
### 3. Reaction of customers to higher prices

The important things for the Romans when shopping, are found in a weight becoming more emotional aspects of category benefits, such as providing a pleasant shopping experience.

It is characterized by the existence of value added services to the buyer, a pleasant atmosphere in the store or a layout that allows quickly find popular products. It is notable that although the vast majority of buyers tend to plan purchases in advance, a significant number of them remain loyal to the list. This means that an attractive

promotion or a better shelf positioning can convince the buyer.

Figure 3. Behavior of buyers



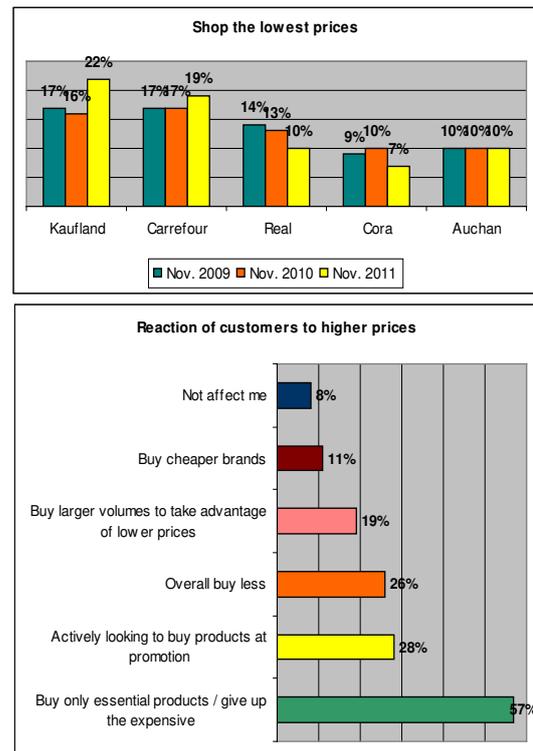
Source: Nielsen. Shopper trends 2012.

Avoid situations of unavailability of products on the shelves is crucial for producers and retailers, as many as half of respondents said that in such circumstances would buy an alternative brand, and one third of those surveyed they go to another store in search for your product. For example, the study showed that personal care products and coffee there is a greater degree of loyalty, a larger number of buyers who say they are willing to go to another store favorite brand in case you do not find it in location already.

On the other hand, in categories such as sweets or carbonated soft drinks, the number who would buy an alternative brand is higher (63%, respectively, 56%). The year 2011 brought nothing new right nor the availability of people to try new things, three quarters of Romanians saying they prefer to buy products that they already know.

As mentioned, promotions play an important role in buying behavior. However, the study emphasized that the promotion is more effective if the buyer has had a positive experience with the product / brand at a time or if the perception is positive. 22% of respondents said that promotions do not buy if not already like the brand. Discounts promotional mechanism is by far the Romans preferred buyers (59%), followed by "1 +1 free" (38%) and "a larger amount at the same price" (23%).

Figure 4. Consumer perception of price



Source: Nielsen. Shopper trends 2012.

Asked how aware are the price of the products they buy, 3 of 5 respondents said they know the prices of most or all the products you buy frequently. And also in this chapter, retailer Kaufland 2011 brought the status of "store with the lowest prices" and are able to unseat him Carrefour competitor who was the first position of the top in the last two years. The top two networks are followed by real, - Hypermarket Auchan and Cora.

Retail market shows signs of recovery, a trend that is seen in increased frequency of access for most formats of stores in 2011, compared to 2010. Modern retail continues to strengthen its position attracted most shopping budgets. Also, frequency of visiting supermarkets and hypermarkets has increased slightly, while the traditional trade has struggled to remain even in the previous years. In this context, 55% of respondents said that they leave most of the money in hypermarkets, with 5% more than the previous edition of the study.

In terms of buying behavior for two main categories - food and non-food - almost do not notice any change. Fresh foods such as

fruits and vegetables, meat or dairy, continues to have the largest share in the shopping cart and default to capture most of the budget (66%).

While visiting the store media in a month only a slight increase compared to 2010 last year seemed more willing buyers to test several shops or to go more places. No less than 33% of respondents said they had visited at least two stores in the last four weeks, while 24% say they have taken it in three different stores. This trend can be explained not only by their desire to find the best price, but also by increasing operational proximity stores

#### 4. Conclusions

Romanian retail continues to grow both in terms of penetration, and in terms of number of players. No headway buyer and simple familiarity with the store brand is not enough when it comes to choosing shopping site. This maturation creates high expectations, that retailers must consider if they want to differentiate themselves from competitors.

Besides location, which must be accessible, offering a broad product assortments and good value for money, modern shops should pay attention to the general atmosphere in the store and small details can make a visit to the store experience nice purchase.

Last but not least, although any modern store should provide at least an intermediate level services mentioned by buyers as important (to have a pleasant, to be in an accessible location, to have low prices on most products high quality fresh products, I find everything I need to find good promotions, courteous employees, etc.), they should choose an attribute and convert it into their brand promise to build a relationship of loyalty with customers.

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## New Strategies of the Retail Market to Attract Buyers

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### Abstract

*New realities of the digital age (continuous growth of internet penetration, card payments and mobile applications) forcing large retailers to rethink their tactics to increase business.*

*The consequences of this development are manifold and manifest more and more that consumers want the ability to get information online on a retailer, you can compare prices - so an increasing demand for transparency - and you can order anytime, anywhere in a simple manner.*

*Online retail allows introducing a wider range of products, more diversified and can help increase the basket of goods purchased. On the other hand waning purchasing power to cause people to turn to production companies cheaper to own brand with a lower final cost by 20%.*

**Keywords:** consumer behavior, market strategies

**JEL Classification:** D12 Consumer Economics: empirical Analysis

### 1. Introduction

Given that the market remains quite difficult for retailers and consumer expectations are changing more rapidly, we expect in the near future (even this year) to see new launches online platform of traditional retailers. Online sales in Romania are now only about 1% of total retail, with the EU average of 4%. And internet penetration is significantly lower than the EU average (47% vs. 72%).

### 2. Online Retail

New realities of the digital age (continuous growth of internet penetration,

card payments and mobile applications) forcing large retailers to rethink their tactics to increase business.

Furthermore, only about 13% of internet users in Romania have purchased products online in 2011 compared to a European average of 57% (82% in Britain). However, given the high growth rate of Internet penetration and use of modern means of payment, e-commerce in Romania is expected to grow strongly in the next period.

Online Retail in Romania recorded very rapid growth in the period 2006-2011 and estimates show that this growth rate will continue in coming years. By contrast, traditional retail has experienced a decline, followed by a resting.

The main barriers to trade online are now about the lack of direct experience in this regard (many consumers have a negative perception of online trade without actually had any negative experience), distrust of modern means of payment and low satisfaction on home delivery services. As these factors improve, grow and demand for online retail. In addition, changes in lifestyle that can be felt in Romania, especially among younger generations, coupled with the growing spread of mobile applications, will lead to more widespread adoption of online commerce.

Analyzing online retail market currently find these attempts to trade on-line:

1. Brasov group of companies, who won the 2011 Masters Spar franchise for Romania, has launched an online trading platform. [www.aprozarulmeu.ro](http://www.aprozarulmeu.ro) shop takes orders both online, and telephone. The site mentioned are available most of the existing products in the 19 Spar stores in Brasov, and deliveries are both outside the city and its surrounding areas. Online purchases allow buyers including

access to promotions conducted in locations in that period, their identification is easy due to site interface. Announces its online store buyers that deliveries are made within two hours after the order. The company's decision to test this concept follows the potential of online commerce is on the Romanian market. Silviu Sumanaru, manager and initiator of the project, says that in December and so far about 100 clients have used this site for shopping. For example, results of a survey research company GfK shows that 28% of urban Internet users have shopped online last year. Almost one quarter of those who buy online do it at least once a month, more study. Young buyers remain among the highest predilection for online.

2. CumparatoruClick.ro was born early last year, with full functionality in June 2011. Customers shop or people who have little free time and prefer to use it other than shopping and standing in lines. Additionally, there are people who for reasons of health or convenience, prefer to order everything online and leave as little of the house. Another representative group of customers is those well-known public. Many of them avoid a variety of reasons, exposing themselves in public and prefer online shopping. The average shopping basket is worth 350 lei, and the products sold are milk, eggs, vegetables, beverages (water, juice, beer, wine), and organic products.
3. METRO Cash & Carry implements, first for the retail market in Romania, the first personalized discount system - Metro Touch. The solution addresses the company's professional customers. Simply scan the ticket the client METRO, METRO Touch new system generates, for each client, a preference list of products ranges fresh and ultra fresh articles. Depending on each customer's profile and transactions, they benefit from a discount granted on a shopping coupon generated instead of METRO Touch. Customers can

use coupons up to five such days. The Metro Touch is already available in the 26 Metro Cash & Carry stores in Romania, except in Metro Point.

4. Cora hypermarket network in Romania plans to introduce online ordering service lift products store called "Cora Drive". The retailer has not established but the launch date of service in the country. Cora Drive operating principle is simple: customers consult online product offerings, send their shopping list and they get to Cora, products are delivered and loaded into the machine. Cora Romania has already started (the end of 2010), Cora Digital service through which customers smaller shops in the province have access to the full range of IT & C and electrical equipment to Cora. Basically, customers offer on site consultations and can order products directly home.

Large retail chains are known mostly in the name of "modern trade" opposed "traditional trade" which brings together small shops usually are not integrated within some chains. From a practical perspective, the notion of "traditional trade" should refer more to the marketing of products in markets and fairs. Thus, modern trade would hold somewhere over 50% nationwide, with higher rates in urban areas, reaching 75% in Bucharest.

Total trade weights but provides a more close to reality in terms of bargaining power of these chains in relations with suppliers of products. That big retail chains are sized buyers increasingly higher. From their perspective, retailers feel entitled to ask for discounts and more uniform quality conditions. From the perspective of manufacturers and distributors, large retail chains become trading partners increasingly difficult to avoid in the way their products to final consumers. Tensions and accusations of "monopolization" occur mostly in relation manufacturers and distributors / retailers, but the latter are caught in the middle, given that the consumer will experience price increases cashier trader and it will be viewed with distaste, even if he is not due to price increases.

### 3. The new structure of the consumer basket

The new structure of the consumer basket, which will be calculated after inflation in 2012, shows that families have been forced to severely restrict daily expenses and give up less important varieties for basic needs.

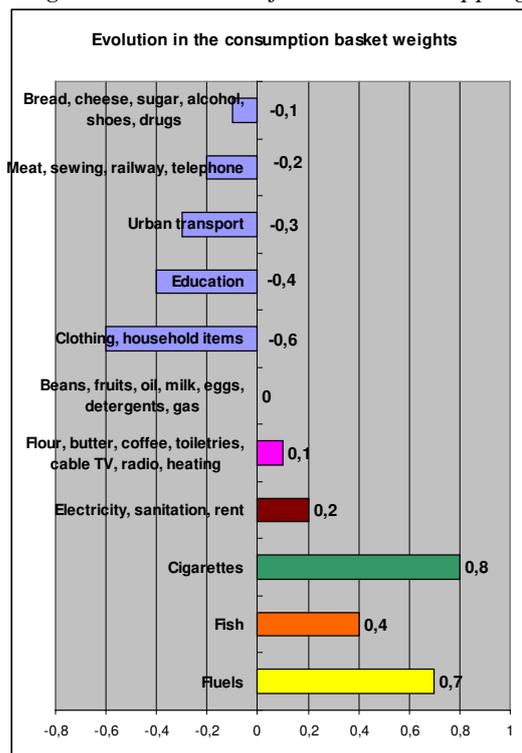
Inflation in 2012 is based on the consumer behavior recorded in 2010 and revealed the family budget survey, conducted by the National Statistics Institute (INS). Data reported by the INS on inflation in the first month of 2012 have revealed a new structure of the consumption basket, which shows first that the goods have gained immediate need higher rates to the detriment of others.

Here are some examples: potatoes, fish and food basic necessities were sold better and therefore have higher rates achieved in the basket, while meat, cheese and sugar have lower weights, that have sold more least. Non-food category, increased demand for fuel, heating, cigarettes and electricity, reducing the clothing, footwear, auto parts and household items. So if services where rent, sanitation and cable-TV subscription gained ground against transport by train or bus. All this reflects a specific behavior financially distressed people, as most Romanians were in the years of crisis. Preferred products are cheaper (but worse quality), to the detriment of the most expensive.

Overall, food reduced their share of the inflation basket, from 37.45% in 2011 to 37.21% in 2012. The share of services in the basket rose from 18.33% last year to 18.53% in 2012, and the weight of food was maintained at 44.2%. Similar to what happened in Western trade, where its brands dominate the shelves in Romania gaining ground segment. The economic crisis has fueled the trend by encouraging retailers to invest more in these products.

Market in our country there is much room for expanding the range of own brands, representatives of retail chains expecting their share Cart novel to rise significantly in the near future.

Figure 1. Priorities of consumers shopping



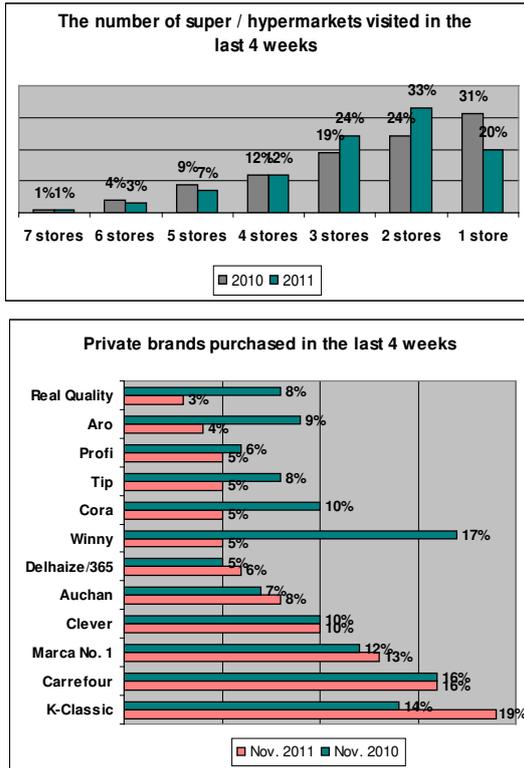
Source: National Statistics Institute (INS)

The explanation of this phenomenon is very simple: the customer has smaller budgets and prefer to shop that range who can provide satisfactory report between quality and price. If in case we can not pronounce quality when it comes to costs that are competitive is clearly being up to 20% cheaper than other products.

Last year, 9% of modern trade was the deliveries by private brands of chain stores. Private label market is valued somewhere around 1.5 billion euros. Large financial turnover generated by this segment has caused quite acidic side of the "nationalist", who claimed that by marketing products retailers fenteaza domestic producers. Analysing the phenomenon better can be seen as a part of the goods sold in our country have entered private brand "Made in Romania".

If in 2010, the question "own brand products you bought in the last four weeks?", 75% of the sampled research ShopperTrends said yes, in 2011, the share of those who said this was reduced to 64%.

Figure 2. Analysis of private brands



Source: Nielsen. Shopper trends 2012

Perception of quality is reflected strongly in store own brand perceptions of that retailer. Thus, in 2011, 72% of respondents have agreed with the statement "the store as the best, with both brands have their best", compared to only 63% in 2010.

A high share of those who tend to compare prices at private label manufacturer of brands, from 64% to 71%. On the other hand, 5% more people believe that own label is for those who have very low budget shopping.

Paper products, basic food and household products categories continue to be the best buy and top choices of those who tend to buy them, the top ranks K-Classic (Kaufland), Carrefour and no. 1 (Carrefour), said the report ShopperTrends 2012, conducted by Nielsen.

Regarding the categories in that register the highest level of purchasing private label, the top remains unchanged from the previous edition of the study: paper products are the first place (62%), followed by basic products (51%) and the care home (43%). In general, private label brands are seen as similar, but the perception of store brand strongly reflects the perception of its private label. Almost one

in two respondents agrees that the more good store, with both the quality of their products is better.

#### 4. Conclusions

The local trade is growing over the next four years, will reach the 2015 level of 19.2 billion euros from 17.1 billion euros this year.

Despite the upward trend, the market will remain on the maximum level of 21 billion won in 2008, last year boom, according to data from retailer Profi, owned by Polish investment fund Enterprise Investors.

Although in words, in recent years, buyers seem more open about trying private label products, there is still a perception that, despite higher prices, brands the manufacturer offers a better value - price and that private brands are more likely for those with low incomes.

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## Overview on Tourist Destination

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### Abstract

*People nowadays have the tendency to travel even for a day in order to get away from their daily routine.*

*The tourism industry seems to have started recovering from the financial crisis and the number of tourists visiting destinations has increased.*

*The concept of tourist destination is very important and should be understood not only by marketers but also by tourists so the purpose of the paper regards this aspect.*

*Each person can become a tourist so it is important to see the all the elements that are behind a tourist destination. Offers are provided to tourists according to their wishes, according to their needs.*

**Kew words:** tourist, tourist market, destination, destination image

**J.E.L Classification:** M31

### 1. Introduction

The tourist industry has an important role in the economy of any country, having a major contribution at incomes of the state budget. Due to the great number of tourists that travel in different tourist destinations, there is a high competition among companies that operate in the tourism area. Trying to reach customers, to fulfill their needs by offering them the right tourist products is done with attention by marketers.

Tourist destinations must offer tourists as many elements of attraction so that they can choose the offer that best satisfies the needs they have.

### 2. Concepts regarding tourism

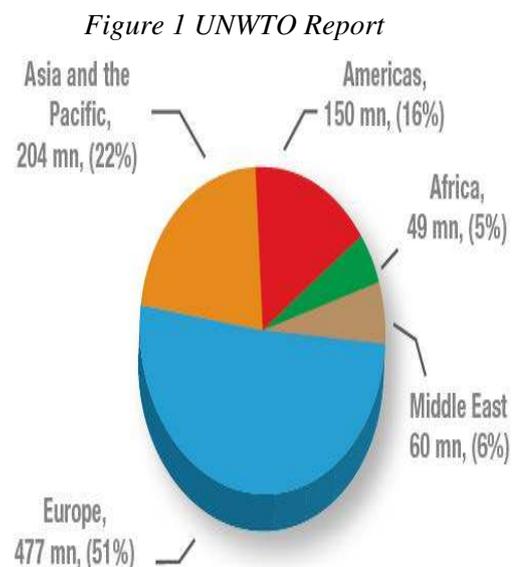
Tourism can be defined as the processes, activities, and results that appear from the relationships and interactions among tourists,

tourist suppliers, host governments, host communities and surrounding environments that are implied in attracting and accommodating visitors.[1]

The financial and economic crisis that has started in the year 2007 has had an essential role in the decrease of the number of tourists, affecting seriously the tourist industry. Thus, the number of tourists has decreased in the year 2009, being followed by a comeback in the next year, the number of international tourists increasing with 7% so that the number of visitors has reached a level of 940 billion.

We find Europe on the first place, with 51% of the total amount, followed by Asia and Pacific with 22%, due to the fact that the economies of the states from the area had known increases. There was also an increase in Africa, an increase of 5%, not much but enough, increase due to the fact that in 2010 the World Championship at Football took place in the countries of the continent.

All these data were released by the report given to publicity by the World Tourism Organization, the report of the year 2010.



Source: UNWTO raport pe 2010, p.10

When they decide to travel, tourists choose a certain tourist destination and a certain tourist product.

A tourist product may be defined as: „a) a complex ensemble of goods and services put at the disposition of consumers (tourists) by one or more tourist companies; form of sale of the tourist offer, its component elements ( accommodation, meal, transportation) can be sold separately or under the form of a tourist package;; b) in a large sense, a specific ambiance to natural and human factors and to tourist facilities that represent component elements of tourist animation and can have a certain attraction over tourists ( for example: mountain tourist product, seaside tourist product, tourist product of resorts)[2]

Tourists have the opportunity to choose a tourist product that best fit the needs the wishes they have or the needs that will be satisfied by travelling.

Each tourist has its own reasons to decide to travel and can have different activities, activities that regard either visiting museums, taking part in certain events, socializing, relaxing, accumulating new experiences.

### 3. Tourist market

In order to understand the concept of tourist destination we need first to take a look at tourist markets. Many authors have tried to give a definition to this concept

A market is a set of actual and potential buyers who might transact with a seller. The size of a market depends on the number of persons who exhibit a common need, have the money or other sources that interest others, and are willing to offer these resources in exchange for what they want. [3]

We encounter on the tourist market, the demand and the supply, two elements that are in a relationship.

Vital demand data include: 1) how many visitors arrived, 2) by what means of transportation, 3) how long they stayed and in what type of accommodation, and (4) how much money was spent.[4]

By taking into consideration the demand, companies decide to set up a certain offer for the clients, in our case for tourists. The offer must take into account all the needs that tourists have.

When discussing about the offer, we must pay an important attention to the services

offered on the tourist market. All tourist products regard offering different services to tourists. The main issue regards the fact that services are intangible. It is not like when you buy a product and you see it, you can touch it.

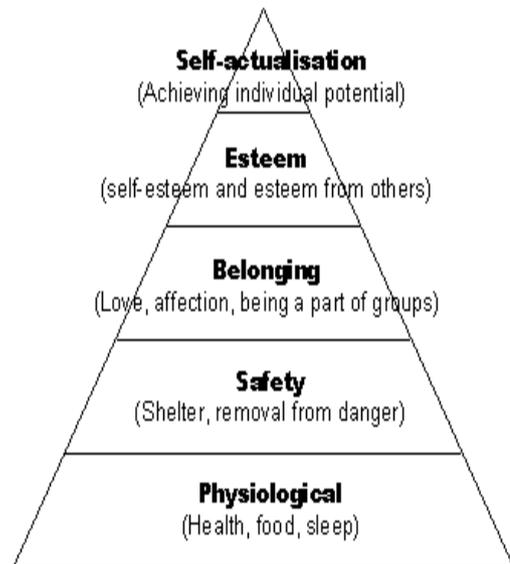
In the case of services, they are produced and consumed in the same time which makes it difficult for a customer to choose among different services.

Services have also other characteristics like variability, inseparability, perishability. All these, offer a unique perspective to this concept and makes it harder for marketers to promote destinations.

It can be noticed that the tourist market help tourists find what they need. Marketers develop their strategies after noticing the needs that tourists have, after segmenting them.

Abraham Maslow has defined in a clear way the needs that people tend to have in a daily basis. Needs that help us survive each day, like hunger, and needs that help us become a part of the communities we live in, of achieving something in life.

Figure 2: Maslow's Needs



Source: Montana, Patrick J., Charnov Bruce, H. Management, Barron 2008, p. 238

An important process in establishing which are the customers a company is interested in is the segmentation process. A process that divides people into groups by taking into consideration certain characteristic like : geographic, as country, city; demographic, like age, income,

occupation, social class; psychographic, like values, attitudes; behavioral, like the degree of knowledge concerning the products and services that customers buy.

#### 4. Tourist destination

Destinations are places with some form of actual or perceived boundaries, such as the physical boundary of an island, political boundaries, or even market created boundaries such as those of a travel wholesaler who defines a South Pacific Tour solely on Australia and New Zealand. [5]

As it can be noticed tourist destinations include both tangible and intangible elements. Each tourist takes into consideration the element he cares the most. But most of them are interested in the experiences they take part.

Experiences are an important element when tourist choose among different tourist destinations. They also help tourist have a certain image of the destination, image that will remain in their minds for a long period of time.

All tourist destinations must try to have a competitive advantage that clearly makes an important distinction between them. Experiences can have an important role in the creation of a competitive advantage.

Having a positive image of a destination is a good thing because on the long term it means that tourists might decide to come also next time in the same location and they can also tell other tourists about the remarkable experiences they have had.

In order to create a certain image of a destination, marketers should take into consideration also using branding techniques. Nowadays people have a tendency to be more interested in well-known brands, they consider that these brands offer them more value, that they have higher quality services.

It is well known that retaining existing customers is less expensive than trying to acquire new ones. By building long term relationships with their clients, companies only gain.

Destination image characteristics can be classified as functional, (e.g. climate, prices, roads, nightlife, mental picture of physical characteristics) and psychological (e.g. friendly people, generally safe, general feelings and impression of the atmosphere of

the place.[6]

Word-of-mouth is becoming increasingly important in the process of taking decisions of many people.

The destination elements include [7] :

- natural attractions: landscapes, seascapes, beaches, climate, flora and fauna and other geographical features of the destination and its natural resources;

- built attractions: buildings and tourism infrastructure including historic and modern architecture, monuments, promenades, parks and gardens;

- cultural attractions: history and folklore, religion and art, theatre, music, dance and other entertainment, and museums;

- social attractions: way of life and customs of resident or host population, language and opportunities for social encounters.

As we can see, destinations are different and tend to fulfill the needs of all tourists that travel. Of course, there are destinations that include only one of these elements but there are also destinations that may include several elements. People have the tendency to choose destinations which offer them a greater variety of possibilities of what to do on a vacation.

The elements presented above regard the attractions the destinations offer to their tourists. It is important that people have a lot to see but there are destinations where the residents do not know how to treat tourists, where some tourists do not like the noise, the crowd. For example, Naples is a beautiful city, with lots of things to offer due to its location, but a few years ago due to the fact that goods were dumped in certain areas of the city, tourists forgot all the beautiful things they had seen and reminded with the image of these goods.

If companies performing in the tourism industry want to have higher revenues they must take into consideration all these elements in the offer they provide to the customer.

Of course, as we have seen destinations do not only have strengths, they also have weaknesses. Therefore, it must be taken into consideration that by analyzing the environment, analysis like SWOT should be performed on a regular basis so that weaknesses do not surpass the number of strengths.

Many believe that tourism is easy to do but as we have seen there are a lot of elements that must be taken into consideration when talking about the tourist market, tourists, destinations.

## 5. Conclusions

As we have seen, the tourism industry has become an important factor in the economy of any country.

Tourists increase the economy of a country by spending their financial resources in travelling, either in their country or in other countries, far away.

Nowadays, tourists have the possibility to travel not only in the country they live in but also in other countries that are far away. All of these happen due to the advances in the means of transportation.

Tourist destinations find themselves in a strong competition for attracting and retaining tourists. Creative a positive image of the destination can be an important competitive advantage in creating long-term relationships with tourists.

Having a bad image can only hurt a destination because tourist that leave dissatisfied tend to not to come the second time in the same place and tell other people about the experiences they have had. People ask for references from their friends so such a thing can have a higher impact when choosing a certain tourist destination.

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# Factors Affecting Performance Evaluation in Public Organizations

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## Abstract

*Although performance evaluation has received a lot of attention in the research literature in the last two decades, it still hasn't reached an universal acceptance as an effective public management instrument.*

*Many public institutions avoid designing and implementing performance evaluation systems, sometimes for good reasons.*

*The paper attempts to contribute to identifying and understanding the factors that influence the utilization of performance evaluation.*

*The study is based on review and analysis of academic research, relevant government documents and personal perspectives, extracting and linking key findings from existing research and practice.*

**Keywords:** performance, public organization, factors, impact

**JEL Classification:** D73, H11, H83

## 1. Introduction

Concern for performance evaluation is becoming more pronounced as organizations try to implement new measurement systems to support organizational objectives [2]. These initiatives originated in the private sector, but recent efforts to improve government performance have focused on evaluation as a means of empowering policy-makers and bringing coherence for the decision-making process.

In the context of the new managerial approach, performance measurement and reporting are critical. For public managers, information on performance is the most valuable resource in decision making and strategic planning. Information on performance of programs, organizations and individuals illustrates managerial commitment for continuous development and

it also contributes to more efficient and effective fulfillment of objectives [4]. As for the accountability of managers, performance evaluation provides information to all stakeholders either within the organization (elected officials, other managers, employees) or outside (customers, citizens, civil society, entrepreneurs).

## 2. Defining performance for public organizations

Public performance is not an objective reality, easily available to be measured and evaluated, it is in fact a social construct, distinctly perceived by different stakeholders [3] and it must be defined broadly enough to include all key dimensions as they are perceived by the major stakeholders. The “classical” dimensions of performance have been considered *efficiency, effectiveness and economy*, but recent theories added other E's to the well-known trio, such as equity, excellence, ethics. Still, most evaluation frameworks focus on the first three.

Regardless the size, sector or activities, organizations tend to be interested in the same facets of performance: financial performance, performance of operations and processes, employee and stakeholders satisfaction.

In public institutions it is necessary to measure achievements and progress against objectives and managers must decide on how to make measurement relevant. That is why, some key measures with more features are more effective than a variety of single-faced measures.

The chosen evaluation system should also resolve the problem faced by many organizations the so-called “drowning in data”. Key measures should include those concerning: operational performance, financial performance and human resources performance [1].

### 3. Performance evaluation and factors affecting its utilization

The performance measurement systems were developed mostly in the 90's as a tool for private companies to support strategic management functions. The most popular system from that time was the Balanced Scorecard, created by Kaplan and Norton (1992, 1996). Initially structured for big private companies, measurement systems have been adapted and recently used for small and medium enterprises and even, the public sector. In the last two decades, the research literature on performance and its evaluation has been well represented and an important number of authors have approached this subject.

Performance evaluation shouldn't be seen as a goal itself or as single determining factor for the future of an organization. It should be in fact an instrument for gathering and reporting information, a support mechanism for public managers either to warn them about problems and difficulties, either to signal potential opportunities. It is also a way to increase accountability for spending public money, especially as the first performance measure frameworks were taking into account only financial data. While in the private sector the main indicator is profit, public organizations don't have generally accepted indicators for performance. In public organizations the concept should be analyzed in relation to program objectives, especially whether or not they were reached through appropriate outcomes.

Due to the characteristics of the public organizations, there are specific aspects that influence the design and implementation of these systems.

#### 3.1. Factors influencing the design of performance evaluation systems

Defining and evaluating performance in public institutions is influenced by particular aspects [6]:

- *uncertainty* – there are external circumstances that influence the activity of the institution and the accuracy of performance indicators;
- *diversity* – because of the high number of stakeholders and their various interests, it is difficult to reach consensus on the

scope and objectives of the organizations and on the most appropriate evaluation method;

- *interdependency* – between the resources available and the decisions and organizational activities;
  - *instability* – social, economic, technological changes influence the policies, aim and objectives already set.
- In Saad's opinion [8], for local authorities an efficient performance evaluation is confronted with specific difficulties:
- each public service has specific characteristics;
  - the main scope it's not profit, it's offering the best services for the citizen;
  - there are many stakeholders, sometimes with conflicting interests and objectives;
  - individual expectations may be different from those of the community;
  - organizational results may be both tangible and intangible.

At the same time, based on past research and his own observations, Saad [8] argues that the effectiveness of a strategic evaluation system for public performance is determined by the following elements:

- evaluation criteria;
- level of importance or priority for each criterion;
- evaluation process itself, including those applying it and the way it's implemented, sequential or simultaneous;
- defining each criterion for each evaluated aspect.

Also interested on this subject, Rantanen et al. [7] initiated a study on three public organizations, in order to identify internal and external aspects that have important impact on measuring performance. The results are similar to those of prior researchers: conflicting interests leading to ambiguous objectives and unclear measures; many stakeholders affecting the unity of the evaluation system; the public servants don't understand the utility of the evaluation and they ignore it or resist it; too many persons responsible for evaluation lead to low accountability.

Orientation toward citizens is one of the main thesis of public management, but at the same time, taking into account all their needs and expectations, integrating them in the organizational objectives and in the

organizational performance standards are the most important problems in designing evaluation systems.

### 3.2. Factors influencing implementation of performance evaluation systems

In implementing performance evaluation systems, De Lancer Julnes and Holzer [5] suggest a classification for the factors influencing evaluation:

- *rational factors* – represented by: available resources, information acquired through training, goal orientation, external requirements;
- *political factors* – represented by internal interest groups, external interest groups and unions. The support from elected officials and citizen may come in two ways: by allowing the organization to devote resources to the effort of evaluation and by using information even when the results contravene a political agenda;
- *cultural factors* – represented by the attitude towards change and risk, the organizational culture. An organizations potential to evaluate performance depends on how open it is to change. This is evident if there are systems that reward innovation and risk taking, if management and non-management employees accept innovation, change and performance measures.

On the same subject, regarding influences on evaluation systems, studies on public organizations [General Accounting Office, USA, 2000] have identified possible impediments in successful implementation, including:

- identifying appropriate goals in an environment characterized by multiple and conflicting interests;
- measuring the performance of intangible or subjective goal/activities;
- deficiencies of the informational system;
- artificial increase of employee motivation for using performance information;
- low managerial commitment towards evaluation;
- low capacity of the informational system in offering valid, relevant, timely data with minimal costs.

As response to these impediments,

Cavalluzzo [2] suggests some positive influences of different organizational factors:

- explicit commitment of top-management for using performance information in decision-making;
- decision power delegated to those who use relevant information for performance evaluation;
- training regarding performance evaluation methods and instruments.

Other research studies offer a different classification of such factors: *technical factors* (capacity to supply relevant data on performance, capacity to develop measurement and analysis systems) and *organizational factors* (management commitment, level of decision authority, specific trainings, elected official mandates).

In order to implement performance evaluation in public organizations, it is important to analyze factors such as political support, management support, and analytical support. In addition, the impact of time must be taken into consideration, as some researchers have argued that it takes time to develop and implement appropriate and effective evaluation systems.

### 4. Conclusions

Designing and implementing effective performance evaluation systems should be an integral part of any public management system.

Performance measurement encourages the use of results for learning and improvement in public organizations and it also supports transparency, value for money and citizen involvement.

Still, due to the characteristics of public institutions and the difficulties in defining public performance as a concept, not all evaluation initiatives were successful and probably it will be the case for some future attempts too.

Analyzing the factors affecting performance evaluation must be a permanent preoccupation for public managers. Identifying and understanding these factors help organizations in reducing their negative impact and also in improving their managerial tools. An evaluation system must be sensitive to external and internal changes.

The design stage of evaluation is important as it should create an adaptive

structure that can integrate and respond to external influences.

The implementation stage strongly depends on internal commitment for evaluation and on available resources. Implementation is related to the organizational culture, and at the same time the performance information that results from evaluation must be used for improving internal working environment and organizational culture.

Performance evaluation brings benefits in decision-making and at the same time increases organizational accountability, both internal and external. In decision-making, evaluation is an important tool supporting diagnosis capacity, strategic thinking, managerial capabilities and organizational development. At the same time, through encouraging accountability, performance evaluation offers transparent reporting and determines citizen involvement.

## 5. Acknowledgements

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## Managing Risks in Dry Port Operations

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### Abstract

*The purpose of this paper is to have an in-depth look into the phenomenon of risk assessment and risk management strategies in managing dry port operations as an integrated part into international containerized freight trade. The fact that world crises take the form of disruptions, bankruptcies, breakdowns, macroeconomic and political changes, and disasters leads to higher risks and makes risk management more and more difficult. This paper aims to discuss the theory behind the dry port concept and to explore the possibility of improving its management by increasing its economic performance by correlating it with new policies regarding risk strategies. The research provides managers with a direction for choosing risk management strategies based on the global supply chain environment. This study provides insights into the applicability of risk management strategies with respect to environmental conditions and it may also draw new directions for policy makers.*

**Key words:** dry port, freight containers, risk management.

**J.E.L. classification:** D81, L92, R40.

### 1. Dry port and risk management concepts

One of the most recent definitions describes a dry port as “an inland intermodal terminal directly connected to seaport(s) by rail where customers can leave/pick up their units as if directly to a seaport” [1] with classification of dry ports [2]. It is important to note that dry ports developments are normally part of a national plan, usually

within the transport section. As such, dry port development programs have to fit with other national schemes and budgets. They often form part of a railway upgrading projects, but it may also be linked to highway construction, sea port expansion and similar transport links. The funding of dry port is related to the key actors as public sector and private sector or a combination of both. Many actors are involved in a dry port, each having its own strategy depending on its core business even if vertical integration could lead to overlapping to a certain extent. At the same time, various functions could be developed in a dry port depending on the actors involved. The most basic dry port is an inland terminal allowing the modal shift of the containers from barges or trains to trucks or vice versa.

Research carried out in 2007 [1] classifies dry ports as follows: close dry ports, mid range dry ports and distant dry ports. This classification is based on the distance between the seaports that dry ports are servicing and dry ports themselves. However, such a classification could not be sufficient in order to get a clear definition of the dry port concept. There is still a wide area for research regarding the concept and we will mention other criteria of classification as it follows:

- According to size (meaning how many TEU it can handle per year): small, medium, large and mega dry ports, which can be implemented in land-locked countries.
- According to means of access: depending on how many rail tracks and roads are in and out of the facility.
- According to value added services: as stuffing/stripping of containers, maintenance of container, handling and

storage of refrigerated/frozen and dangerous goods.

A summative definition, as observed from above, is that dry ports, having the word “dry” as a structural part of their name, are supposed to be viewed as different from inland intermodal terminals which have, in addition to standard dry port facilities, at least one inland waterway, by means of which goods can also be transferred by water means: either by barges, tugs, or other navigational equipment; moreover, its handling equipment is operated at a higher scale than that of dry ports.

There are still a lot of academic debates over dry ports definition and classification as the research field in container trade and inland logistics has been developing over the recent years.

The analysis of the literature on risk management in supply chains [3] led to the identification of three major gaps, in connection with operation of dry ports, as an integrated part in the supply chain. First of all, no existing definition adequately takes into account the unique dimensions of risk and risk management in a global supply chain. Secondly, strategies to address risks require increased attention. Although several studies provide a list of risk management strategies [3], these studies do not address the manner in which managers select among them, i.e. the precedents to global supply chain risk management strategies, and their consequences. Third, there is limited research on moderators of the risk management process [3].

- One definition of supply chain risk was developed and four types of global supply chain risks are defined.
- Another definition of risk management in a global supply chain context is developed. Rich descriptions of risk management strategies are provided and important antecedents to strategy selection are discussed.
- Three moderators in the process of risk management are explored, namely team composition, supply chain complexity management, and inter-organizational learning. [3]

We will provide a more thorough analysis on the assessment and management of risk go in the next section.

## **2. Framework for risk assessment and management**

The proposed framework provides a means to assess the relative importance of codes and standards, good practice, engineering judgment, risk analysis, cost benefit analysis, company and social values when making a decision. It is an appropriate basis on which to improve decision making and will result in a more transparent process to the wider public.

The methodology used is called risk analysis (RA), and it was taken from the work of Giziaki and Giziaki [4]. This method is used extensively in other fields such as medicine and epidemiology. It has been applied to marine accidents by the authors. RA generally deals with the pathology of a system. It tries to quantify the risk resulting from the exposure of the system to certain factors and thereafter takes specific measures to control this risk.

Accidents related to maritime freight can be thought of as cases indicating a pathology of the maritime safety system. In this sense, these accidents create the conditions for employing the risk analysis technique. The technique is divided into risk assessment and risk management [3]. The task of risk assessment is to analyse scientific evidence in order to evaluate the relationship between exposure to certain factors and the potential occurrence of failure (accident), thus quantifying the corresponding risk. Then, risk management uses the results of the risk assessment procedure to produce a decision about actions to be taken.

Due to lack of extended knowledge on the issue, we must proceed towards grounded theory methodology. Grounded theory is a qualitative research methodology that allows the exploration of concepts, identification of relationships in raw data. Another advantage of grounded theory is the ability to handle a complex phenomenon such as risk management because the methodology emphasizes the need for developing multiple concepts and their linkages in order to capture the central phenomenon. Insights from the grounded theory study and existing literature were used to develop the model presented in the article by Manuj and Mentzer[3].

Further in this paper, the term ‘dry port’ is

treated as an inland container terminal which operates with freight containers, these representing an important aspect and integrated part of the supply chain management of the globalised international freight trade and worldwide logistics.

These and several other definitions provided by supply chain managers are consistent with the literature which suggests two risk components:

- possible losses (if the risk is realized, what losses will result and what is the significance of the consequences of the losses;
- probability of those losses (the probability of the occurrence of an event that leads to realization of the risk).

Therefore, risk is the expected outcome of an uncertain event, i.e. uncertain events lead to the existence of risks. These uncertain events are named “risk events.” While probability and impact of losses are the most commonly discussed dimensions of risk, two more risk dimensions - speed and frequency - are important in global containerization.

The speed of risk can be divided into the rate at which the event leading to loss happens, the rate at which losses happen, and how quickly the risk event is discovered. Coupled with increased lead times, lead time variability, physical distances from sources of risk, and less control over the supply chain, speed increases the magnitude of global supply chains problems.

Frequency is a measure of how often a similar kind of risk event happens.

The results of a study [4] show a striking conclusion - 60 percent of the accidents involved in pollution have occurred in regulated zones and ports, an aspect which increases the importance of proper inspections by port state controls. The risk assessment method used in the mentioned study has shown that tankers have an almost four times higher risk of causing pollution and this risk becomes more than double in bulk carriers. Despite the fact that laws are nevertheless important, case studies show that too many rules and regulations can also increase the level of risks. Some notifications here can be mentioned as results in an effective reduction of risk of accidental environmental pollution [3].

### **3. Elaborating risk strategies in dry ports operations**

The complex system of network connections inside the supply chain and international logistics are inclined to disruptions, bankruptcies, breakdowns, macroeconomic and political changes, leading to higher risks and thus making risk management difficult.

The literature [3] suggests four categories of risks: supply, demand, operational, and security risks.

Supply risk is the distribution of consequences related to adverse events in inbound supply that affect the ability of a dry port to meet customer demand (in terms of both quantity and quality) within anticipated costs and time.

Operations risk is the distribution of consequences related to unfavourable events within the dry port that affect a firm’s internal ability to produce goods and services, quality and timeliness of production, and/or profitability.

Demand risk is the distribution of consequences related to unfavourable events in the outbound flows that affect the possibility of customers placing orders with the local dry port, and/or variance in the volume and assortment desired by the customer.

Security risk is the distribution of consequences related to unfavourable events that threaten human resources, operations integrity, and information systems; and may lead to outcomes such as freight breaches, stolen data or proprietary knowledge, vandalism, crime, and sabotage.

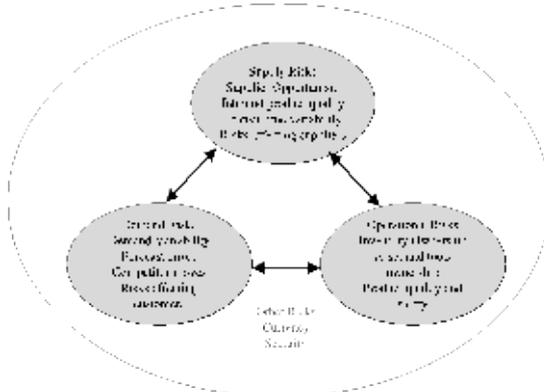
Another widely used classification [3], classifies risks as:

- macroeconomic risks associated with significant economic modifications in wage rates, interest rates, exchange rates, and prices;
- policy risks associated with unexpected actions of national governments and local authorities;
- competitive risks associated with uncertainty about competitor activities in foreign markets;
- resource risks associated with unanticipated differences in resource requirements in foreign markets.

The risk events most frequently

encountered by the global supply chain managers [3] were currency, transit time variability, forecasts, quality, safety, business disruption, survival, inventory (and tools) ownership, culture, dependency and opportunism, oil price fluctuation, and risk events affecting suppliers and customers.

Figure.1. Risks in the global supply chain



Source: Manuj & Mentzer, 2008

In the above-mentioned authors’ article, six risk management strategies in the qualitative study, also supported by the literature, were specified: postponement, speculation, hedging, control/share/transfer, security, and avoidance.

Postponement refers to delaying the actual commitment of resources to maintain flexibility and delay incurring costs.

Speculation (also called selective risk taking) is a risk management strategy on the demand side that is the opposite of postponement.

Hedging is a supply side risk management strategy. In a global supply chain context, hedging is undertaken by having a globally dispersed portfolio of suppliers and facilities so that a single event (like currency fluctuations or a natural disaster) would not affect all the entities at the same time and/or to the same extent.

The importance of control, share, or transfer of risks takes the form of vertical integration, contracts, and agreements. Vertical integration increases the ability of a supply chain member to control processes, systems, methods, and decisions. Vertical integration may take the form of forward (downstream) or backward (upstream) integration, and is therefore, both a supply and demand side risk management strategy.

The global supply chain security

encompasses information systems security, freight breaches, terrorism, vandalism, crime, and sabotage. The security strategy is aimed at increasing a supply chain’s ability to sort out what is moving, and identify unusual or suspicious elements.

The qualitative study [3] pointed to the existence of two types of avoidance strategies. The first type of avoidance strategy is used when the risks associated with operating in a given product or geographical market, or working with particular suppliers or customers, is considered unacceptable. The second type of avoidance strategy takes the form of overriding adverse events. Managers must understand the advantages and disadvantages of various risk management strategies, and must be able to seize the moment when they should be applied. Managers should also consider the composition of risk management teams, in terms of functions and orientations represented, to assess and manage the multitude of global supply chain risks. The risk management outcomes discussed in this paper also provide a direction to managers in the performance metrics which should be developed to assess the success or failure of the global supply chain risk management.

Thus, this paper is an important initial step in developing models of global supply chain risk management strategies. The area is rich in opportunities, both for future research and competitive advantage.

In 2008, Panayides and Song [4] showed that the scale can be used for benchmarking purposes in order to identify the level of supply chain integration of different terminals. Managers can assess the level of integration of different terminals, something that will allow container terminal managers to pursue a competitive strategy. Using this instrument would allow terminal operators to assess which variables and measures the terminal needs to improve upon.

Since the actors involved in containerised freight logistics increasingly focus on the provision of door-to-door logistics services, it is important for dry ports to strategically position themselves as able to facilitate the provision of high quality services to their users through integration with their supply chain, an assessment of which can be made by using this instrument. In addition, a measurement instrument may be used to

provide a ranking of the supply chain integration of terminals at the global level.

What is becoming increasingly important for ports as well as port users is not merely the efficiency of the port per se, but the efficiency of the supply chain that the port and its users are involved in. Port productivity and performance is therefore related to the effectiveness of the supply chain and, by integrating in the supply chain, ports and users can take advantage of complementary strategies and capabilities to improve performance.

Having as a departure point the above-mentioned risk assessment, with the introduction of supply chain systems in other areas of transportation like liquid and dry bulk, new possibilities of extending the study of dry ports' integration in supply chains arise [5].

#### 4. Conclusions

The study takes a much needed step toward building a theory of risk management in global supply chains, which opens important future research directions. It should be tested in other contexts and with other methods to provide universality. This research provides direction to managers for choosing risk management strategies based on the global supply chain environment. Moderators have practical implications for the global supply chain managers. The study provides insights into the applicability of six risk management strategies with respect to

environmental conditions and the role of three moderators. The present paper can help policy makers to concentrate on actions necessary to protect ports and regulated zones from accidental environmental pollution, a risk which has now become more immediate due to their increased importance as links in the logistics chain next to dry ports.

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## Orientation and Integration of Volunteers in Organizational Culture

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### Abstract

*For an individual to become a volunteer in a organization, he must ensure himself that he will be compatible with the values, standards and procedures of the organization. Multiple problems and failures, that may negatively affect both volunteer and beneficiary organization, can be avoided by a real knowledge of the organizational culture in which will act volunteers. Paper aims to analyze some aspects of organizational culture on one hand, and orientation and integration of volunteers, on other hand.*

**Keywords:** volunteer, organizational culture, norms, NGO.

**J.E.L. Classification:** L31.

### 1. Introduction

The organization is a dynamic system that aims to achieve some goals and is influenced by social by social characteristics of its members, and also by external environment. Every organization consists of three elements of internal nature, between which it may observe a close synchronization, on one hand, and coordination, on other hand.

The first element includes the totality of formal and tangible characteristics, respectively, the *structure* of the organization. It refers to a number of issues, such as: official objectives and employed strategies, politics and rules, hierarchical relations and the forms of leadership and of exercising of power, existing resources within organization etc.

The second is the *culture*, which incorporates the values, traditions, beliefs, symbols and attitudes common to a group of individuals and supported by specific structural arrangements, which confer a basis of each organization. The culture has often a

strong influence on decisions' premises, on the behaviors and actions of managers, employees, volunteers.

The third elements refers to the *individuals*, leaders and staff of all hierarchical levels, they contributing to the creation and the change of organizational culture.

### 2. The concept of organizational culture

Generally speaking, the culture represents an assembly of definitions whom the people have at certain moment about what exists and happen around them – their representation of the world. In the sphere of culture are symbols, norms, laws, values, rituals, morals, myths that form a style that defines a specific way of each organization.

The organizational culture was defined in multiple ways along the time. The most representative definitions present organizational culture as follows:

“A learned and accepted set of presumptions about the norms (standards, rules) which regulate the behaviors of members” [Burke W.W. și Hornstein H.A., 1972];

“Is a model of common assumptions learned by the group learned once with the solving of problems, which proved functional and were considered valid in a sufficient measure to be transmitted to the new members as the correct way to perceive and approach the similar problems arose later” (Schein E. 1985);

“It is a unitary system of thinking of members of one group which make it different from other groups” (G. Hofstede 1991);

“The philosophy, values, presumptions, beliefs, expectations and attitudes which are common and act as a chain of the organization” (Sherman WA and Bohlander G.W., 1992);

“Organizational variables of the system

that, although difficult to define precisely, they exist and are described by employees in common terms; a system of accepted significations of organization’ members, which differentiate it from other organizations” (Robins SP 1992).

Thus, the concept of organizational culture refers to all that mean collective standards of thinking, attitudes, values, beliefs, norms and customs that exist in an organization. In cultural component may remark some visible elements like behaviors and common language, rituals and symbols, but preponderant there are components less visible, perceptions and representations of what is “value” in organization, myths, empirical standards about what means to work well and to behave properly etc.

The organizational culture is influenced by each of the elements mentioned above, but especially by the mood how this relate with the external environments, but also between them.

The organizational culture:

- mission of the organization;
- decision’s mechanism practised in organization;
- approaching mood of problems in organization;
- standards after which functions the organization;
- motivation / reward and / or reprimand practised in organization;
- traditions, habits and values that are promoted and transmitted into organization;
- degree of the adaptability of the organization at changes of social environment in which activate.;
- degree and mood of incorporation of the diversity in the structure of the organization;
- traditional partners of the organization;
- compatibility between the individual systems of values;
- motivation of the organization’s members to take part a long period in the organization;
- personality of the leader;
- individual personalities of those taking part in the organization;
- compatibility between individual personalities of the members of the organization;

- atmosphere at the working place etc.

### **3. Aspects referring to the discovering of culture of an organization**

Like people, each organization has a unique personality and transmits itself organizational culture. The behavior of members, the approaching moods of problems and / or people entering in contact with the organizations, promoted values, habits and procedures of the organizations, chosen symbols to represent the organization (mission, logo, colours) etc., may represent as many characteristics that contribute to individualization of the organization.

In the goal that a future volunteer will discover the culture of an organization, it is imposed the realization of an analyse referring on behavioural norms, procedural norms and habitual norms within organization, by finding answers to a series of questions.

*Behavioural norms:*

People from organization are preoccupied on their colleagues?

- There is opportunity for everyone to ask questions to anyone?
- Can you get help from anyone, regardless of hierarchical positions they occupy?
- People in the organization rather act and think positively or negatively?
- There is a desire of permanent improving and excellence?
- There is a feeling of contentment to the place of working?
- What are the individual qualities most prized and valued in the organization?
- Procedural norms:
- Are included all organization members in decision making?
- The mistakes are encouraged?
- There are enough resources for the assigned tasks to be fulfilled?
- There is centralized authority or decision making at different levels?
- Everyone is encouraged to think about solutions to existing problems and to contribute solving them?
- What are the cultural groups represented in management structure and / or in the row of members of the organization?
- How are tackled and resolved the conflicts?

- Operates the organization according to a long term vision?

*There are running procedures of consultation and cooperation*

*Habitual norms:*

- Why people leaved out the organization?
- What are legends that were said about those who left?
- What are the relations with those who left?
- Why remain people in the organization?
- There are traditional partners of the organization?

#### **4. Orientation and integration of volunteers**

Volunteering is the activity done on own initiative, through which an physical person offers his time, knowledge, talents, abilities and energy in the support of others, but without receiving a financial compensation. In the frame of volunteering the options are as much as possible diverse, from social attendance and services to education, culture, religion, environment protection, health, art, sport, human rights protection an many others.

The orientation is the process of training of volunteers to have a clear relation with the organization and represents an opportunity for volunteers to become familiar with the organization and its concrete activities.

Trough orientation it will be provided accumulation by the new volunteers of all knowledges and abilities that are necessary to the activity of volunteering.

Thus, in order to conduct in a efficient way the activity, a new volunteer needs to know a series of basic informations, such as:

- description of general activities of the organization;
- description of target groups;
- mission and vision of the organization;
- programs and services that are offered by the organization;
- other organizations working in the field;
- future plans of the organizations;
- expectations of the organization from the volunteers;
- benefits of the volunteer from his activity;
- the moods to communicate within the organization;
- equipment that can use volunteer.

In a systematic form, previous informations which presumes the orientation of volunteers can be realized by following stages:

- introduction about the organization;
- presentation of the vision statement;
- presentation of the volunteers management system, respectively, of the policies, of working documents etc.;
- aspects related to organizational culture;
- rights and responsibilities of the volunteer and of the organization which are stipulated in the contract on volunteering.
- The orientation of volunteers is usually realized by oral way, by a discussion, although in the frame of NGOs is reccomended to be an Manual / Guide of Volunteer, which has different roles:
- to communicate to volunteers information about the organization;
- to transmit clear, direct and in written form the expectations from the volunteers and their responsibilities;
- to present to volunteers the organization in a positive manner, in order to help them to adapt themselves by providing informations, which may indicate the role and place in the organization;
- to have a common basis of reference in case of disputes or conflicts.

In orientation session is very important that to volunteers to be gradually given vital informations they need, both to avoid around them agglomeration of the informations and confused estate, as in order that the information received on this occasion to be useful later.

Although for volunteer it is necessary to be introduced volunteer coordinator, who has an essential role both in orientation process, as in integration process, and also the team working within the organization.

Generally, integration represents reunification in the same place of several components, activities, production units or individuals, in order to obtain a common result (V. Popescu and A. Deaconu, 2008).

Many times, however, the orientation of volunteers is not sufficient and should be completed with full training program in which volunteer coordinator should:

- a. develop an orientation program for volunteers;

b. support the employees to work with volunteers;

c. develop training program;

d. prepare training materials (manuals, brochures etc.).

In an NGO, integration ensures assimilation of the volunteer and his adaptation to the requirements of the group to which he belongs. New volunteers need support to fit the existing team, especially because of multiple informations from this environment which is new for him.

Integration of a new volunteer takes end when this is able to perform correctly the tasks of the position he occupies. It is necessary to try providing as much as possible good correlation between aspirations of new volunteers and demands of the organization, leaving them the necessary time to a good knowledge of both the function and the organization, as a whole.

## 5. Compatibility of individual culture and organizational culture

Volunteers wishing to participate in various volunteer programs should first find out if a certain organization has an organizational culture that can be compatible with their own individual culture. In this sense, the volunteer should undergo a test which highlights a number of key words, written in capital letters, grouped in two sets.

*Questions about yourself:*

- I always tell the TRUTH?
- I am COMMUNICATIVE?
- I always work in TEAMS?
- I invest ENERGY into daily work?
- I PARTICIPATE in decision making?
- I am well PREPARED for the activity I will perform?
- I LIKE really the people from this organization?
- I NEED really to activate in this organization?
- If I have decision making I could CHANGE something in good in this organization?
- I think I will INTEGRATE myself in this organization?

*Questions about organization:*

- In this organisation it is saying always the TRUTH?
- In this organisation people are

## COMMUNICATIVE?

- In this organization it is working in TEAM?
- People in this organization invest ENERGY into daily activity?
- In this organization all members PARTICIPATE in decision making?
- In this organization people are well PREPARED for the activity they perform?
- People from this organization LIKE me really?
- It is a NEED of me in this organization?
- If I propose a CHANGE in this organization, my proposal will be taken into consideration?
- Will I be ACCEPTED in this organization?

The volunteer will accord to each question from two sets a score from 1 (false / disagreement with the statement / not applicable) to 5 (true, full agreement with the statement / applicable). The limit of compatibility is established by each volunteer according to his beliefs, standards and / or rules which guide his behavior.

## 6. Conclusions

Both people with whom he will work, and the organization in which he will work, will have an important role in the success or in failure of achievement of the desire of the individual to be volunteer.

For an individual who wants to become a volunteer in an organization, the easiest criterion for choosing the organization is its domain of activity. A number of other aspects, such as image of the organization, what kind of activities were carried out till now and what is the culture of the respective organization must be taken into account. So it is necessary to know what is the personality of the organization, what are its characteristics, what is the mood of functioning and what are the principles on which people are integrated and accepted within the organization.

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## Nutritional Aspects of Romanian Feeding that are Required to be Corrected

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### Abstract

*Food quality is a concern because it directly affects the health of the population.*

*In Romania, fruits, vegetables, fish, milk and dairy products consumption is even lower than nutritional recommendations resulting in a lower contribution to the need of nutrients such as potassium, calcium, vitamin D, polyunsaturated fatty acids and therefore reasons for concern to ensure the health of population.*

*It is recommended the consumption of the so-called „dense nutrients” which provide vitamins, minerals and other substances with favorable effects on health but low in calories, such as: vegetables (except for potatoes), fruits, whole grains, milk and other dairy products partially or completely defatted, fish and sea fruits, lean meat and chicken meat, eggs, legumes, fruits, prepared without added solid fats, sugar, starch and salt.*

**Key words:** food consumption, quality of food, biologic active compounds, dense foods, nutritional recommendations

**Classification J.E.L.:** I 15 - Health and Economic Development

### 1. Introduction

Beyond the common trends manifested in the diet for each region and each nation, certain particularities are distinguished.

Romanian food specific for each period was grafted by the historical particularities of the time, by the socio-economic development level and not least the adopted lifestyle. After 1980 Romanian eating habits start to be

gradually characterized by chronic imbalances typical for modern human diet, including excess caloric intake of fat and carbohydrate (especially from concentrated and refine sources), but also by the uncontrolled usage of food additives through rigorous mechanisms, alongside stands insufficient consumption of animal proteins vitamin deficiencies that are based on insufficient intake of fruit and vegetables and low calcium intake, phosphorus and iron (especially with children, women and elders).

One can appreciate the fact that the socio-economic transition period after 1990 is characterized by a decrease of the living standards, accompanied by inflation and unemployment extension, all these resulting in nutritional imbalances widening, especially in deeply disadvantaged groups by this evolution such as children, elderly, unemployed, and alteration of health more frequently and more severe. For years, the majority of budgets of most families in Romania have been directed at trying to cover the daily requirement of food, many high quality products are, unfortunately, less accessible because of financial impediments.

### 2. Romanian’s food consumption during 1990-2010

Romania has one of the largest share of food expenditure among the 27 member states of the European Union, being 2.63 times higher than the 27 European Union average. The magnitude of this percentage decreases with the increase of the purchasing power, which confirms Engel’s law of consumption.

Although expenditure indicator has indicative average value and hides important

variations within each state, it provides an image of the low living standards in Romania compared to EU states, measured by the importance of food expenditure in the budget of families reducing their size increased opportunities for consumer goods and food services. Even in comparison with the less developed states from Europe, Romania has a high share of food expenditure in total consumption expenditure, almost twice as Estonia, Hungary and Malta, which suggests the fact that the convergence process of consumption patterns specific to the European Union is a long one.

The comparative analysis of the main groups of food consumption, per inhabitant, in some EU countries (table 1) indicates the fact that in Romania, cereal and cereal consumption products is higher, while milk and dairy consumption is among the highest. All these, together with low augger and butter consumption (table 1) represent some of the most positive features characteristic to a balanced diet. Instead, meat consumption is the lowest among EU countries, its structure being unbalanced due to the very high proportion (51.72% from the total meat consumption) of pork meat and of a relatively small share of poultry and cattle respectively. This, together with relatively high consumption of potatoes, is evidence of a subsistence diet, which could lead to the installation to powerful diet imbalances that could lead to nutritional deficiency diseases.

Table 1. Average consumption of food, per capita, in 2009, corresponding to several EU states

Country	Cereals		Meat					Milk	Cheese	Butter	Oil and vegetal fats	Potatoes	Sugar	Wine
	Total	Cattle	Pork	Sheep/ goats	Chicken									
Belgium	nd	nd	18	40	nd	nd	61.8	1794	5.67	nd	85.69	nd	25.032	
Denmark	nd	nd	24	80	nd	26	98.67	nd	nd	nd	nd	nd	nd	
Germany	112.713	84	17	54	1	19	62.64	21.06	5.94	nd	58.669	nd	24.275	
Estonia	82.897	84	14	44	1	27	117.94	18.55	5.52	6.704	84.224	41.165	9.896	
Ireland	99.018	nd	20	20	3	25	189.8	6.38	2.57	nd	97.022	28.001	15.646	
France	111.386	94	25	35	4	23	65.05	23.92	7.86	15.608	51.238	34.985	48.038	
Italy	160.057	90	29	78	1	18	nd	nd	nd	nd	44.341	nd	31.812	
Luxembourg	25.707	91	28	38	2	15	nd	nd	nd	4.326	63.622	44.785	37.278	
Hungary	66.753	80	5	44	0	28	72.67	9.0	6.75	14.715	67.345	28.294	22.023	
Netherlands	115.950	nd	nd	nd	nd	nd	nd	nd	nd	17.771	44.541	27.712	18.456	
Austria	116.667	100	18	57	1	20	72.18	17.89	5.18	nd	56.476	38.680	28.218	
Portugal	28.006	113	19	48	3	55	nd	nd	nd	21.017	82.373	36.995	42.814	
Romania	200.898	63.8	7	33	2	19	190.13	20.92	0.7	10.187	89.268	23.905	22.703	
Slovenia	108.839	65	4	31	0	21	96.55	7.74	2.9	nd	96.743	nd	11.702	

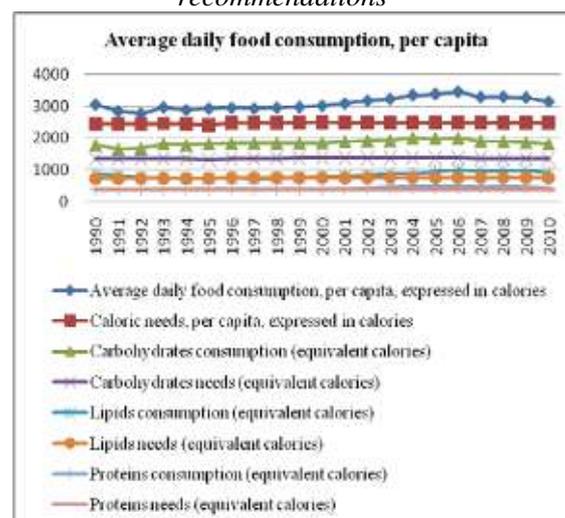
Processing after Eurostat

The analysis of daily average consumption, per inhabitant, expressed in kcal (figure 1) compared to average daily caloric needs, per inhabitant, being calculated considering the structure of the population

from Romania and FAO recommendations, shows a surprisingly dietary caloric surplus of 20%, during the period 1990-2000, in the context of real average earnings decreased, probably maintained by the consumption of cheap calories, while for the 2001-2008 period to increase the caloric surplus at 24-33% compared to the needed one, and after the year 2008, following the registration of a new decline in average real wage in the surplus population to decrease at 27.2% of required.

Reducing food quality in Romania during 1990-2000 can be highlighted by reducing protein intake by 3.16% in 2000 compared to 1990. More than that, the proportion of animal protein, with high biologic value, is inferior to the proportion of vegetable protein and recommended value of 50%. During the period 2000-2010 food quality slightly improves, fact noted by the increasing protein intake with 1.51% than the one for the year 1990, as well as by the increase of animal protein with high biological value. Thus, in 2004, the share of animal protein, with high biological value, equals the share of vegetable protein and the dietary recommendations, while for the year 2005 the proportion of proteins with high biological value to exceed 50%.

Figure 1. Evolution of average daily consumption, per capita compared with the recommendations



Processing after National Institute of Statistics

In the balance between fat intake and lipid requirements, the 1990-2000 period can be considered as fairly balanced, while starting with the year 2001, due to the increase of

consumers' real incomes, increase fat intake to a maximum of 32.7% than required, in 2006, as for later to decrease slightly, up to 24% than required (for the year 2010). Analysing structural fat intake an imbalance can be observed, imbalance to the nutritionists recommendations, determined by a share of more than 10% saturated fatty acids, at the expense of polyunsaturated fatty acids intake which is well below the FAO recommendations of 10%. Starting with the year 2003 an intake of fat is found over 35% of average daily energy intake, which can be associated with the increased intake of saturated fats and daily caloric intake, promoting obesity.

The largest imbalance between intake and the need to register for carbohydrates, due to high food intake of grains and cereal products, that in the context of lower levels of income in Romania, contributes to a high proportion to ensuring the caloric needs (over 40%, compared to up to 30% in developed countries). In this way, the imbalance between the carbohydrate intake and requirements are noted throughout the analyzed period, being continuously increasing from 21.78% in 1991, to 46.16% in 2003, when, due to higher incomes, it begins to decrease reaching 32.7% in 2010.

Disaggregating caloric consumption by type of family, it suggests potential nutritional deficiencies among poor families. Thus, average caloric consumption in families of unemployed was less than the minimum amount recommended for adults by nutritionists (2450 cal), calculated considering the consumption basket required for a healthy life. Therefore, at the level of 1999, families from the 1 income decile had an average daily consume of 2036 cal, below the one recommended by nutritionists for a healthy life.

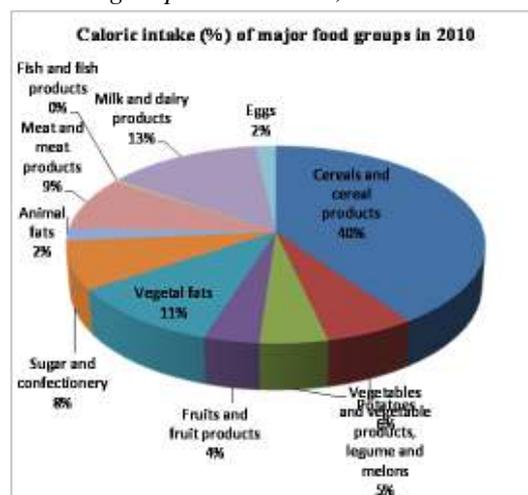
There are signs of nutritional deficiencies in the more numerous poor families, since poverty was systematically associated with a high family size. Most frequently, the victims among these families, are children. Food quality is poor in low income families, standing lower share of animal proteins, on lower purchasing power for meat and dairy products. The dominant share of these families and especially caloric protein consumption is represented by vegetable products, animal calories representing on

average only 25%, actually considered an indicator of poor food quality.

The analysis of nutritional factors in consumption by deciles of income suggests that with the increase of income, a reduction in calorie consumption share of plant products, especially in the protein has taken place. In the same time, the increase in education level is accompanied by a reduction of animal fat, which shows a possible positive association between this variable and the knowledge level of healthy eating .

Figure 2 presents what can be called a typical Romanian food, which is based on grains and cereal products (bakery products, maize, etc), milk and dairy products and meat and meat products, potatoes, vegetables, fruits and fish products. One can appreciate that Romanian diet is close to the one from the Mediterranean countries (high percentage of grains and low of meat).

Figure 2. Caloric intake of major food groups in Romania, in 2010



Processing after National Institute of Statistics

Respecting religious traditions, especially within the countryside families, creates the opportunities for deficiencies of protein and calcium, due abstinence from animal products, during relatively long periods of the year. Families with low incomes among the unemployed and pensioners constitute a special risk group.

Deficiencies of vitamins and minerals, especially in children, can have long-term dramatic effects: impaired due to vitamin deficiencies, anemia due to the reduced rate of absorption of iron from food, especially in

children with vitamin C deficiencies, high risk of diarrhea and respiratory diseases caused by lack of iron.

The structure of caloric consumption in the year 2010 does not reflect any major signs of concern, the proportion of protein (14.13%), carbohydrates (57.39%) and fats (29.23%) being close to the OMS recommendations. Regarding the consumption structure in depth, although fat consumption is within the limits of nutritional recommendations the high percentage of saturated fats (by the consumption of pork and animal fats), increases the risk of cardiovascular diseases, actually supported by a high rate of cardiovascular disease in Romania, one of the highest in the European Union. Examining the incidence of mortality by specific categories of diseases of the circulatory system, it is shown a very high incidence of especially cerebrovascular diseases, women being more vulnerable, a distribution different from the distribution of ischemic heart disease.

Another cause of high incidence of cardiovascular disease is the relatively high egg consumption associated with high cholesterol intake. Thus, according to a study performed by prof. Dr. Cintează, M. in December 2010, 30% of the population from Romania, both at the urban and rural level, presents a high level of cholesterol, while 42.6% among people aged over 70 record a high level of serum cholesterol which explains the high rate of sudden death caused by stroke. Over 30% from the Romanians have a high level of cholesterol and approximately 40% are hypertensive, the consequence being that 2 out of 3 Romanians die from cardiovascular diseases compared to the situation in the traditional core of countries in Western Europe, which have been popularized as the devastating effects of high cholesterol, from the same cause 1 out of 3 Europeans die. One can appreciate that this phenomenon is caused by poor education on diet and induced risk of high cholesterol. Therefore, in countries with a traditional diet rich in fiber and low in cholesterol, diseases such as colon cancer, diabetes and cardiovascular diseases are much rarer than in Western countries.

As it can be observed from the analysis consumption of the population from

Romania, a number of food or food components are consumed in excess, which increases the risk of chronic disease. It is the high consumption of saturated fats (food rich in saturated and trans fatty acids) cholesterol, salt and even alcohol.

The body uses a quantity of saturated fatty acids to support structural and physiological functions, but their food intake exceeds by far the requirements in meeting these needs. Several studies indicate the fact that the high intake of saturated fats is associated with high levels regarding both the total content of cholesterol in blood and LDL-cholesterol levels, considered important risk factors for cardiovascular disease. The diet of the population of Romania intake of animal fats is 15.5% from the total daily energetic intake, which exceeds the experts' advice, this largely due to the high consumption of pork and animal fats. In order to reduce the intake of saturated fats, the consumers should limit their consumption of foods rich in animal fats, replacing them with foods high in monosaturated fatty acids and respectively polisaturated ones. If the decreasing consumption of butter is analyzed against the backdrop of margarine, we can say that the first step was taken, but it is not enough. In this respect it is recommended to use low-fat dairy products, weak meat, the increase of dietary chicken meat and especially fish.

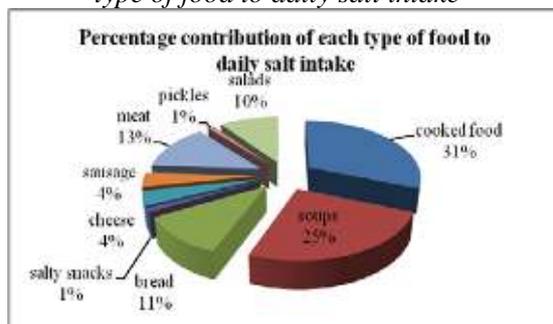
Following the analysis of food consumption of population from Romania, there was high cholesterol food intake, over 450 mg cholesterol / daily, the most important sources being the eggs, pork meat, beef, whole milk and high fat dairy products. Cholesterol intake can be reduced by limiting the consumption of these foods high in cholesterol. Cholesterol intake from foods was associated, for some individuals, with increased LDL-cholesterol. However, this effect is reduced when the intake of saturated fatty acids is reduced; the potential negative effect of cholesterol is lower than that induced by the presence of trans-saturated fatty acids. A series of studies has demonstrated the relationship between the high level of cholesterol and the increased risk of cardiovascular disease. Thus, nutritionists believe that the consumption of cholesterol below 300 mg /daily ensures maintenance of normal serum cholesterol level while the consumption below 200 mg

/daily can reduce the risk of cardiovascular disease.

Sodium is a macro element required by the body in relatively small amounts. Numerous studies have shown that increased intake of sodium in the body is associated with increased blood pressure. On the other hand, maintaining normal blood pressure reduces the risk of heart disease, congestive heart failure and kidney disease. This is the reason why for the sodium intake to be limited to 5g/ daily, that is 2 g /daily in people aged 51 and those people with hypertension, diabetes or those who have a chronic kidney disease.

Salt consumption in Romania, in 2010, according to a study performed by Zugravu, C.A. (2011) is of 11,25 g /daily, the biggest contribution being that of homemade food (soups/broths/cooked food), followed by homemade meat and bread (figure 3). Cheese, salty snacks and meats, although having a high salt concentration, due to their limited use, their net contribution is low [1].

Figure 3. Percentage contribution of each type of food to daily salt intake



Processing after Zugravu, C.A., 2011

### 3. Recommendations to correct certain nutritional aspects

In Romania fruit, vegetables, fish and even milk consumption and dairy products are inferior to nutritional recommendations, which determine a lower intake than the need for some nutrients like potassium, calcium, vitamin D, polysaturated fatty acids and therefore of concern to ensure the health of the population. In order to avoid maintaining these potential long term gaps, with adverse implications on the health status of the population, the following recommendations can be made:

- Increase the consumption of fresh fruit and vegetables;

- Reduce the consumption of potatoes and increase the consumption of vegetables and legume;
- Replacing refined cereals with whole ones;
- Increasing the consumption of partially or completely skimmed milk products, foods and beverages fortified with soy;
- Diversification of protein in the diet: fish and sea fruits, lean meat, poultry, eggs, legumes, soy products, unsalted fruits;
- Decrease in food weight of pork and the increase in meat eating fish and seafood;
- Reducing foods high in solid fats with other lower-calorie or high aromatic oils ;
- Replacing the consumption of solid fat oils, whenever possible [2].

The biggest challenge for consumers is that these recommendations careful control the body weight. That is why it is recommended the consumption of certain „dense foods” which provide vitamins, minerals and other substances with favorable effects on health but with low calorie intake. These foods are rich in dietary fiber, but do not contain or have a very low fat content of solid fats, sugar, starch, sodium or high sodium containing compounds. Legumes (except for potatoes), fruits, whole cereals, milk and partially or totally defatted dairy products, fish and sea fruits, lean meat and poultry, eggs, legumes, oleaginous fruits that are prepared without prepared added fat solids, sugar, starch and salt are considered nutrient dense.

There are three arguments behind the recommendation to increase consumption of fruit and vegetables. The first one is that, most of fruits and vegetables are the main source of certain nutrients whose food intake does not equal the daily needs of the body, namely magnesium, potassium, calcium, dietary fiber, vitamin A, C, folic acid, making it a concern to ensure the health of the population. Secondly, fruit and vegetable consumption is associated with reducing the risk a numerous chronic disease. Thus, there are evidence in this regard, that a daily consumption of 2<sup>1</sup>/<sub>2</sub> fruit and vegetable portions reduce the risk of cardiovascular disease, including myocardial attack and stroke. Furthermore, certain fruit and

vegetables can have a protective role against different types of cancer due to their high content in antioxidants. In the third place, most fruit and vegetables, when consumed fresh or prepared without added fats or sugars, have a low caloric content, which allows a good control of daily energy intake and body weight default.

Although Romanians diet contains a sufficient quantity of cereals, a problem that could have serious repercussions on the health of the population draws the attentions that are the even higher share of refined grain products rich in fat and sugar solids to the detriment of whole cereals. Whole cereals are an important source of iron, magnesium, selenium, vitamin B complex and dietary fiber. There are studies supporting that whole cereal intake reduces the risk of cardiovascular disease and it is associated with the reduction of body weight and the incidence of type 2 diabetes. In this way, to keep the daily energy intake within the recommended limits and to have a better weight control, at least half of cereal intake should be represented by whole cereals, the remaining cereals being required to be fortified with several vitamins and minerals.

With regard to protein intake in the diet of Romanians, these may be considered appropriate in terms of quantity but not quality.

Fish consumption among the population of Romania is very low and it is recommended to increase further because, among other nutrients, it represents an important source of fatty acids  $\Omega$ -3 type, and eicosapentaenoic acid (EPA) and docosahexaenoic acid (DHA). There are studies which demonstrate the fact that weekly consumption of 225 g of fish or sea fruits ensures the body a weekly intake of 250 mg/daily EPA and DHA, which is associate with the reduction of death caused by cardiovascular disease. Furthermore, it has been demonstrated that this food intake in pregnant women or those breast-feeding is associated with improved health status of children, especially in terms of cognitive and visual acuity.

#### 4. Conclusions

The analysis of food consumption of the population revealed that a number of nutrients are below recommended values:

vitamins (especially A, B, D), calcium, due to low consumption of fish and lower consumption of dairy products recommended by nutritionists, vitamin C, folic acid, iron (due to low consumption of fruit and vegetables).

The increasingly higher share of refined grain products rich in fat and sugar solids, to the detriment of whole cereals, may represent a health risk which must be corrected.

It is recommended the increase of fish and fish products consumption which would ensure an adequate intake of polyunsaturated fatty acids of type  $\Omega$ -3, with positive effects in ensuring the health of the population. It is also recommended the increased consumption of meat and a special focus on the percentage of pork whose increase could contribute, together with other factors, to the increased risk of cardiovascular disease.

Correcting all these consumption deficiencies of the population from Romania is absolutely necessary to achieve and maintain the health of the population, in order to avoid nutritional imbalances that could lead to the increased risk of chronic diseases.

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## Occupational stress reduction, between theory and practical case

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### Abstract

*This article includes 2 parts: theoretical elements and a case study. Theoretical elements define and explain concepts such as: stress, stress management, organizational change and counseling.*

*In the case study these elements are applied on a research unit development. The reason for this analysis was to understand and try to find solutions for an existing tense situation in the analyzed company. Work methodology included: observation, direct discussions with staff (in small groups) and the application of a questionnaire consisting of 6 modules. On that base, major dominant stressful manifestations were determined. Following, the obtained results solutions have been proposed to management and employees. In the last part the obtained results from the implementation of some of proposed solutions are presented.*

**Key words:** Stress, management, counseling, organizational change, results.

**J.E.L. Classification :** J2, J24, M54.

### 1. Introduction

Whatever we do in life, we often experience stress. A study conducted by Reader's Digest in 15 European countries showed that, at present, the Romanians have "managed" a spectacular counter performance: we are number 1 in Europe at perceived level of stress: 52% believe that stress is the greater health problems, compared to European average of 33%. Stress is not necessarily negative, characterizing it as negative or positive stress depending on each particular situation. Up to a certain limit, the stress is even motivating to business.

### 2. Theoretical elements

**Stress.** Positive stress is necessary for our protection, for example in case of an accident

by mobilizing all body resources in order to avoid it. In this case, we speak of a positive stress because in a stressful situation, typical stress reactions of the body show - heart begins to beat faster, the brain receives more oxygen, the muscles are tense and so on - but for a positive resolution of the situation.

The negative stress is a reaction to the inherent psychological stressors demands that have the potential to make a person feel tense and anxious, because he or she is not able to face these demands. It is a tension that arises when a person responds to job demands, family and other external sources as if they were generated by its internal needs, obligations and self-criticism. Stress is both additive and cumulative. In time it accumulates up to the state of crisis when symptoms appear. These can manifest physically by: irritability, anxiety, concentration decreased, frustration and hatred. Also physical symptoms can occur: muscle tension, headaches, back pain, insomnia and hypertension. Untreated, symptoms may lead to illness and even death.

**Stress management** refers to:

- Identifying causes which produce and adopt measures such as: individual responsibilities change (reduction or increase them); increased autonomy in carrying out tasks; agreeing to employee goals; providing appropriate training (e.g. in time management techniques); allowing adoption of a flexible schedule; offering professional and personal counseling; improved working conditions; employee relocation; providing access to the sports centers (e.g.: Many Japanese companies insist their employees workout at the beginning of a working day).
- Helping employees in developing the capacity to cope better with stress by: providing counseling services; organizing working sessions on stress; sports and social activities; training in

relaxation techniques; serving meals and providing spaces for adequate rest.

- Counseling is essentially a discussion (a series of talks) between the person who needs help (the client) and another person who masters the techniques of counseling. Managers should know such techniques if they wish to solve effectively their subordinates' problems and obtain maximum results.

**Counseling** is a process that helps clients to:

- 1) identify the problem;
- 2) determine which would be ideal or preferred outcomes;
- 3) explore ways of achieving results.

Besides the specialists within the human resources compartment (economists, sociologists and psychologists) an extremely important role falls upon managers at all hierarchical levels, from top managers to team leaders because they are the ones who work directly with people, who create a climate, those who know them best and who can think, with the support of specialists, the best solutions and most important, who can actually implement them.

**Organizational change.** In contrast to stress management and assistance programs for employees, some organizations try to reduce stress by using a specialized consultant who is responsible for recommending some ways for improving working conditions. This approach is the most direct way to reduce stress at work. It involves identifying the most stressful aspects of work (e.g. overwork, conflict) and design strategies to reduce or eliminate the identified stressors. The advantage of this approach is that it treats directly the main cause of stress at work. However, sometimes managers do not agree with this approach because it involves changes in work routine, production schedule or in the organizational structure.

As a general rule, actions to reduce stress at work should pay particular attention to organizational change in order to improve working conditions. But even the most conscious efforts to improve working conditions are unable to eliminate stress completely for all employees. Therefore, a combination of organizational change and

stress management is often the most useful approach to prevent stress at work.

### **3. Case study: research and development unit of public utility.**

#### **3.1 Methods**

In order to identify stressors, the following methods were used: passive observation (a 3 days period), informal discussions and an inventory of stressors.

Passive observation - Simple observation was done over a period of 3 days, direct, discontinuous. Data were recorded following each stage of observation. The purpose was to make an observation of the original image on the environment, activity and behavior caused by this environment. By observation we distinguished characteristic manifestations from the random ones.

Informal discussions - were held in small groups (2-3 employees) and focused on grievances, problems and difficulties they meet in their work. Conversations with employees were the most direct way to find out details of the motivations, aspirations, emotional experiences, interests. Following that discussion an inventory of stressors was made. This inventory was then submitted to all employees and constituted the support for differentiation of stress levels present at employees.

In order to complete the data a 6 modules questionnaire on stress at work was used:

I. Work requests: My work requires me to work very quickly. My job makes me work hard. I am not required to provide a large amount of work. I have enough time to finish my work. My work requires me long periods of intense concentration. My tasks are interrupted before they are finished and I will have to pay attention to them later. My job is very hectic. Pending due to other colleagues or departments slows down my work.

II. Decisional authority: My job allows me to take many decisions. At work, I have little freedom to decide how to do my work. I can determine the order in which I finish my tasks. I can determine when I need to fulfill a task. I can easily go away from work for a short period. I can set my own working rhythm. I feel that my work gives me a place in the community.

III. Abilities: My work requires me to learn new things. My job involves a lot of repetitive work. My work requires me to be creative. My work requires me a high level of skills. I have to do different things in my work. I have the opportunity to develop my specific skills.

IV. Working contract terms: I can determine when to start and finish work. I can determine when I need a break. I know my work schedule a week before. I can determine when to take my holidays. The health and safety norms are well known and respected. Prospects for my career development are good. In five year time, my skills will still be valuable. I have the opportunity to attend training courses, specialization and training. My wages is satisfactory.

V. Bosses and colleagues' aid: The atmosphere at work is good. Most of the people irritate me. If needed, I can call in for help one or more colleagues. Where I work, daily order is good. My work is properly appreciated. I'm informed about the situation of the company. I feel free to discuss problems and complaints with companies' management. My suggestions regarding changes in working practices in order to streamline work are taken into consideration. Magazine company (if any) is useful. If there is no magazine, don't answer.

VI. Socio-demographic: Sex; Age; Marital status; Family component: number of members.... out of which children .....; Training level; Activity field: public service; other: research projects; Personal income; Income per family member; City: Bucharest

### 3.2 Stressors inventory

The following dominant stressors resulted from discussions: complaints about career: the impossibility of advancement; conservatism in terms of job design; conflicts with superiors, colleagues, subordinates and customers of the company; contradicted requirements from the institution; unstructured or unclear objectives; inadequate resources; conflicts between the needs and expectations; bad working conditions (noise, faulty lighting, lack of performing equipment); inadequate time management; routines; overload; poor management of potential and skills of

employees in the way of not-exploiting resources, capacities, skills; responsibilities on other people; unrealistic deadlines, inadequate schedule; conflict between home demands and those from work; lack of free time; family and housing conditions; financial status; insufficient sleep; legislative changes; the risk of occupational diseases; poor communication.

The substantial presence of following stress indicators was noticed: high level of sickness; headaches and stomach aches; mental states such as absenteeism, apathy, embarrassment, boredom, dissatisfaction, fatigue, alienation, anger or irritability, negativism; low productivity and inability to achieve the objectives set forth; increased error rate ; increased number of internal conflicts between employees, excessive rate of staff fluctuation, phenomenon increasing while time passes by.

### 3.3 Proposed Solutions

Because a fairly large number of employees expressed dissatisfaction about the same issues, we believe that these are active factors of stress. So the stress reduction strategy will focus mainly on reducing them.

The solution we proposed is a combination of a stress management with organizational change.

It is necessary to be mentioned that the contribution of both parties, especially their readiness to achieve a positive result, respectively a not tensioned and productive working atmosphere, an environment in which the human potential that exists in the organization is able to express and develop.

Thus, after the analysis, the following recommendations can be made:

#### **For management:**

1. It is recommended: that specialized programs, involving all employees at a time, are to be developed, in order to enable wider perspective on the possibilities offered by working with companies' clients. Apart from these courses, there may be some changes within the institutional behavior by promoting friendly attitudes between management and employees of the institution. These can start from the management or from the employees. In this way the managements' image of the

employees may improve and the employees can evaluate, diversify and develop professional capabilities.

Participation in specialized courses enables interaction with other leading business media and professional re perception of the employees' activities.

Evaluation of this strategy can be made after at least 6 months, time required in order to assure the participation of at least one set of employees at specialized courses related to the effects of less formal atmosphere due to behavioral changes. A form of assessment could be done through interviews.

2. To improve communication between management and employees, besides the possibility of friendly relations, meetings can be organized involving both management and employees where they can express every opinion. An indicator of good communication is the degree in which the chief and subordinate agree on job issues and each is sensitive to other's point of view. It may be that the parties "agree they disagree" in some respects. These meetings aim to present several points of view and to emphasize that those can lead to expected results. Agreement between the parties "implies increased confidence in the professionalism of others. Training team work spirit aims to increase the efficiency by improving interpersonal relationships, clarifying goals and roles (what is the team trying to achieve and who is responsible?). It can thus facilitate communication and coordination. Training team spirit usually begins with a diagnostic session, "often kept out of work, in which the team examines their current level of functionality"[4]. Because our group' main factor of stress involves extended working hours, the opportunity of doing these sessions away from the workplace is appropriate.

3. Defining jobs in a manner that allows a maximum freedom of exercising the skills and discernment of the job' owner, in order to maintain the interest for the position.

4. Design activities so that the employee should have a certain degree of responsibility, sufficient authority and the right to participate in decisions that influence its activity.

5. The way employees are treated should give confidence about job security and the position they occupy in the institution.

6. Employees must be treated with respect. Addressing inadequate generally leads to conflicts, and when they cannot show it creates a complex kind of "impotence" which maintained, creates a constant state of stress.

7. Providing counseling services for employees, internally, using their own qualified advisors, or resorting to the services of an outside consulting organization. In this way the organization obtains several advantages using minimal resources. For example: a good external image (the company is interested in the welfare of employees), different employees' attitude towards the management of the institution (including reducing of conflicts frequency), compared to the work they perform, high efficiency, intellectual comfort and so on. In terms of resources used, comparing the financial problems that may arise from inefficient work or staff fluctuation, it can be easily concluded that in fact this will not be considered a substantial effort.

8. Create optimal conditions for work – adjusting locations in accordance with occupational health, providing required equipment in order to perform duties.

9. Where there is lack of possibilities for material reward, it is recommended to provide other facilities, e.g. granting time off, merit and performance recognition in public.

10. Identifying the right person for a specific job - execution, management. This may lead at the same time to: the optimal use of human potential, rewarding the deserving, avoidance of conflicts arising between employees on grounds of incompetence, unnecessary loading of the work of some others, allowing the direct superior to delegate his power because he will do it efficiently.

11. Implementing a management system that takes into account the fact that people have also have family problems, such as taking children to kindergarten, and therefore to accept the request of the employee to a flexible or lagged working program. Thus we obtain multiple benefits: the employee is satisfied that he/she is understood and helped, personal problems are solved, and the institution benefits from a stable committed and flexible enough employee (considering that they agree to the working conditions and benefits they get from the institution).

***For employees:***

Learn to manage stress in order to ensure long-term professional success and to maintain physical and mental health:

1. Change of perspective. For those employees who think the employer requires too much (quite a big number), it is advisable to check if the problem lies within its personal organization or the way that the department is operating. It is better to turn to a career counselor to make an action plan, which will lead in time to the intellectual and personal comfort.

2. If tension or stress is felt, a five minutes break it is recommended outside the working space, away from work routine. There has been noticed in time that this contributes to a significant stress decrease.

3. Respect the time dedicated to family or itself. It is important to leave work at the office, in all the cases. Decreasing personal time in favor of the professional one has proven to be a powerful stress factor, regardless of the individual position on the social ladder.

4. Organizing the workplace and tasks, keeping a list of priorities and supervising them. Feeling overloaded and out of control are situations that cause stress.

5. Manifestation of personal feelings towards a close person. The existence of support, of a person who wants to listen, helps relaxation and reduces stress.

6. There certainty that help exists in situations of overload will decrease the tension. But that relationship should be work both ways, from the transmitter to the receiver and back, because in time, roles can reverse and the one who help in a certain situation must be sure that the same support will come back from the one who's been helped now, when a similar situation should appear.

7. Laugh therapy. Almost any situation can be detensioned through a joke or a good disposition created by a man with a sense of humor.

8. The employee must be realistic. Too high and unrealistic expectations of what can be done in a day, week or month can cause negative feelings. High levels of stress negatively affect motivation and influence professional outcomes. In time, a very capable and performing professional, but unmotivated properly, will come to point of not providing appropriate outcomes.

9. The idea of perfection has to be dropped. No one is omnipotent. Failures don't have to be lived dramatically, but viewed positively and considered ways of learning from their mistakes.

10. A positive attitude is recommended, avoiding negative people with a bad attitude because they can "contaminate" others with their behavior. Negativism destroys energy and motivation. A positive atmosphere needs to be created around people with which one interacts and within the working environment. Achievements should be a cause for joy, even when nobody else feels the same.

#### **4. Implemented solutions – Obtained results**

Following the analysis and the proposed solutions, management has decided to organize a team building outside the city, involving a part of the company's staff.

Although the main purpose of the delegation was work, the delegation's evolution from a psychological and behavioral perspective was a positive one during the three days.

Starting from a general and permanent state of stress, manifested in various ways, from the high tones of voice to expressed depressions, in the second night a state of relaxation and good communication within the team was reached, which has generated a good mood, maintained after the return to work.

As each, at a time, felt able to express him/herself freely, without regard to function, age and corporate position, the atmosphere was detensioned, accounts adjusted and nerves exhausted.

Even though organizational problems arose during the delegation, they were treated with more relaxation than normal, and clearly resolved quicker and more efficient.

The applied solution was very simple and less expensive for the company, with maximum results.

Multiple outcomes were registered:

- Delegation target was achieved, cooperation between the analyzed company and hosts was perfected and joint projects have been proposed, convenient for both parties;

- People to work more relaxed, returned as more than daily colleagues, depending on compatibilities, constructing or deepening a friendship relationship and they became to know each other better than they can do it in the office;

- In terms of the impression created by the analyzed company's management, one can argue that using a reduced amount of money, yet something was offered to its employees, which tempered, at least for a while, reluctant and nervous attitude shown before.

## 5. Conclusions

In terms of stress there are 2 main ways of approach: total ignorance, with negative results or amplify the importance of the phenomenon and justify the majority of failures on its expense.

We believe that no one's approach is neither normal nor useful for companies or employees. A middle way is always best. Far from us the idea of reducing the importance of this element within daily activities, but we do not believe that stress is responsible for all failures, whether personal or professional. Thus, from our experience, we recommend to the institutions and employees to consider the evidence presented in this work, both as theory, and practice and seek to apply, according to the specific job, one or more of the solutions we proposed. Obviously, depending on stress factors and dominant manifestations that result from an analysis, other solutions might be proposed. Therefore we consider it appropriate for everyone, before you diagnose by ear or take a position depending on appearances, to make a brief analysis of the reasons which lead to disruption of the daily activity of everyone.

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## The Challenge of Innovation for Employees

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### Abstract

*Many companies try to create a centralized program for managing innovation. Usually innovation is delegated to the marketing or R&D department or sometimes a new function is created to manage innovation across the organization. Unfortunately such models for fostering innovation are insufficient and inefficient. Innovation is limited by the available talent, attention, insights and instincts of the managing group. They don't allow a largely pool of talented and insightful employees to create and act on their ideas. We believe that a solution can be to create a system for stimulating potentially valuable ideas and managing the process of converting the best of them to innovations that have an impact on competitiveness.*

**Keywords:** knowledge management, competitive advantage, innovation.

**J.E.L. Classification:** M10.

### 1. Introduction

The word innovation derives from the Latin word *innovatus*, which is the noun form of *innovare* "to renew or change" stemming from *in*—"into" +*novus*-"new". Diffusion of innovation research was first started in 1903 by seminal researcher Gabriel Tarde, who first plotted the S-shaped diffusion curve. Tarde (1903) defined the innovation-decision process as a series of steps that includes: First knowledge, Forming an attitude, A decision to adopt or reject, Implementation and use, Confirmation of the decision.

Almost every company includes innovation on their core mission and values statement. Many exhort their people to think outside the box, to generate ideas and to submit them online. Some invite front-line employees to idea generation and innovation training sessions. The innovation learning is shelved until the day when the everyday load lessens. The learning is likely to become out of date as the business context changes [1].

### 2. Theories of Innovation and How Innovation works

There are many different theories of innovation: breakthrough, incremental, open source to name but a few. There are arguments stating innovations have to be disruptive to qualify; others argue that any change—as long as it is measurable—qualifies as innovation. Some people want innovations to be open and available to all as a means of challenging even more growth and ingenuity; others believe that new discoveries and paths need to be developed privately and secretly.[2]

Our assessment is that front-line employees, those closest to the customers and the work of delivering the products and services, have some of the freshest ideas and insights. Unfortunately, because they are largely unfamiliar with the business plans of the organization, their ideas and insights, may not be adequately framed. But setting broad corporate challenges, teaching employees new skills and engaging them in the quest for innovation can produce powerful insights, innovative approaches to problems, and an increase in the capacity of an organization to implement new ideas. It

also produces the positive side-effect of aligning the employees' efforts with major strategic goals and encouraging quick and effective action toward those goals. To be effective the effort must be locally managed and staffed. Local decisions and quick actions reduce the need for scarce corporate managerial talent.

Front-line employees – tellers, clerks, customer service representatives – are given tools to generate ideas around local and corporate challenges and forums to assemble teams that develop the ideas themselves. A locally managed governance process evaluates ideas and allocates local resources. Local coaches help teams through the process of idea development and implementation. A series of metrics helps manage the effectiveness of the local innovation process.

The corporate leadership will have to ensure that successful front-line innovations are disseminated throughout the company and that ideas generated requiring large, complex, and resource intensive development are fielded appropriately. Both systems complement each other. Front-line innovation results in many ideas with local application that require fast, simple, and cheap development, whereas centrally developed innovation results in few big ideas with company-wide application, that require time-consuming, complex, and expensive development.[3]

Each team has a small set of people who do most or all of the work. Every manager knows who these “go-to” people are. They are a very scarce resource. The aim is to create more of them in every unit. Provide them with small set of simple tools on what to look for in a nascent idea, how to describe and how to elaborate a rough idea. Publicize them and their role on your company intranet. Since they are likely to be locally known and well respected, employees find it easier to approach them with their ideas than to try to persuade a central innovation group or even their own managers.

### **3. Methods and Tools for Innovation**

There are methods and tools for innovation. Although innovation is highly touted as the future of business, very few people have any idea for how to actually make that happen other than hoping they hire

someone who will keep coming up with good – and profitable – products and services each year. (Trial-and-error is not an effective or efficient means of facilitating innovation.)

Install an innovation pipeline, a process for shepherding ideas through to implementation in each location. Ideas are stimulated and generated by periodically posing innovation challenges or strategic imperatives to the front-line employees. When ideas are submitted by employees, they are quickly evaluated by the coaches and local managers against a set of transparent and publicly-known criteria and shelved or green lighted to the next stage. The bar for success is set higher and each stage and process demands more rigor from the innovator and the team as the idea progresses along the pipeline.

An occasional off-site to promote creativity or any other off-and-on-again motivational program, cannot be counted upon to generate a steady and sustained flow of innovative ideas. Managers need to learn how to deploy innovation tools and methods to stimulate ideas, to initially describe and to elaborate ideas.

Apply technology to declare innovation challenges, to publish and share nascent ideas with the widest possible group across the enterprise. Encourage the formation of virtual communities by having coaches, managers and innovators openly comment on each other's ideas. [4]

Effectively managing innovation requires a somewhat peculiar combination of allowing chaos to happen within a set of well-defined boundaries. Under such conditions, proposed ideas may range from the ridiculous to the sublime. Separating the wheat from the chaff, extracting kernels of insight from ideas and guiding tentative innovators is an unfamiliar capability for many managers. Get started by creating a local innovation board consisting of coaches and a few local managers – a team that balances imagination and experience. Set a tempo for monthly innovation board meetings to review new ideas and green light or shelve them. Have innovators present their ideas in an open critique session. Once the pipeline has been established, schedule sessions quarterly. Rotate membership within the management team. [5]

### **4. Measures of Innovation**

There are no definitive metrics for innovation. Measures of innovative success vary by company and industry. And, as with any type of statistic, the numbers must be looked at closely in order to withstand analysis. The most common metrics are patent creation and R&D.

- Patent creation – Some companies create patent after patent and boast of their innovative capabilities. While this may be well and true for a few, if the numbers of patented products, processes, and services are now making it to the marketplace, then their relevance diminishes.
- R&D – This metric assumes that the amount of money spent on research and development directly correlates to the amount of innovative products, processes and services that get to the public.

Other measures? Total shareholder return is gaining in popularity, but for the most part the field is still open to metrics competition.

Metrics help local management effectively run their local innovation process, ensuring that at any given time, there a set of interesting ideas that are being generated, elaborated upon and experimented on, and implemented. Three general types of metrics are useful. The first measures the level of engagement that employees have in the front-line innovation program. Examples of engagement metrics include the percentage of employees submitting new ideas and the percentage of employees commenting on others' ideas.[6]

The second type of metric looks at the results of front-line generated ideas. In aggregate, the innovations adopted should have an impact on the bottom line of the enterprise as a whole. To maximize impact, management needs to ensure that developed ideas are implemented so that their full potential is achieved, that the results are recorded, and that learning from experiments, successful or otherwise, is widely shared across the enterprise. The last type of metric tracks the flow of ideas. In order to maintain positive momentum there needs to be a constant and regular stream of ideas through the innovation pipeline. This is effectively a measure of how regularly local management is making decisions to promote attractive ideas to the next stage of development while

pulling the plug on unpromising ideas that are consuming resources.[7]

The employees are exceedingly valuable assets. It surfaces new leaders and gives them the tools to create and act on ideas that are aimed at the most difficult problems facing the organization. It builds a capacity for creativity, resilience and agility into the fabric of the organization. Each organization must learn how to optimize its own process of frontline innovation – developing best practices for managing people, process, tools, technology, governance and metrics. Clearly, a creative front-line employee is a potent competitive weapon when supported by such a system.[8]

## 5. Conclusion

In sum, it is important to be clear as to what innovation is not. Innovation is not invention, even if invention is the mother of necessity. These two words are sometimes used interchangeably, but although connected they are not the same. An innovation is the extension of an invention.

If an inventor discovers the "next big thing," but is unable to find anyone to produce it, then the next big thing remains undiscovered to the world. For this invention to become an innovation, a public needs to be introduced to the invention and have said invention improve their lives in some way. This may happen behind the scenes (e.g., streamlined processes that lower costs to the customer) or be clearly visible (e.g., the flexibility of a laptop vs. a desktop).

"Real" Innovation does not happen haphazardly or sporadically within organizations. "Real" Innovation is accomplished consistently and systematically, given the true voice of the customer and a process for delivering solutions. Companies that innovate successfully do so using an efficient and repeatable methodology. Success is not dependent upon genius – it emerges from the disciplined application of a proven innovation methodology.

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## Communication an Important Management Tool for Leaders

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### Abstract

*Leaders can create an organization that is used with change and thrives on innovation, one where people embrace the chance to do things differently. Top executives help leaders throughout an organization to see the necessity for that. These leaders are able to communicate their enthusiasm to others. Management practices will create an organization that is comfortable with change only if leadership effectively inspires enthusiasm for change. To set the stage for adaptive innovation, what matters at the outset is what leaders say and whether it motivates the required risk taking – or the opposite.*

**Keywords:** leader, management, communication.

**J.E.L. Classification:** M10.

### 1. Introduction

Leadership is "organizing a group of people to achieve a common goal". The leader may or may not have any formal authority.

Good leaders are *made* not born. If you have the desire and willpower, you can become an effective leader. Good leaders develop through a never ending process of self-study, education, training, and experience.

To inspire your workers into higher levels of teamwork, there are certain things you must *be*, *know*, and *do*. These do not come naturally, but are acquired through continual work and study. Good leaders are continually

working and studying to improve their leadership skills; they are not resting on their laurels.[1]

Communication is the activity of conveying information. Communication has been derived from the Latin word "communis", meaning to share. Communication requires a sender, a message, and an intended recipient, although the receiver need not be present or aware of the sender's intent to communicate at the time of communication; thus communication can occur across vast distances in time and space. Communication requires that the communicating parties share an area of communicative commonality. The communication process is complete once the receiver has understood the message of the sender. Feedback is critical to effective communication between parties.

### 2. Inspiring enthusiasm through communication

Studying the communication process is important because you coach, coordinate, counsel, evaluate, and supervise throughout this process. It is the chain of understanding that integrates the members of an organization from top to bottom, bottom to top, and side to side.[2]

Working with a number of organizations to achieve these goals indicates that over time, a number of managerial practices will have their effect: identify and explain the irresistible forces of change; establish a larger purpose for the organization; recognize that innovation is everyone's job; create the innovation capability across the organization; take structural steps to support innovation.

Inspiring enthusiasm for change requires a distinct shift from the traditional mode of communication, in which the leader states the problem to be dealt with, followed by an analysis of the options, and a recommended conclusion.

Good organizations convey a strong vision of where they will be in the future. As a leader, you have to get your people to trust you and be sold on your vision.

Communication is the exchange and flow of information and ideas from one person to another; it involves a sender transmitting an idea, information, or feeling to a receiver. *Effective* communication occurs only if the receiver understands the exact information or idea that the sender intended to transmit. Many of the problems that occur in an organization are the either the direct result of people failing to communicate and/or processes, which leads to confusion and can cause good plans to fail. [3]

### 3. Getting the audience's attention

There are a number of factors which affect attention, and can be used to control the audience's attention. These are variety, the length of time concentration is needed, the time of day, and the amount of arousal and motivation the speaker can communicate to the listeners. Motivation, in turn, is affected by the audience's sense of security, how much their natural responses are repressed, and how much enthusiasm the speaker shows. Let me deal with each of these factors in turn, to give you some ideas about how to control the audience's attention.

Levels of arousal have been compared to an inverted 'U' curve, where performance levels rise as arousal increases, but dissolve in chaos as arousal gets too high. Most people spend most of their life in the restricted performance, low arousal part of the curve. Speakers spend much of their time in the hyper-active, anxious and over-aroused part of the curve. The art is to get both speaker and audience on the peak performance part of the curve. For listeners, it usually means awaking their interest, arousing them, by energy and variety.

Define problem > analyze problem > recommend solution. This is the common sense way of communicating and it is present in organizations. When you're trying to get

human beings to change what they are doing and act in some fundamentally new way with sustained energy and enthusiasm, it has two serious problems. One, it doesn't work. And two, it often makes the situation worse.[4] Successful leaders inspire enthusiasm for change through communication that is fundamentally differently from the traditional, abstract approach. They communicate by first, getting attention; then stimulating desire and only then reinforcing with reasons. [5]

Get attention > stimulate desire > reinforce with reasons. The language of leadership can inspire enduring enthusiasm for a cause and spark action to start implementing it. Successful leaders don't stop with a one-time communication. Leaders and their followers stay in communication and co-create the future by continuing the conversation.

Leaders try to get people's attention. If people aren't listening, speakers are simply wasting their breath. Usually people simply aren't listening in any attentive way. They may be aware in a background way that someone is talking, and maybe know the discussion subject. The most important in communicating is to get their urgent attention.

It is very important to know the ways of getting people's attention. Social scientists have also shown that negative messages are more attention-getting than positive messages. Among the more effective ways to get the audience's attention are: stories about the audience's problems, stories about the likely trajectory of the audience's problems, an unexpected question or warning.[6]

### 4. Creating desire for a different future

Change is everywhere you look in business today as organisations continue to seek out new ways to transform themselves and get ahead of the competition at an ever increasing pace. A good organisational change professional can help you navigate through and select the most appropriate tools, methodologies and techniques for your organisation and will assist with your organisations understanding, planning and implementation of the change.

By focusing at the individual level and understanding peoples' attitude to change you are then able to target and engage the

people most affected by different strategies in order to increase their desire to accept the changes being introduced. Your change initiative becomes much more successful with more people making a personal choice to embrace the change.[7]

Failing to distinguish between getting attention and stimulating desire can have disastrous results. That's because what gets people's attention typically doesn't stimulate a desire to act. Whereas getting attention is generally done more effectively by negative content, getting people to want to do something different needs to accentuate the positive. Negative stories, questions or challenges wake us up. They activate the reptilian brain, suggesting fight or flight. They start us thinking, but they also generate worry, anxiety, and caution. They don't stimulate enthusiastic action. To be effective, a leader needs to establish an emotional connection and stimulate desire for a different future. Without the emotional connection, nothing happens.

Only the emotional connection isn't enough. Still relevant are the reasons. The desire for change may wane unless it is supported and reinforced by compelling reasons why the change makes sense and should be sustained. Placing the reasons in a presentation is crucial. When we encounter strange new ideas, psychological studies show that we seek to preserve our existing viewpoint. We stubbornly ignore, discredit or reinterpret information that is contrary to views we already hold, to avoid the dissonance of being wrong. By contrast, when we have made a decision to explore change, we actively look for elements that confirm the decision we've already made. Giving people reasons at a time when they are ready to receive them is one of the keys to communication that leads to action. Reasons are put at a different position in the flow from the Western intellectual tradition. They come, not at the beginning or middle, but at the end. [8]

## 5. Conclusion

In sum, these three steps – one, getting attention, two, creating desire for change, and three, reinforcing the desire for change with reasons, are the same whatever the leadership setting. Of the three steps, the middle step –

stimulating desire for change – is the most important, because it generates desire for change. Without desire for change, there is no energy or enthusiasm. Indeed without desire for change, there is hardly any point in getting the audience's attention. And without desire for change, there is nothing for reason to reinforce. It's desire for change that drives the change process. So if transformational leaders do only one thing, they should make sure that stimulate desire for change.

If change is to be pervasive throughout the organization, then it's not enough for top management to be able to inspire enthusiasm for innovation. Many leaders will be needed throughout the organization, and they in turn need to have the capability to create new champions in their audiences. An ability to spark enthusiasm for change thus becomes an essential competence for all leaders in the organization.

As this competence usually requires a fundamental rethinking of the way communications are conducted in the firm, to acquire it, most firms will need (1) to establish training programs for all leaders in the firm; (2) to appoint mentors to support the development of appropriate capability and (3) to incorporate an ability to spark change in career planning for leaders.

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## Main Challenges in Generating Loyalty Among TV Viewers

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### Abstract

*In a global context marked by consistent changes in the media channels consumer's behavior, the main challenge for the organizations operating in this field is the retention of their readers, listeners and viewers. As television is the media that still focuses the large majority of consumption, the manner in which the TV stations manage to calibrate their communication strategy is critical for the entire evolution of the marketing and communication environment.*

*Through this paper, we aim to underline the fact that TV stations no longer rely exclusively, anywhere in the world, on the “on-air” communication vehicle, strictly limited to the broadcast in the promotional undertaking. Each station develops a lateral structure consisting of its own medium (“owned media”), builds strong partnerships with other types of media, such as newspapers, magazines, radio stations, websites or social networks (“earned media”) or even purchases exposure on other vehicles, using a so called “paid media”.*

**Key words:** TV, viewers, loyalty, communication mix, new media

**J.E.L. Classification:** M31

### 1. Introduction

All the strategic options that might be used in approaching the communication effort come under the central business objectives – achieving the rating and audience market share goals on the main target of that specific channel, but also image

objectives, focused on the brand power of the channel. The key performance indicators for the brand power are the awareness of both the channel and its products portfolio (programs, categories of programs, stars), the favorability (positive perception of the TV station among the viewers), as well as the loyalty, the way and the degree in which the audience is actually consuming the programs of the channel.

Critical for the organization is the manner in which it manages to integrate the 3 types of media into a structure able to implement the viewer's loyalty, in an environment marked by a sharp competition, within a crisis that affects the budgets and, of course, the quality of the programming that has to meet the needs of a “spoiled” consumer nowadays, due to the high amount of information, entertainment and socializing vehicles.

### 2. The communication mix of a TV station

The entire range of communication vehicles mobilized by a full-format TV station consists of:

- On-air promo. The promos are those video and graphic works that communicate the offer of that specific channel. They are placed in the advertising breaks, together with the ads from external advertisers and are focused on shows, movies, series, stars of the channel, but also they might be “brand promos”, centered of establishing an emotional link with the viewers, promos that revolve around the concept and the statement of the entire channel and

not around a specific program. The short duration of these types of works is a key aspect in tailoring a communication campaign. A promo at the full-format TV stations in Romania, such as ProTV, Antena1, Prima TV or Kanal D has an average of 30-50 seconds. This leads to a higher concentration of the message in a more expressive manner, from a creative point of view. It is, actually, the most important “owned media” type of vehicle that TV station benefits of. According to a Data Media Romania Survey (“ProTV brand power analysis, 2011), the promos of a certain program influence in a “high manner” the decision of 38.8% of the respondents towards watching that program, at the time it will be aired.

- The graphic package, also known as ID package. Its elements come as links between two separate fragments of programs on the channel, being also a reminder of the station, because they contain its name, slogan, all packed in line with the visual identity of the TV channel. Similar with the promos, the graphic executions’ duration is small, this type of insertions having from 5 up to 20 seconds each.
- Public relations. In case of television, this vehicles deal with the exposure of the programming schedule offer, but mainly the anchors within the written publications (newspapers and magazines, either daily, weekly or monthly ones, as well as TV guides). It is one of the most important vehicles in terms of building loyalty among viewers compared with the “on-air promo” where the duration limitations do not allow the description of all the details deriving from a specific channel’s offer.

Apart from the above mentioned “conventional” vehicles, the last years brought a lot of innovations among them, but also the development of completely new ones, appeared as a consequence of the online and social networks evolution.

### 3. The globalization of the social networks

Beyond any doubt, the social networks become the dominant force in the social media “ecosystem”, a fact that was revealed by a series of annual research studies conducted by Universal McCann, starting 2006. So called “The waves”, as they were named by Hutton, G. and Fosdick, M. in “The globalization of social media: Consumer relationships with brands evolve in the digital space” (Journal of Advertising Research, 2011), the research captures the evolution, dynamic, structure and the behavior of the elements this “ecosystem” consists of.

Having a profile on one of the social networks was familiar, in 2011, to 61% of the respondents from 57 countries that were part of the above mentioned annual research. The evolution of this index was consistent in the last 3 years (starting in 2008) and it is estimated to continue the same way in 2012, with a higher increase in the BRIC countries (Brazil, Russia, India and China), where the values as with at least 10% above the global average.

One of the main conclusions of the last waves in this research is that in the top 3 of activities the users list, we can find so called “passive” ones, such as: “watching videos online” (mentioned by 77% of the respondents), “visiting a company or a brand’s website” (done by 74%) or “viewing the social network profile of a friend or a person I know” (mentioned by more than 69% of the respondent). The so called “active” actions that imply a certain involvement of the user are lower in the ranking: “maintaining a profile on a social network”, mentioned by 62% of the respondents, “leaving a comment on a blog or a website” (51% from the panel), “opening a topic of discussion on a social network profile or websites dedicated to photo sharing” (mentioned by 48%).

### 4. The importance of interactivity

The interactive eve that we are going through this century marks, according to Don Peppers (“Managing Customer Relationships” – John Wiley & Sons, Inc., New Jersey), a major change in the approach the organizations use in order to gain a sustainable competitive advantage, based on

the information they gather regarding their own clients.

The author defines this approach “a branded relationship”, a connection that evolves based on a continuous dialogue between the organization and the client, with the clear objective of meeting and satisfying the needs of the last one of them. From Don Peppers’ point of view, there are two fundamental evolutions that have marked the impact of technology in the business environment in the last years. The first one refers to the increasing influence of the new media (including the entire range of vehicles from blogging and micro blogging to social networks such as Facebook, LinkedIn, Hi5 or MySpace). The second one consists of continuous development of the mobile devices and of the interactive applications revolving around these types of technology. The overall presence of wireless internet, combined with the increasing number of smartphones and tablets allow easy access to internet pages, calendar check and update, e-mail exchange, photos and video content sharing, all being interactivity enhancers.

The psychological means involved in the evolution of the interactive vehicles and social networks are the main subject of “Connected. The Amazing Power of Social Networks and How They Shape Our Lives” (Christakis, N, Fowler, J., Harper Press, 2010). According to the authors, the individual behavior is strongly connected to the involvement in these social networks, in which members are able to have a significant impact on actions that were considered until now exclusively autonomous. Therefore, the social networks are a monographic image of how the whole society works, authors insisting on the need to enhance the positive elements deriving from it, in parallel with the attenuation of the harmful ones. The key element, from the behavioral perspective is, according to Christakis and Fowler the way in which individuals become groups.

In March, 2012, an unprecedented event happened in the global media. The website of one of the most important newspaper in the world, The Guardian, has received a higher number of visitors coming from Facebook than from the search engine Google. The event is even more spectacular, because in the entire history of the [www.guardian.co.uk](http://www.guardian.co.uk)

website, the percentage of viewers brought by Facebook was not above 5%.

In that month, the publication managed to capitalize in the best manner the homonym app launched on Facebook five months before, app through which articles read by a user can be seen by the user’s friends that can also read the materials themselves on the newspaper’s website. The wave of new visits that followed, called “social traffic”, was facilitated by the massive use of this application that was advertised through an aggressive campaign, using mainly the communication vehicles having a high affinity with the particularity of The Guardian’s main target readers.

A surprising factor is related to the age categories of the new visitors. The app was mainly downloaded by the users from the 18-24 years old target, usually the most difficult to reach by any written press organization, taking into account that most readers of publications come from the above 40 years old category. Then, the geographic area where the visitors come from has increased considerably after the app was launched and adopted by the users. Millions of new online readers come from countries such as Brazil, Japan, Egypt or Nigeria, outside the usual area, traditionally limited to Great Britain and United States of America.

##### **5. The integration of the new media vehicles in the TV stations communication mix**

The “new media” type of vehicles complete the conventional communication mix explained above. A channel’s website is a very important pivot in implementing a communication campaign through all its stages. For example, the website of the “MasterChef Romania” show, aired starting March, 2012, on ProTV was launched from the teasing phase of the program, in August, 2011, almost a year before. That was actually, the main platform for registration of viewers wanting to become competitors. Together with the development of the launching campaign, the website has evolved into a new tool for communicating the show’s content, containing details regarding the program, as well promotion materials initiated and carried by other vehicles (on-air TV promos present on ProTV, the news aired

on the same channel related to the program), plus exclusive materials, meaning an important value-added element for the loyal viewers. Once the show started, the website became the space in which the visitors can review the best moments in the previous episodes, but also an area where comments and points of view could be posted, regarding the mix of content: competitors, jury, hosts, acts, set, suspense deriving from the evolution through the phases.

The Facebook page of the same show completes the online communication done through the website. Concentrating a high number of “fans” (individuals that have pressed the “like” button of the MasterChef’s Facebook public page, [www.facebook.com/MasterChef-Romania](http://www.facebook.com/MasterChef-Romania) and the real time messaging able to generate instant reactions towards the program is vital for creating a bigger online community and also generating a higher audience on TV.

One of the main benefits of having such a big community of fans on Facebook is the consistent feedback generated, through comments, likes before, during and after an episode is aired. Apart from this, any post related to the show is directly linked with its website ([www.masterchef.protv.ro](http://www.masterchef.protv.ro)). Another link with the site, having a high promotional impact is the newsletter (weekly), reminding to the subscribed fans about a new episode.

Online banners present on other websites belonging to the ProTV S.A. group (so, still in the “owned media” category), such as: [www.acasatv.ro](http://www.acasatv.ro) (the online dimension of the AcasaTV channel) [www.sport.ro](http://www.sport.ro) (the website belonging to Sport.ro, the leading sports channel in Romania), [www.procinema.ro](http://www.procinema.ro), (online extension of Pro Cinema, the series and movies focused channel), [www.profm.ro](http://www.profm.ro) (belonging to the ProFM radio station) [www.protvintl.ro](http://www.protvintl.ro) (the website of ProTV International, the station that aired abroad the main programs of ProTV and Acasa) and many other complete the integrate approach of communication for this specific show. The result is the MasterChef’s audience (an average of 10.3 rating points and 23.4% market share, compared to the main competitor, Antena 1, having 5.1 rating points and 12.4% market share), that managed to be the highest this spring after the record-breaking “Romanians Got Talent,

aired every Friday, in Prime Time, also on ProTV

## 6. Conclusions

The challenges deriving from the shift within the consumer’s behavior, together with a sharp competition on the media market, are elements that determine a quick adaptation of the communication strategy for each channel, in the direction of extending the traditional communication mix by integrating vehicles from the “new media” field, intensively used by the media consumers lately. A critical success factor is the perfect synchronization of these vehicles from the concept point of view and also from the strategic perspective, with the conventional tools, so that the synergy between all of them would be able to fortify the viewer’s loyalty and, as a consequence, to reach higher audience results.

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## The Place of Railway Transport in Romania’s Transport System

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### Abstract

*The transport activity in all its forms represents one of the most complex sections of an economy, but also an important factor of influence over the quality of life, that is why current preoccupations of international organisms are oriented towards measures meant to develop performing transport systems and compatible with the environment.*

*In the article the main activities and resources of Romania’s railway transport system are presented , the place of the railway transport in the transport system being approached in a integrative manner.*

**Keywords:** railway transport, railway management, human resources

**J.E.L. Classification:** O18, R41, M12

### 1. Introduction

An important place in the sphere of human preoccupations is represented by the activity of passenger and goods transport, which as the economy developed it has known a continual improvement in the way of enhancing the comfort for travelers and regarding the security of transported goods, of reducing the energy consumption and enlarging the degree of traffic safety.

A country’s economy is made up of three big activity fields [4]: the primary field, determined by agriculture and obtaining agricultural products; the secondary field represented by the industry with all its subcomponents and the third field represented by services. Viewed as a whole, the transport activity is part of the third field of economy and represents moving the elements entrusted for being transported from

a starting point to an arrival point.

Transports, no matter their type have as a main purpose satisfying human needs regarding movement, servicing national and international economy, ensuring economic exchange, circulation of goods and passengers. As a general rule, the transport demands of the economy and population are satisfied by several technical transport systems: railway, road, naval, aerial and by pipeline. In our country’s specialized literature, the railway system is defined as being the sum of infrastructures represented by ways to travel and terminals, of means of transport and of control systems which allow people and goods to be moved from one place to another, in time to participate in a timely manner to a required activity [3].

For a long time the idea that railway transport represents the most complex and well-organized transport system has been certified, Thus its characterization as ” a country’s second weapon” . Through the explosive development of automobile and aerial transport, things have been reconsidered, without questioning the importance of railways in the general transport system. This significance imposes the actual and perspective necessity to modernize railway transport in order to cope with competitive pressure on the behalf of the other ways of transport. There are several ways of transport in Romania their status being presented on categories in Table 1.

According to the information in this chart, railway transport on rail is the most used transport system no matter the regional level to which we refer. The specific features of transport activity in railway traffic performed in our country, they are determined by the structure of transported goods, the diversity of transport relationships, means of transport being used and their ownership.

Table 1. Types of transport systems in Romania

Types of transport	URBAN		INTERURBAN		NATIONAL		INTERNATIONAL	
	Goods	Travellers	Goods	Travellers	Goods	Travellers	Goods	Travellers
Railway	*	*	*	*	*	*	*	*
- train	*	*	*	*	*	*	*	*
- subway	-	*	-	*	-	*	-	*
Road	*	*	*	*	*	*	*	*
- Bus	-	*	-	*	-	*	-	*
- trolleybus	-	*	-	*	-	*	-	*
Naval	-	-	-	-	*	*	*	*
- Liner	-	-	-	-	*	*	*	*
- Maritime	-	-	-	-	*	*	*	*
Aerial	-	-	-	-	*	*	*	*
By pipeline	*	-	*	-	*	-	*	-

LEGEND  
Transport system:  
\* present  
- absent

Source: Adapted from Iancu, G. *Economical and management principles in transport*, Tomorrow’s Foundation of Romania Publishing, Bucharest, 2003, p. 30

Transport systems, being distinct and competitive, they are organized so that they can contribute to performing a transport combined on different distances. The five fundamental ways of transport – railway, road, naval, aerial and by pipeline together with the infrastructures and necessary vehicles forming the transport system, not being able to perform their activity outside their system.

## 2. Activities and main resources of railway transport system

In the specialized literature, the railway transport system is analyzed as a set of processes which try to optimize general performance of railway exploitation management. The effects of railway transport are important, because this means of transport represents an essential component of the economic and social developing process, often absorbing an overwhelming proportion of national budgets. At the development of an economy by facilitating trade, both national and international, the strong correlation which exists between covered miles and gross domestic product; thus the population’s access to working places, education, health and other services is improved.

In order to analyze the main activities and resources of railway transport system is important to define it. In a narrow way, railway transport represents a benefit service of special type, in the way that it cannot be stored nor preserved, being executed in special conditions in order to face peak times regarding requests. At large, through railway transport we mean any passenger and goods

movement accomplished with railway vehicles by transport operators through railway infrastructure [5]. Main activities of railway transport are:

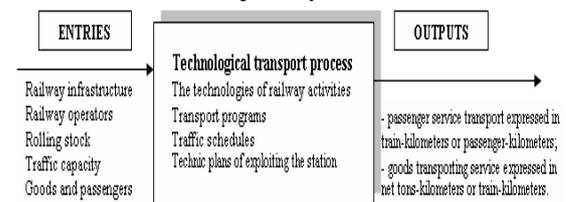
- commercial operation of passenger and goods transport;
- repairing and maintaining railway infrastructure;
- commercial exploitation of subsidiary heritage.

A challenge for railway management is to identify the best way to use the railway as a mechanism for efficient managing of management of all types of railway activities. Railway transport has as a purpose maintaining and improving the current railway network to allow its continual use, by commercial exploitation of traffic in a safe and efficient manner. Depending on the main activities in railway transport, we can distinguish between several types of railway management, namely:

- management of maintenance activity specific to railway infrastructure;
- management of leading train traffic;
- management of commercial operating in goods and passenger transport;
- management of main organizational functions, human resources, financial control and inventory.

As a whole, the railway transport system is made up of entries, transport activities and outputs in Figure 1.

Figure 1. The elements of railway transport system.



The resources of railway transport system are engaged inside the system of technological process transport, resulting from the following technologies specific to railway station activities, outputs of the system materialized in the transport service provided for goods and passengers entrusted. Of all the railway transport system’s entries we consider the railway infrastructure the most important

resource of the system.

Railway infrastructure is defined from a technical point of view, as being the ensemble of elements required by traffic and operating the rolling stock, railway station buildings with related facilities, sortings, bridges, tunnels, signaling telecommunications and voltage installations for enabling railway transport [1]. The most important element of railway infrastructure is represented by the railway lines. The most widely used classification is current lines, placed between railway stations and station lines, which fulfill multiple purposes: traffic, maneuver, connection or that of waiting.

Railway transport operators public or private are national companies or commercial ones licensed to perform public or in own interest transport, of goods or passengers by using the capabilities of railway infrastructure. For this purpose, railway operators sustain a utilization fee of the railway infrastructure called TUI, which thus becomes own income from developing the activity for the national company which manages the railway infrastructure.

The rolling stock of the railway transport system made up of railway engines, wagons for the transport of goods and wagons for passenger transport. The railway engines, which travel on the line of a traffic department, assure the traction of goods and passenger trains on the traffic departments as well as making maneuver activities in stations.

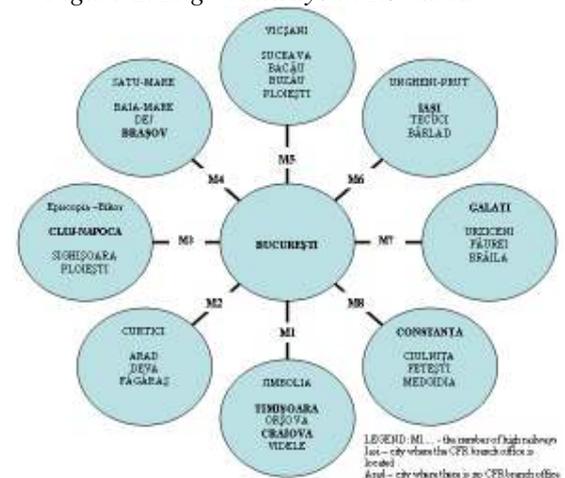
Traffic capacity represents the biggest number of direct goods and passenger trains that travel on a traffic department in 24 hours. This capacity depends on several factors: the type of line and its condition, the number and length of sidetracks from the station, the type of facilities available and the way of managing traffic.

According to their economic and volume traffic, railways are classified in:

- *main railways* which ensure the link between the capital and main cities in our country and with the transport systems of neighbouring countries;
- *main lines*, with a special; economic importance because they make connections between the capital and main cities, being partially included in the high railways system;
- *secondary lines*, serving certain urban areas and ensure links with main and high railways.

The railway network in our country includes eight territorial areas serviced by eight high railways, each being under the management of a branch of infrastructure. The current configuration of high railways is presented in Figure 2.

Figure 2. High railways in Romania



In order to identify the place of the railway transport in Romania’s transport system, the evolution of significant and quantitative indicators of the railway infrastructures has been analyzed, their situation being presented in Table 2.

The indicator of railway network length in our country, presents at the end of 2010, a percentage of 36,6 % electrified line from the total length of railway network, growing since 1990 and a network density of 45,8 km/1000 km<sup>2</sup> dropping during recent years because of the decreasing in total length of the network, which had a total of 10820 railway line.

Table 2. Quantitative indicators of railway infrastructure.

INDICATORS	U.M.	1990	2000	2010
Total length of railway network	km	11348	11057	10820
Developed length of lines	km	22567	22247	20347
The length of electrified lines	km	3680	3885	3971
Percentage of electrical lines	%	32,4	35,1	36,7
Density of railway network	kml/1000km <sup>2</sup>	47,8	46,7	45,8
Number of railway stations		1419	1100	978

Source: website of the National Company CFR SA, www.cfr.ro [6]

Also, because of restriction in the activity of railway transport, the number of railway stations has dropped by a third in the last 20 years, from 1419 stations in 1990 to 978 functional units at the end of 2010. Railway transport is the second way of transport in Romania's economy after road transport, from the point of view of the indicator for transported goods, scrolling annually about 50 million tons of goods from a total of near 380 million tons, which represents almost 13,4% on the market of transported goods in Romania, as you can see in Table 3.

Table 3. The evolution of market share of main types of transported goods.

Goods transported, from which: (%)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
SNTF Marfa	17,1	20	19,7	18,8	18,5	15,9	13,6	11,8	10,9	9,7	7,8
Private transport operators (OTF)	0	0	0,2	0,7	0,7	2,5	3,4	3,9	4,2	4,9	5,6
TOTAL Railway	17,1	20	19,9	19,5	19,2	18,4	17	15,7	15,1	14,5	13,4
Road	75,8	73,5	73,7	73,7	74,3	74,6	75,6	77,6	78,8	79,5	77,8
naval	5,94	4,94	4,59	4,87	4,32	4,87	5,25	4,39	3,82	3,77	5,95
aerial	0,1	0,2	0,1	0,1	0,1	0,1	0,1	0,3	0,2	0,2	0,4
by pipeline	1,06	1,36	1,71	1,83	2,08	2,03	2,05	2,01	2,08	2,03	2,45
TOTAL	100	100	100	100	100	100	100	100	100	100	100

Source: website of the Ministry of Transport, www.mt.ro [7]

The market share of goods railway transport in Romania dropped from 17.1 % in 1999 to 13,4 % in 2009. Railway transport, SNTF Marfa, diminished from 100% in 2000, when it was the only railway company which operated on the market of goods railway transport, to 58,2% in 2010, for the volume of transported goods expressed in net tons-km and to 48,5% for goods route expressed in train-km since 2001, the market of goods railway transport is divided between SNTF Marfa and the 27 private railway transport operators which were granted

license of goods transport. During this period, the market share held by SNTF Marfa dropped from 19,7% for transported goods in 2002, to 7,8% in 2010. Regarding ownership, railway transport has been entirely a public state transport until 2001, both from a transported goods point of view and goods route.

In the system of Romanian railway transport, private railway transport operators started to conduct business, OTF, since 2001, those transporting goods, reaching at the end of 2010 to own almost half the market of transported goods in the railway system, respectively, since 2005 OTF passengers, which now transports almost a third of the total number of passengers.

In the last three years the goods and passengers railway transport has decreased continually. The reasons for this decreases find themselves in the general drop in large companies production, the shutting down or clearing some economic agents due to the economic crisis, the orientation of others towards road transport with the dispersion of dissolution towards a big number of partners, in short time and in small amounts and not least, lower family incomes because of budget cuts. Because of lack in necessary funding, public railway companies were forced to dismiss part of the staff, to limit expenses to the essential in order to perform exploitation, cutting maintenance expenses, repairs and investments in order to maintain a balance relatively equally-balanced.

### 3. The advantage of railway transport

The decisive role of railway lines in the development of a country's economy, both internally and externally is major but the economic development also has a contribution to the expansion of exchange relations between producer and consumer, and the more this network is developed faster, the more the transport services increase. Railway technique had a major role in the development of goods and passenger transport, so that, starting from a transport speed of almost 30 km/hour, today you can travel with more than 300km/hour; in addition to this, railway transport presents a higher degree of safety and security. Considering these aspects, EU granted priority to the development of community

railway transport, even more as, in terms of energy, the cost per transported unit is smaller than that of road transport. Comparing the energy consumption in different means of transport indicates for passenger transport by car a consumption of 3,5 bigger and double in naval transport than that of railway transport [2]. In goods transport, the energy consumption for lorries is of 8,7 bigger than using railway transport. Another argument regarding the advantage of railway line is given by the transport on electrified lines which don't need fuel. Thus, the case of Romania is eloquent, because the electrified network represents almost a third of the total network, and the railway transport on electrified network represents 54% of total volume of transport.

The system of railway transport in its evolution has become a complex and specialized system, with remarkable features and in economic conditions of efficiency superior to the other forms of transport: large quantities of goods or an increased number of passengers transported at the same time and under safety conditions, access in areas where other means of transport cannot enter, the strategic role and environmental friendly character.

#### 4. Conclusions

The fact that it connects through a unique network all country's counties, railway transport presents an important role in the economic and strategic life of the country. This role is emphasized by the fact that, by its good operation, the economic agents depend of their provision with raw materials and goods, the swift satisfaction of the population with consumer goods, ensuring passenger transport. Any delay or disorder of railway traffic has powerful repercussions over the entire gearing of social life.

Establishing the place of railway transport in the ensemble of transport system in Romania is facilitated by the conclusions revealed by researching the activities with railway singularity, namely:

- train traffic is performed without interruption in any season of the year and at any hour, which demands a perfect coordination of all fields of railway activity;
- the result of productive work isn't

represented by a new merchandise, but a service; by using railway transport, the merchandise keeps all its properties, but increases its value;

- the railway network spreads on a large surface, thus being a close interdependence between different departments and units of railway;
- railway lines constitute a means of mass transport, ensuring the most favourable condition from a traffic safety point of view;
- the variety of activity fields of railway transport from a mechanism which, thus complicated, forms a whole and imposes using a qualified staff in exploiting installations and railway infrastructure.

Today, the railway companies in our country, like most Romanian organizations are confronted with a recession imposed by the world financial –economic crisis. In this context, taking into consideration only the sides connected to technology and the imperative of economic recovery, without taking into consideration social consequences, individual and collective motivations of the employees, cannot lead to a quick solving of the social-economic problems of nowadays, in which the effects of the financial-economic crisis overlap with the necessity of the alignment of Romanian railway system to the standards and demands imposed by the EU.

A major challenge for railway management in a world continually changing, we consider it isn't only that of minimalizing the effects upon the environment but to identify the best way of using railway, especially, ensuring and using proper human resources, with a high level of specialization, that will ensure the function of the railway transport system as a mechanism to sustain economic and social development.

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## New Research in Handling Consumer Behaviour

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### Abstract

*Market research has never been a model in terms of professional ethics. But these findings link market research field to that of science fiction in terms of their implications. Neuroscientists have used laboratory research to sketch a map of brain activity responses to the desires and needs for certain products. About this new field is said to click the buy button in the consumer's mind.*

**Key words:** mind, consumer, behaviour, neuromarketing, MRI.

**J.E.L classification:** M31.

### 1. Introduction

Consumer behavior research marks the progress every year, gaining new approach.

In a direct relationship with post-industrial society, stand new ways to influence consumer behavior. In this respect it refers to satisfying consumer needs. Postmodernism is seen as a major conceptual background that enables a superior understanding of changes in contemporary society, by an increasing number of researchers in marketing.

Postmodernist social orientation was characterized by emotions and feelings, and postmodern consumer looking more like for a way to relate with others in communities, and less than looking for a way to make sense of life. Consumption is no longer perceived to be a priority and overcontrolling of the social interbond, but is secondary and subordinated to the social bond. Postmodern man is looking for products and services, not so much for their use value, functional or symbolic value, but especially for their value to establish social relationships.

The new techniques for studying consumer behavior shall contribute to the decision process by triggering direct act of acquisition, which will influence companies from top down and bottom-up, with big corporations setting the base of their own research departments of consumer behavior.

Anticipating consumer behavior, identifying ads that consumers remember, selecting media channels that are the most accessible can be made through new methods that combine several specialized disciplines, such as neurology, and marketing. With this revolutionary tool and daring, the neuromarketing, researchers distinguish personal patterns to those taken (received) in research groups.

### 2. Method and results

The fundamental science underlying neuromarketing is neurology, which study how the brain creates the mind. In other words neurology is how the brain causes us to perceive, to think, to make decisions, to feel emotional, to communicate. Techniques used in neurology are psychophysiology (planning/ levels detection), magnetic resonance imaging (MRI) Magnetoencephalography (MEG) and electroencephalogram (EEG). The most interesting tool is MRI neuromarketing. This technique is used in specialty practices, the seriousness of this practice being the subject of TV specials, where patients move in and out of cars which make noise and different sounds.

The prominent professor Sean Kelly at Harvard University said that marketers have even used hypnosis in groups of market research for specific market topics.

The current challenge is the use of science to discover the subconscious of consumers.

Studying consumer subconscious techniques was born at Harvard Medical. In the late '90s, marketing professor Gerry Zaltman and his collaborator began scanning people's brains at the request of different companies.

Consumers' brain research through neurological instruments has become a boom in past years in the U.S.

The new discovery has reached climax following the research conducted by Clinton Kilts, a professor and vice president of the Psychiatry and Behavioral Sciences Department, expert in addiction and author of numerous professional papers at Emory University Hospital, USA. The research was continued by BrightHouse Institute for Thought Sciences, where Clinton Kilts became manager, using neural findings of Emory University Hospital. The Institute has an advertising agency whose clients are: Coca-Cola, Pepperidge Farm, K-Mart and Home Depot.

BrightHouse Institute has begun using magnetic resonance imaging, traditional technology used in health, to create images of brain activity to reveal what people feel for things, for certain products and services, much more accurate than people can explain through their feelings.

BrightHouse Institute methods are based in part on an experiment that Kilts conducted in early 2002. He gathered a group of research subjects and asked them to look at a number of products, assessing how much they liked or disliked them. Then while their brains were scanned by the MRI scanner, he showed them pictures of the products again.

Brain scan results surprised him. When watching the image he observed that whenever a subject saw a product, he identified it as one to which he was very attached to, it could be observed that that product would represent the person a lot. Thus his brain showed increased activity in the median prefrontal cortex. That brain region is associated with the identity of each individual, with self-image.

In market research, these methods study sensory feedback, cognitive and emotional stimuli of consumers to products or services. The brain scan reveals areas of brain activation sequence. Pleasure, interest and desire to buy is activated in all segments of the public, but only on the basis of hierarchy.

In a study published not long ago, called "The source of neurons", researchers monitored the brains of 67 subjects who tasted Coca-Cola and Pepsi. Half of the subjects chose Pepsi to Coke, MRI images in the cortex of the brain, revealing activity in the region for thinking and in the region of emotions and memories.

The results show that Pepsi should have half the market, but consumers actually drink Coke for reasons related less to taste and more about brand. However it should be noted also that the studies showed that Pepsi is sweeter and Coke is stronger. Many people who prefer small quantities of Pepsi would probably like to consume an entire bottle of Coke to one of Pepsi, because people were tired of his sweet taste.

When subjects learned that they drunk Coca-Cola, three quarters of them said that it is better for the sake of brand and less for the sake of taste.

Human brain is often viewed as a "black box", something rather mysterious. Marketers undertake activities" advertising, direct marketing, sales target set, target market. The results of these marketing efforts can be measured in time, sales, preferences and other. We understand quite well the beginning and the end but not the middle part, which is vital. The middle part is the mind of consumers.

Neuromarketing has contrary opinions. Since the BrightHouse Institute supports it because they created it, another entity should have been formed to oppose the scientific approach. This is about the American Association Commercial Alert.

Criticism to Emory University about neural findings were strengthened by the principle that universities are places where it clears the mind and not for commercial purposes.

This is because, at physical level, neurological research in marketing is conducted using magnetic resonance on human subjects. Magnetic waves can harm subjects if they have metal inside their body (cardiac prostheses, rods, etc.) or if they wear metal such as coins or jewelry. Risk which subjects undergo is low, however, this does not mean that there is no possibility. Subjects undergoing these tests report dizziness or nausea because of brain investigation in the drum of the MRI equipment.

We wonder then how can a technique which aroused so much criticism, can be used, and have gathered so many subjects in "focus groups". The answer is simple: each subject is paid for participation in these experiments.

We must highlight a statistical aspect regarding this practice, namely that there were never problems during a brain scan.

It was definitely discussed the moral conduct of some market companies, which using such techniques had an unfair advantage over other companies which did not have the financial resources and therefore could not enjoy the almost certain results of this technique.

Large companies include the cost of such research in the annual budget. Magnetic resonance imaging (MRI) are not yet as expensive as one might think, being a little more expensive than average costs of other types of research, but not everyone can afford.

Many financially potent companies have learned about images of the brain and were really eager to use them to get results for their sales department. An example is DaimlerChrysler, which used technology among young people at the University Ulm in Germany, to highlight types of car design they preferred.

The popularity of this instrument has made it to be used even in the field of political marketing in the United States, obviously. Professor Marco Jacobin, of California University, Los Angeles, has made several studies on the political issue regarding election loyalty against George Bush Jr., John Kerry and Ralph Nader. In the first election campaign after the attacks of September 11, 2001, neuromarketing techniques were also used.

We also noted that in the United States after 2007, interest in neuromarketing fell slightly, as is still seen as an expensive technique, that on the one hand, on the other hand, companies who had financial resources to use the technique got the results and now they use them and competitors do not have the resources needed to use it.

After 2002, these market research methods were developed in Europe, especially Germany, France and Austria, the first attempts were related to when a customer comes in contact with a new advertisement.

However a difference appears. Because research by MRI is very expensive, Europeans use electroencephalogram a cheaper neurological tool.

Romania, the country we live in, is ready for such market instrument only at a theoretical level, as there aren't the necessary resources for implementation of such an approach, being a subject far too distant from the realities we live.

### 3. Conclusion

The best neuromarketing product is anticipating consumer behavior, identifying ads that consumers retain, the selection of media channels that are accessible and how consumers personal patterns differ from those taken (received) in research groups. Marketers will use these techniques to better measure the consumer's preferences and the question whether we like a product will be closer to the truth. This discovery will help researchers to create marketing products and services with an unique and practical design, and companies to handle more brain responses.

The neuromarketing tells the marketers what consumers react to, which could be the color of the container, which makes it sound to vibrate, or idea which they have and that consumers would embrace it.

Most importantly, perhaps, merit of this technique is to have opened means of using it in more areas, to establish certainty about some market aspects through brain scanning. So, specialists in the field can learn how the human brain responds to the advertisement and they can improve to perfection a popularity of a brand appealing to a sample of consumers who are shown some pictures while being inserted into a machine and subjected to a radio-magnetic flow.

It is important to determine for the future what suddenly stopped the rising of a marketing tool with a huge success through its positive results of which some companies enjoy today, lack of money or criticism coming from consumer protection associations?

About this revolutionary new method of research of consumer behavior has been said many, beyond justified criticism this practice has proved a huge success. No one would have thought a few years ago, that the

resounding success of some products on the market is due to neuromarketing. Answering the question why buy a product is clear: the selling shop knows in advance that we like that product.

Besides talks for and against violation of human brain, response to our study with straight answers as consumers has been created, and hence to the coming out of new techniques has been only one step. The new technique also appeared in Harvard, with Professor Gerry Zaltman on forefront and is based on conscious and unconscious retrieval of thoughts using neurobiology, psychology, semiotics, linguistics, art theory, called ZMET (Zaltman Metaphor Elicitation Technique).

Finally, as young professionals, we can tell that we would like to use in a research such a tool, but as its use is very financially difficult even for well known companies, we are pleased to discuss this issue, hoping that you will do the same thing.

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## The Businesses and the Environment

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### Abstract

*In almost entire civilized world there is an emerging consensus about respecting the environment and an increasing level of the sound of voices that sustain that companies have social and environmental responsibilities. But not always it was the same thing. Great economic and political personalities sustained that this issue is of secondary importance for our business. Nowadays, the idea of including environmental protection among the production factors, near capital and human resources has more and more followers.*

**Keywords:** environment, business, social responsibility, environmental laws

**JEL Classification:** M29

### 1. Introduction

This is a comparatively recent development. In *Capitalism and Freedom* Friedman [18] observed:

The view has been gaining widespread acceptance that corporate officials and labour leaders have a “special responsibility” that goes beyond serving the interest of their stockholders or their members. This view shows a fundamental misconception of the character and nature of a free economy. In such an economy there is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits ... Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility

other than to make as much money for their stockholders as possible.

This approach to economics stands within a tradition established by Adam Smith. By directing his industry “in such a manner as its produce may be of the greatest value”, each individual:

... intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectively than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words indeed need be employed in dissuading them from it.

Similar views have been expressed by management theorists such as Drucker [10]:

To do something out of social responsibility which is economically irrational and untenable is . . . never responsible. It is sentimental ... That business should stick to its business, that is, to the economic sphere, is not a denial of responsibility. It is indeed the only consistent position in a free society.

### 2. The growth of environmental awareness

The environment became a major subject of public (and political) concern in the 1970s. Greenpeace and Friends of the Earth were both founded in 1971. The 1972 United Nations Conference on the Environment (Stockholm) was the first major international

conference which addressed environmental issues in a systematic and coherent manner. The following decade witnessed the emergence of coherent systems of environmental law in the UK, the USA and the European Community. Early legislation tended to be concerned largely with pollution. “Acid rain”, for example, was an important issue in many European countries. In the 1980s there was increased interest in conservation and “sustainable development”. The publication of *Our Common Future* by the World Commission on Environment and Development [31] (the Brundtland Commission) was highly significant. The principle of sustainable development received international support at the 1992 United Nations Conference on Environment and Development (Rio). The evolution of international environmental law was given further encouragement at the 2002 Johannesburg Conference.

Environmental law is relatively new, but legislation is developing rapidly. More prosecutions for environmental offences are taking place annually. Much of the legislation is based on the “command and control” approach. This approach has been criticised and market based alternatives advocated. Market failure suggests that an absolute trust in markets is misplaced. Alternative solutions to the regulatory problem have been sought in self-disclosure. Although this is a regulatory approach there are both legal and economic benefits accruing to firms from environmental auditing and self-disclosure.

### 3. Corporate social responsibility

How have businesses responded to the challenges of sustainable development and related environmental issues? Corporate social responsibility (CSR) is an umbrella term used to describe the various ways in which firms attempt to integrate environmental and social obligations within their business activities. According to the European Commission [16]:

Socially responsible initiatives by entrepreneurs have a long tradition in Europe. What distinguishes today’s understanding of CSR from the initiatives of the past is the

attempt to manage it strategically and to develop instruments for this. It means a business approach, which puts stakeholder expectations and the principle of continuous improvement and innovation at the heart of business strategies.

A recent PricewaterhouseCoopers survey revealed that 70 per cent of the global chief executives interviewed took the view that CSR was “vital to their companies’ profitability” [9]. Although CSR is widely regarded as a good thing many companies seem to interpret it rather narrowly. Social issues tend to receive far more attention than environmental ones.

Emphasizing corporate philanthropy is also easier than analysing and remedying the consequences of a firm’s activities on the environment. Many executives undoubtedly feel that CSR is essentially a matter for their marketing departments.

Despite its rising profile, the debate about CSR often lacks depth. A major problem is the scarcity of reliable evidence concerning the relationship between CSR and profitability. The situation is described by Dickson [9]:

Numerous academic papers have concluded that improved corporate reputation, better recruitment prospects and bigger sales to environmentally conscious consumers are among the benefits [of CSR]. All such studies are long on description, but the vast majority are distinctly short of quantitative data.

„Triple bottom line” reporting (which measures a company’s economic, environmental and social performance) is potentially a valuable source of such information [12].

### 4. Auditing for the environment

Why should firms engage in environmental and social auditing? In most jurisdictions, companies are only required to audit their economic activities. Additional audits and reports absorb time and resources without producing the immediate results associated with traditional corporate

philanthropy. Demands on staff may cause salaries to rise [26]. Advocates of triple bottom line reporting such as Elkington [12] argue that these costs are more than off-set by the advantage of having a green reputation.

Analysts have calculated that approximately 25 per cent of their company's reputation is linked to issues relating to sustainable development. They estimate that overall customer satisfaction would fall by about 10 per cent if all CSR activities were abandoned [9].

This was confirmed in studies cited by McDonagh and Prothero [22] where respondents to questionnaires reported a concern for the environment and even a willingness to pay more for goods manufactured in a way which produced less pollution.

Conversely the evidence strongly suggests that a poor reputation on an environmental issue can be damaging. Bad environmental news certainly appears to have greater commercial significance than its opposite [Chan and Milne, 1999] and firms often adopt environmental reporting procedures after receiving damaging media coverage [3]; [7].

Moon and Bonny [24] are clear about why companies should adopt an ethical stance, saying that the motives are to avoid expensive court cases, to avoid bad publicity, to avoid activist action, to boost brand value and attract funds from investors. In *Business Ethics: Facing up to the Issues* [24] they argue that unethical behavior can cost a company its reputation, hard cash, and reduce its share price. To back this up they give the examples of Nestle which was, and they say remains, tainted by its unethical stance on baby nutrition in selling baby milk to mothers in less developed countries, Perrier for selling contaminated water, and Shell for its perceived non-environmentally-friendly disposal of the Brent Spa oil rig.

## 5. Nature of environmental auditing

Environmental auditing and environmental disclosure are increasing in popularity with corporations. An environmental audit is a means of assessing environmental performance and, as Welford and Gouldson [28] point out, the first corporate

environmental audits were carried out in the USA in the 1970s in response to domestic liability laws. During the 1980s these audits were extended beyond simply adhering to legislation. Shell Oil introduced a proactive audit as early as 1981.

The environmental audit checks (at least in theory) a corporation's environmental performance against stated objectives and environmental policy. It is an integral part of the environmental management system (EMS) and is promoted by institutions such as the International Chamber of Commerce and the European Commission. The aims and objectives of the audit would be to check regularly and systematically, amongst other things, whether the management systems are performing well, compliance with health and safety legislation, and the impact of the organisation's activities on the environment.

It is increasingly common for businesses to conduct audits to assess environmental risks, energy consumption, and waste or pollution emissions. They often seek third-party verification of their EMS using a standard such as ISO 14001, the European Eco-management and Audit Scheme (EMAS), or by signing up to an initiative such as the United Nations' Global Compact. Although corporations set standards and gather masses of data, the disclosure of environmental information is not compulsory in most countries and there are no internationally agreed standards. In 2001 Tony Blair, the British Prime Minister, challenged all FTSE 350 companies to publish environmental reports by the end of the year. Only 76 did so. In the White Paper *Modernising Company Law* [8] the Department of Trade and Industry (DTI) proposes that companies should be obliged to produce environmental reports if their directors take the view that such issues are a material consideration for shareholders.

## 6. The importance of environmental reporting

A study by Gray *et al.* [20] examined social and environmental disclosures. In their own study the authors found that larger companies and those in environmentally sensitive industries made greatest use of voluntary disclosure. They also cited findings from earlier studies such as Deegan and

Gordon, Filos, Jones and Tilt [7] which highlighted factors such as organizational culture, experience with pressure groups, and media profiles. From their research Gray *et al.* [20] concluded that:

Social and environmental disclosures are an important phenomenon employed by corporations for a variety of purposes.

### **Is honesty the best policy?**

Rather than analyzing why firms undertake environmental disclosure, Niskanen and Neiminen [25] looked at whether reporting is objective. To establish objectivity the authors tried to establish whether firms report equally on positive and negative environmental issues related to their own operations. After studying the annual reports of Finnish companies published between 1985 and 1996 they concluded [25]:

The environmental reporting of the sample firms cannot be considered as objective since the proportional share of negative events reported was negligible compared to the respective percentage for positive events.

Between 1985 and 1996 there were only seven negative news items disclosed by firms out of a possible 50. Niskanen and Neiminen [25] say that it is not only Finnish companies which do not report on environmental issues objectively. Indeed, their findings have been replicated in studies in other countries.

There is considerable evidence that British companies seek ISO 14001 accreditation without making genuine efforts to improve their environmental performances.

According to Brian Kraus, the chief executive of ERM Certification and Verification Services, firms often exhibit a “breathtaking level of commitment to achieving certification”. Unfortunately:

Resources are largely being expended in a way that is giving little of value to the environment, to companies themselves, or to the communities they operate in . . . Most companies do not realise the true costs of waste and other causes of poor environmental performance. However, ISO 14001 certification seems to be

yielding little in these terms for companies.

## **7. Accountancy and the environment**

When the impact of the corporation’s activities on the environment is reported in company accounts, accountants face the difficulty that in economic terms the environment has typically been treated as a free good. That is, no price is recorded in the marketplace for such things as clean air, quietness and a beautiful countryside. Such things are therefore not easy to value. In similar fashion, pollution has been treated as an externality, i.e. something external to the marketplace. So long as corporations do not incur recorded costs such as the fitting of air filters or water purifiers, the cost of pollution will also go unvalued. It would be difficult, though not impossible, for firms to estimate these costs. This is unlikely to happen in the absence of a willingness to commit the resources necessary to gather such information.

## **8. Conclusion**

The Coalition for Environmentally Responsible Economies (CERES) is attempting to address this issue by launching an international reporting initiative which corporations could participate in but this may be some time in coming. In the meantime, the above studies suggest that as long as environmental accounting continues to be a voluntary activity over which the corporations have total control, there must be a real danger of businesses either ignoring the process entirely or of skewing their environmental reporting in order to “greenwash” their accounts.

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# Eco-Innovation and Eco-Efficiency Influence Over Management Systems

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## ABSTRACT

*The evolution of the economy in the last century was influenced by the development of concepts such as the industrial revolution, technological revolution and globalization. The “new economy” is characterized by sustained growth in the long term and refers to the quantitative and qualitative changes which have transformed the structure, functioning and rules of the economy.*

**KEY WORDS:** *eco-innovation, eco-efficiency, sustainable development*  
**JEL:** O32, Q01

## 1. INTRODUCTION

After ecological disasters and progressive degradation of the environment, the society begins to exert pressure increasingly larger both on Governments and on companies, in order to determine a responsible behavior on their part.

Sustainable development, contoured in 1987 as a concept and goal to be achieved, extended the existing economic perspective by bringing into attention the serious environmental problems and by emphasising the importance of environment conservation and environment protection on long-term.

The concepts of sustainability and sustainable development naturally raised the question of whether businesses can provide a basis for promoting the principles of the relevant, answers focusing primarily on the analysis of eco-efficiency.

Efficiency measures the relationship between output and the input size of a system

or process, which will be the more effective the higher output value will be higher for a given value of input or as input value is smaller for a given value of output.

Knowing that the resources are limited, it is evident that efforts aimed at optimisation of activities should focused on maximizing output for a given value of inputs.

## 2. INCREASE COMPANY VALUE BY ECO-INNOVATION AND ECO-EFFICIENCY

In the eco-innovation literature two research directions can be identified:

- one direction focused on eco-innovation adoption;
- other direction focused on consumer resistance to eco-innovation.

**Eco-innovation**, as a new concept, emerges in several recent papers:

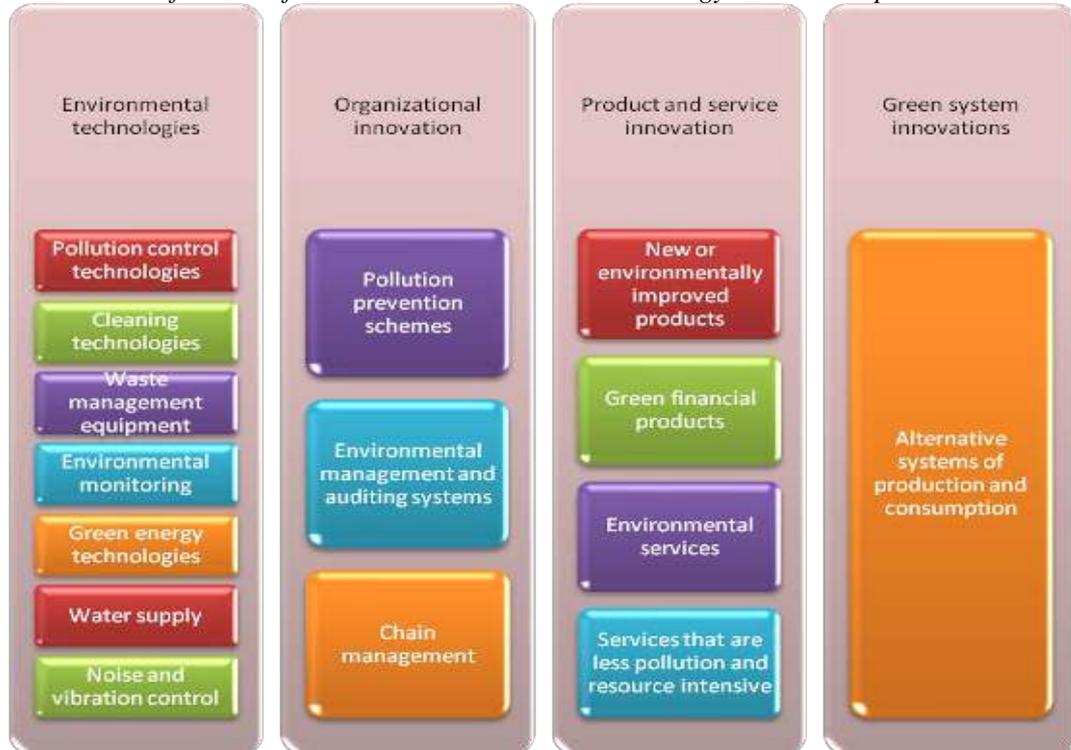
- P. James (1997) defines eco-innovation as “ new products and processes which provide customer and business value but significantly decrease environmental impacts”;

- R. Kemp (2008) defines eco-innovation as “the production, assimilation or exploitation of a product, production process, service or management or business methods that is novel to the organisation (developing or adopting it) and which results, throughout its life cycle, in a reduction of environmental risk, pollution and other negative impacts of resources use (including energy use) compared to relevant alternatives”;

- K. Rennings (2000) defines eco-innovation as “shorthand

for environmental innovation”;

*Classification of eco-innovation based on technology and market practices*



Source: Author based on Clark (1985) and Arundel (2011)

Any investment made by an entity in order to increase the degree efficiency and more responsible use of resources, means reduced production costs, and creates an essential competitive advantage.

Eco-innovation, in the case of production processes, excluding technology, organization or marketing, has won the most adherents in agriculture, while the construction sector preferred to invest in ecological materials and food industry focused on organizational innovation. In the past two years, more than 40% of the companies in the EU who have understood the importance of eco-innovation have managed to reduce by up to 20% the quantity of raw materials used. Although it seems a minor change, any competitive advantage it may prove essential in the current business environment. In the view of the managers, raw material crisis is an important vector for eco-innovation. In the same time, the managers identified increasing energy prices as an essential factor for stimulating innovation.

Unfortunately, eco-innovation is often slowed down by obstacles such as:

- economic or financial constraints, especially lack of external funding;
- uncertainties regarding market demand, as the European economic recovery is not up to the previous expectations

**Eco-efficiency** as a multi-dimensional concept, can be define as ratio of an environment variable (effort) and financial (effect) (S. Schaltegger, 1992).

$$\text{Ecological Efficiency} = \frac{\text{Outputs}}{\text{The effect on the environment}}$$

Depending on the nature of the subject measuring efficiency of action, ecological efficiency can have two forms:

- product eco-efficiency - measures the ratio of a unit of product supply and environmental
- impacts created by it, during the product life cycle (Schaltegger S., 1996);

-- activities eco-efficiency - measure the ration of a unit of product supply and environmental impact generated by a specific activity for a period of time (Buritt R.L., 2006).

Eco-efficiency is achieved by offering competitive products and services in terms of price, to satisfy human needs and to contribute to raising the standard of living, while contribute to raising the standard of living, while reducing ecological impacts and intensity of the use of resource. According to the Organization for Economic Co-operation and Development, eco-efficiency characterizes the effectiveness with which natural resources are used in human needs, the result represented by the value of the products and services offered, and the amount of effort the environmental pressures generated by the entity, industry or nation.

Increasing eco-efficiency is determined by the pursuit of those activities that generate economic value while reducing impacts on the environment and reduce consumption of natural resources. Pollution and poor waste management shows that production processes are inefficient, thus grabbing additional production costs can be reduced or eliminated by improvements in manufacturing processes or technological innovations.

Efficient use of environmental components in the entity's strategic planning, contribute to the creation of a direct links between the environmental objectives of the company and its profitability.

### **3. SUSTAINABLE DEVELOPMENT AND ECO - EFFICIENCY**

Sustainable development should be viewed in terms of economic, social and environmental grounds that can be correlated with the notion of eco-efficiency.

Reshaping the new economy in terms of ecological perspective, involves the use of new management tools in the entities, as Environmental Management System and Environmental Accounting.

Sustainable development is related to the concept of quality of life and include the achievement of three desiderata such as economic welfare, social stability and environmental protection. The three desiderata are defined as:

- economic welfare is that which seeks to generate a maximum flow of income by keeping the capital that produced these benefits;

- the establishment of social and cultural systems, providing human capital needed in type of development, including by reducing the destructive conflicts;

- regarding environmental protection, sustainable development aims to preserve the physical and biological stability of national systems.

Concept of eco- efficiency will be reflected in reduction costs and environmental impacts by efficient use of energy, water and materials, planning and implementation of investments in pollution control project, planning and implementation of projects for energy and material efficiency, evaluation of revenue's annual investments in eco-efficiency activities.

Strategic management of an entity can be improved by:

- designing green products and services;
- reviews of the internal costs in the light of future regulations;
- reporting to internal and external users.

### **4. CONCLUSIONS**

The decision to conduct a study on environmental accounting in accordance with community requirements was based on the growing need to highlight the economic and social impact of the environment.

Permanent concern of the academic and business environment is to identify effect of the integration problems of conservation and environment protection issues, as:

- practicing environmental management and developing an environmental management systems;

- introducing of “end-of-pipe” technologies;

- developing technologies to prevent pollution.

So, economical growth can not be analyzed and modeled in the absence of material and human resources and without providing a dynamic balance of natural economic structures.

In the future, entities concerns will be related to the development and implementation of the eco-efficiency concept

whose purpose will be reflected both in reducing total cost of the entity and consolidating its position strategy in long-term, by increasing competitive advantage.

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## **Appreciations on the Entertainment in the Rural Environment – Promoter of Sustainable Development in Tourism, that Practice Tourism Activities Centrated on Nature**

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### **Abstract**

*Increasing the role of leisure in promoting rural areas, to ensure their sustainable development and meet the needs of tourists has led to its transformation into tourist motivation itself, leading to the emergence of new types of vacations. Recreational activity is one of the effective ways for reducing the minimum periods in travel request. Forms of tourism in rural areas represents a complex of activities that relate to cultural-sport, entertainment, recreation, etc., and which is intended for lovers of nature. The aim of the research is to identify the main connection between rural tourism and recreational activities in rural areas. The entertainment activity in the rural tourism is becoming an important facilitator of sustainable development of any industry or community. In our article we intend to show the constituent elements of entertainment in rural areas within sustainable development and suggest how this could be applied to tourism.*

**Keywords:** entertainment, recreation, rural tourism, sustainable development, tourism based nature.

**J.E.L Classification:** L83, Q01, Q57, Q58.

### **1. Introduction**

International leisure tourism in recent years began to grow, attracts many tourists showing increasingly a higher attraction for this form of tourism, the country has much to offer specific leisure tourism attractions.

Entertainment aims to relieve the physical and recomforting, entertainment and tourist capacities, the development of mental satisfaction, through fun and educational activities, cultural enjoyment and growth of knowledge. Entertainment can become, therefore, an element of differentiation to organizations or destinations, which represent the main motivation for making a journey. Once it becomes the main motivation for travelling, the entertainment could lead to the emergence of new types of holidays: holiday vacation skiing, climbing, holiday tennis, yachting and surfing holiday, holiday for hunting, holiday for cultural tourism, etc.

The entertainment services are designed to maintain a coordinated tourism product, to harmonize relations between supply and demand, thus satisfying the tourist a multitude of tourist motivations. Therefore, entertainment is a quantitative and qualitative indicator of the touristic phenomenon, along with the quality factor of tourism development itself. Competition of touristic companies, but also at the level of tourism destinations highlights the development process and diversification of tourist services, and recreational nature and diversification of development of these services continued, more than in the case of other categories of tourist services.

Recreational service delivery assumes a suitable material and technical bases, to properly trained human resources, to make continuous efforts to improve their destinations. Given the place in contemporary services is necessary to consider the arrangement of tourist areas by

developing entertainment strategy, which enhance the economic component of each area, to make an overall planning and long term of the man - nature, to ensure weighted rational sizing of the equipment, an adaptation of their configuration spaces and landscapes. Leisure services are equally important to travelers (provide conditions for recreation, entertainment, capacity building and improved knowledge etc.) and for provider organizations (source of income, way to create differentiation and competitive advantage, customer loyalty, etc.). In relation to leisure services is necessary to recall the animation, which means a set of activities, like sports games mere entertainment or to which participation is free, aimed at physical and mental relaxation and facilitate mutual agreements, namely the creation of good provisions.

## **2. Leisure activities – promoting sustainable development**

Leisure and entertainment services in the rural space can be organized and provided by the accommodation and / or food companies, generally upper class, and those activities are simple and require no special effort or investment personnel. This might include: practicing sports like swimming, skiing, skating, riding, golf, tennis clubs, discos, video, bar, night-club, musical performances, dances, events - exhibitions, festivals and so other examples.

Leisure services can be organized in tourist destinations, the cooperation between tourism organizations and / or between them and local governments in this case the benefits are more diversified and have a greater degree of complexity (specific services for equestrian centers, sport centers, polygons, holiday clubs, marinas, etc.).

Leisure services can be services organized by third parties, usually highly complex forms, resulting from involvement of specialized bodies, other than tourism - amusement parks, tours of theater ensembles, dance, music, recreational vehicles (aircraft sports, boats, trains).

Depending on the content and touristic destination, recreational facilities and equipment can be classified, in our opinion, the next model:

- tools and equipment specific cultural entertainment - museums, theaters, exhibitions, cinemas, cultural houses, philharmonic orchestras, libraries, etc.;
- specific tools for physical well-being maintenance - pools, saunas, solariums, fitness centers, etc.;
- leisure equipment sports - football, tennis, basketball, gyms, swimming pools, sports pools, artificial ice rinks, miniature golf, go-kart tracks, horse riding, water sports, etc.;
- entertainment production equipment - entertainment - bowling, billiards, slot machines, casinos, restaurants, clubs, amusement parks, rides, cable transport, etc.;
- entertainment production equipment specific mountain and rural tourism - golf, horse riding tourism, travel on foot, hiking, cycling, river trips, fishing etc.

## **3. Types of tourism specific rural environment**

Tourism in rural environment allows people to approach, to know the conditions of material life and spiritual contact with other persons who connect with. From experience of other countries - especially European ones - has been observed that rural areas are suitable for tourism and have, in many ways, the conditions for developing such tourism activities. What could be more wonderful than a breakfast with fresh milk, a walk in the paths of the mountains or valleys, to look unique landscapes, a sunset or sunrise, to hear the murmur of a stream or the roar of a waterfall, to walk on the village street, to wait a few moments before an exhibition or home to artisans, ride a sleigh rides, a few hours dreaming in front of the stove are just a few moments of life universe Romanian village?

Apparently tourists from urban environments run by the civilized world, with a desire for isolation and return to nature. However, modern people wants his holidays in the middle of green countryside a series of activities that dream, that actually think or practice in large urban areas (it is true or accident, lack of free time maybe ?) when he has leisure for the thought to roam [6].

Consequence of industrial development and urban population growth, rural tourism

has become a reality. Search the countryside as a way for rest and recreation is a general trend in domestic and international tourism [2].

*Agro-tourism* is a particular form of tourism, a more complex form of tourism, including the actual tourism activity (accommodation, board, tourist traffic, running programs, basic and supplementary services, etc.) and economic activity, agriculture usually practiced by hosts tourists - manufacturer of agricultural products processing and marketing of household by tourists.

This form of activity which is agro-tourism which takes place in guesthouses and farms includes accommodation, meals and recreation and other services provided during the stay of tourists and tourist services at their request.

Agro-tourism, rural tourism is an alternative environmentally gentle mass tourism, a source of income for rural population, a solution for the unemployed labor force.

Agro-tourism is one of the important branches of national economy that aims to develop tourism in rural areas, in close correlation with the local economy, with strong linkages between tourism and other branches of local economy and in this case especially with agriculture.

For many of our urban citizens arrived in the rural houses, many of the life aspects of the inhabitants are new. The guests' participation can be as spectators, beneficiaries or even workers in such activities [3]:

- the land cultivation, raising the animals, woodcraft ship, skin craft ship or woolen craft ship, the obtaining of the cheese, or wine as well as cultivation of the fruit bearing trees, of the grape wine, vegetables, flowers, mushrooms, chicken raising; doves and even ostrich give a certain image to the holiday and presents many advantages;
- allows a better understanding and communication between the host and the guests;
- assure the host a helping hand (through a symbolic one), which can be evaluate don the paying services by diminishing it or by offering food and fruits to the guests at their departure;

- permits the clients' loyalty by sentimental bonds. It may occur initiative from the guests to collaborate for utilization of the product son the city market or for advertising and bring new clients.

All this comes to greet tourists offering a wide range of tourist activities in order to relax and make it come back again and again. Agro-tourism is related to the *farm tourism* which usually means the use of peasant houses as accommodation for tourists. Farm tourism is not agro-tourism in the strict sense of the term, as these homes lose peasant agricultural function or is not too long occupied by active farmers. Despite losing the direct connection with actual farming, farm tourism is an important form of rural tourism and an important contribution to the local economy where it is practiced [4]. Tourist activity is closely linked to agriculture and often the viability of domestic economy [7].

*Rural tourism.* Utilisation of resources through activities of rural tourism takes place and by: leveraging specific resources (Winerry Association, skilled trades, essays, ethnographic or numismatic interest, revitalisation of art crafts specific rural areas, the keeping of traditions and customs specific to a rural area, recouping primary agricultural products and of water resources, fisheries, for example.

Rural Tourism is that form of tourism where the crop is a key component of a recreational tourist product, as it says World Tourism Organization. Trait distinguishing feature is the rural tourist products on the fact that visitors are offered personalized contacts, enjoy the physical and human environment of rural space and participate, as far as possible, activities, traditions and lifestyle of the local population [11].

Connection of rural tourism with entertainment is a long term one. If the definition of entertainment is accepted then it can not be ignored what activities might have tourists, offering highly attractive activities to fill free time.

*Nature based tourism* is that form of tourism where activities are dependent on the natural properties. Nature tourism involves travel to destinations and activities and experiences that are totally dependent on nature, may include visits to popular

attractions and can appear as mass tourism, alternative tourism, or a combination of adventure tourism, cultural tourism and ecotourism. Nature tourism is closely connected with ecotourism, often promoted as a factor in recovery and conservation in many parts of the world.

#### 4. Forms of entertainment in rural areas

Recreational activities can take various forms, from active to passive. But the essential element is not what makes a person but how do for getting satisfaction [8].

*Horse riding tourism.* It is considered that this activity could give more fun and entertainment to holidays spent in the countryside. If this activity comes to the attention of Romanian entrepreneurs eager to do business in areas such as leisure tourism could bring many benefits to rural tourism. In present there are horseriding centres in all country (nearly Bucharest are 8 such centres, in Valcea County – Brezoi is a specialized centre, in Breaza – Prahova County). Of particular sports that attract and are very loved and appreciated, is horseriding followed by tennis, football, swimming or fishing. This leisure activity is a problematic one regarding the legal statement, but it should be noted at the same time is increasingly required.

*Day trippers.* The development of this product is frequently performed by travel agencies. Pedestrian travel enjoys greater appreciation among both youth and other ages. Desire to admire natural landscapes combined with a passion for photography, painting or flee from urban stress are among the main reasons for this form of entertainment. Currently this entertainment product market is confronted with the following trends [6]:

- a relative stagnation for large customers walking pedestrian;
- progress of „daytripper” tourists or half a day, regular clientele who do not seek operation of sports;
- the increasing search, especially by organizers specialized hiking "bagless" and comfortable accommodations.

*Bike riding.* is the ideal of leisure for mountain biking enthusiasts on trails and valleys. It is a form of entertainment that can take place alone or with friends, to explore

the bike away from factories and cars, without intersections, traffic rules or horns. That would be hiking and novelty: the unknown and more vegetation. With luck, it can be found deer, pheasants and wild rabbits.

*Mountain excursions.* The so-called "trekking" can be made throughout the year regardless of season. These trips are made to safe areas in every way, areas that do not present any danger to the sport loving tourists. There are leisure form to spent free time in nature, and nature lovers can explore it all over the trip.

*Fishing.* For many of those who love nature freshwater fishing remains a possibility to spend moments of respite during the holidays or on weekends or near home, or even further. Recreational fishing is a form that can be practiced at any time of year. Lovers of this form of entertainment can admire the landscape, taking part in protecting the natural beauty.

Another leisure activities that might take place in countryside: motor rally, climbing, rafting, snorkeling-ul (in this sport exists the opportunity to observe underwater attractions with relatively little effort).

#### 5. Entertainment and rural sustainable development

A key challenge in sustainable tourism is to develop economically viable enterprises that provide livelihood benefits to local communities while protecting indigenous cultures and environments. Such ventures are difficult to assess due to a general lack of effective assessment and monitoring methods, a lack of consensus about methodology and the inability of some monitoring systems to incorporate all elements of tourism impacts [5].

Sustainable tourism development is that important part of the process of activity planning, which, as far as tourism is concerned has a purpose to avoid any action that might affect the very base of development.

Sustainable development is a strategy whereby communities search ways of economical development, while benefiting from the local environment, or creating benefits for the life quality.

In order to succeed on the market, organizations must permanently focus their efforts towards understanding and fulfilling the necessities and expectations of all their clients, both the current and the potential ones [9].

Organizing tourist activities, especially in a rural area leads to a number of implications that arise from good management and local resource management and creating a positive image of the host community and those involved.

Development of tourism and travel arrangements for enrolling in the positive pole of the attractiveness of activities as environmental and urban areas requires [2]:

- protection, conservation and prevention of environmental degradation;
- touristic assets conservation;
- integration of tourism activities and entertainment forms;
- educate participants to develop respect for nature and create a green behavior.

In witness whereof said above is talking increasingly more controlled development of tourism. For this reason rural localities use the term of sustainable development, which includes current and future needs of society.

A definition of sustainable rural development is a reflection of this process on improving overall economic and social well-being of rural residents and the institutional and physical environment in which they live.

Rural Development is the term often confused with rural growth, which is totally wrong. The same error is made and when boundaries or terms of growth and economic development, which even they are not synonymous. This distinction is explained by the fact that economic growth does not always improve the living conditions of rural residents. Thus, rural development concept focuses mainly to the welfare of rural residents living [1].

Sustainable development, for a certain period of time, leaves intact the entire property, including natural capital. We should leave by the same capital will future generations, including potential opportunities for the current standard that we want.

Sustainable development is a development strategy that involves all property, natural resources and human resources and financial and physical resources to increase the long term welfare [10].

## 6. Conclusions

Most travelers are seeing their vacation to nature as a vacation getaway from everyday activities, as a "moment" in which they are lacking any care and do not need no little concern for what is around.

We consider that rural tourism will solve the problems of planning and will try to reach a balance between urban and rural environment. This type of tourism represents a sustainable development way of the main tourist regions in Romania. Although Romanian tourism is currently going through difficult times, Romanian rural tourism will join the segment that it is European rural tourism. Therefore the ethnographic characteristic of tourist villages, maintaining the traditional style of life must be preserved and perpetuated in order to become a real tourist attraction and a visitor reception permanent basis.

Leisure in tourism can be defined by all means, equipment and forms provided by the unit, resort or tourist areas capable of providing an individual or a social group status fun, pleasure, to give the feeling of satisfaction, of fulfillment, to leave an impression and a beautiful memory [8].

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## Entrepreneurship and Entrepreneurial Romanian Environment. Perspective of European Integration

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### Abstract

*Entrepreneurship is a concept of current as of great significance as it is cultural. Direct correlation with the manifestation of his country's economic development comes only to update the strategic importance and invariably interdependent with other factors that influence development. Expression of free enterprise and entrepreneurship is done mainly in small and medium businesses that provide effective and stimulating the exercise decision. During recent development of SMEs in Romania enables us to ask more than the Romanian business environment, more support and accountability from the state and more consistencies of policy makers. Reality economic, social and European policy today requires more than ever to create a business environment to highlight the private initiative, entrepreneurship, competitiveness and innovation. How real economic integration efforts are consistent on both sides, the focus of political attention is warranted and is intended to be a sustainable.*

**Key words:** entrepreneurship, small and medium-sized enterprises (SMEs), european integration.

**J.E.L. Classification:** L26, M13.

### 1. Introduction

Entrepreneurship is generally accepted to be "background noise" of long-term economic development [1]. Entrepreneurs are initiators, ie those introducing new products and production processes in an economy. In this process, companies are forced to innovate to withstand the pressure generated by new businesses. As a result, entrepreneurship has a rejuvenating effect, training and transforming economies. This

theoretical relationship has inspired a large amount of empirical studies in developed countries are largely in agreement, the positive correlation between entrepreneurship and economic growth [2]. Entrepreneurship is often seen as a positive result, and also as a pivotal economic development [3]. The main argument for entrepreneurship is the positive effect it has on economic activity. The idea can be found in Schumpeter's work [4] in which he shows that, by introducing new ideas, products, production processes and organizational structures, causing entrepreneurs and future economic conditions affect the current. Existing firms are forced to adapt to new standards. Those who are unable to do so will experience loss of performance and, eventually, disappear. This process of "creative destruction", increases productivity and regional competitiveness and as a consequence, regional economic development. This is actually the reasoning applied in assessing the role of entrepreneurship in economic growth for developed countries. It remains unclear whether the same positive relationship can be expected in developing countries. There are reasons to expect that the situation be different in developing countries. Schumpeterian views on entrepreneurship, assumes that new firms are started based on perceived business opportunities that are left unexplored by existing firms. The distinction between opportunity and necessity require as starting points in starting a business. In countries developing motivation for entrepreneurship is the need for self-subsistence, because all other options are either nonexistent or unsatisfactory work [5]. Appearance of necessity entrepreneurship is linked to early development stage of an economy. Developing countries are expected to have higher shares based on necessity entrepreneurship because of the need for self-support and lack of employment

opportunities [6]. GEM reports demonstrate the link between a country's economic development level and rate of early-stage entrepreneurial activity (Bosma et al., 2010, 2009, 2008) [7]. GEM results confirm that institutional and demographic characteristics, entrepreneurial culture and economic wellbeing of a country emerging entrepreneurial characteristics (Bosma et al., 2010). In 2009 early-stage entrepreneurial activity rate was 5.02% higher rate than that measured in 2008 (3.98%). Even if this rate increase, remains one of the lowest among savings based on efficiency. Variables that significantly influence their desire to start a business are: household income, knowing other entrepreneurs, age, sex, fear of failure, confidence in knowledge and entrepreneurial skills, entrepreneurial success perception of promotion by the media and occupation. In 2007-2008 the factors of influence or change, age, sex, fear of failure and factors that influence becoming occupation probability of becoming an entrepreneur at an early stage during the global financial crisis.

## **2. Origins of Romanian entrepreneurship in European context**

Since sec. XV and XVI, the main centers of business activity in Romania were cities like Sibiu and Brasov, which have become large shopping centers, first entrepreneurs of Romania is of foreign origin, many of whom were Germans. Entrepreneurial activity involving trade markets, fairs called, where people exchanged goods they produced the goods we consume - Tîrgu Mures, Tîrgu Neamt, Tîrgu Jiu, etc. The first and most important business writings are in Romania are: "Neagoe teachings" (leader of one third of Romania between 1512 and 1521) to his son Theodosius, containing advice on leadership in general, the army, coordinating messengers and things like the military bill. Entrepreneurial activity has been seen increasingly in terms of management and trade concept is nonexistent free market due to political instability and military innovation. Energy and resources have been invested in potential entrepreneurs species to obtain education or military or administrative functions within the power structures of that time. In terms of economic history, the period between 1500 and 1800 may be of

character by increasing the share of trade in relation to self-consumption, asserting a set of specific institutions of market economy and slow real growth yet the stock of real economic assets capita [8]. Internationally, noted German historian Rudolf Vierhaus educational monopoly of the Church, scientific criticism and reform movements within the Church, overseas expansion of European powers, the genesis of world trade and global military conflicts, international diplomacy formation of a codified law of nations and a practiced *jus publicum europaeum* blossoming of modern science, philosophical criticism, and literary history, and theories of reason of state, increasing literacy and the development of public space communication [9]. Neither West nor East European economic areas were not homogeneous, but includes countries and regions such as outstanding overall development and the pace of development during the three centuries so that increased economic disparities have increased in the European continent. Sec period. XVI-XVIII permeates Ottoman rule and the pressure it put it on arrhythmic development of the Romanian Lands. Peşcheşurile (taxes on goods and money to the Ottoman Empire, mainly related to obtain appointment as ruler) and later dramatic increase in taxation (including their perception of money) have resulted in forced selling of output produced or accumulated wealth, poverty free peasants, forced to sell land and / or self (personal addiction to landowners, moneylenders or ecclesiastical large landowners). Default prevented accumulation of capital and delayed emergence and development of local entrepreneurship.

The nineteenth century was one of accelerating overall growth and demographics. Several factors have contributed to economic performance: the demographic transition, agrotechnical innovations and increasing agricultural production, the industrial revolution (coal engines), the benefits of oil, electricity, metallurgical, engineering, electrical and chemical industries, the spectacular progress of transport and communication, service development and international trade (the first wave of globalization). Evolution syncopated upward trend but was characterized by a deepening division of labor (where

development differentiated regions or countries) and by an intensification of economic integration processes, especially the transport and trade, international conventions on postal systems (1865 ), Protection of Industrial Property (1883 and 1900), the international movement of capital (loans, foreign direct investment) and the people. Romanian entrepreneurs in sec. nineteenth and twentieth-century Romanian economic literature uses the concept of the entrepreneurial manager synonymous, "a specific person overseeing the process and ensures secure a particular result, predetermined". Romanian market when the first types of entrepreneurship: public meetings established (1831), elective assemblies Convention (1858), the bicameral system in Romania (1886), "Trade Rule" E.Ion Nechifor - considered classic manual management.

World War has not only produced extensive casualties and material destruction, but also agricultural and industrial production fall, the phenomenon of inflation (Germany, hyperinflation) and a severe reduction in international trade. Social struggles, economic structures to adapt to new borders, restoration and inter-Allied debts were made at different rates from state to state [10]. Short recovery period, '24-'27, not obviously offset the decline of agriculture, and no boom or revival services industry. Statistics are proof GDP / capita in different European countries grouped in three categories: 12 developed countries, 4 countries and Southern Europe Western Peripheral and 7 central-eastern European countries including Romania. It decreased in the 1919-1929 and returned to growth since cu1938. In the early twentieth century was initiated innovative process in a textile factory in Pitesti - unique in Europe - and was to organize scientific work after Taylorist theories (Frederick Taylor). It is noteworthy initiative of scientists (D.Gusti, Gheorghe Ionescu-Sisesti, V. Madgearu Gheorghe Marinescu, Gheorghe Buzila) from the Romanian Institute for Scientific Organization of Labor (IROM). Also, have been translated into Romanian classical management important books (Industrial and General Administration, Henry Fayol) and economic works have been published as: N. Smith,

commercial and industrial enterprises as monetary stabilization, 1939, C. Filipescu, Textiles Romanian, 1939, V. Madgearu Romanian economy after the World War. By 1948, the Romanian state was ruled by a constitutional monarchy modeled on Western monarchies, with a liberal political and economic.

After 1948, the model followed by the Romanian economy was the Soviet Union, the abolition of all democratic political institutions, individual rights, free speech and individual property - building socialism brought about the nationalization of industry, banks, transport companies, the collectivization of agriculture (1949 -1962) and organized a centralized economy with an emphasis on stalinist industrialization. Types of businesses most common were: state enterprises and cooperatives. Entrepreneurship in the communist era that is characterized by various forms of private entrepreneurship coexisted with public ownership and entrepreneurship in the state enterprises during the socialist period. There were: the official economy owned and controlled by the state and economic activity consisting of gray economy tolerated but illegal. Gray economy refers to all forms but unregistered private entrepreneurial activity condoned by the state, including private sector activities that were not officially registered and illegal use of state property. In such case add "lack of institutional preconditions that facilitate transformation scheme has now in the absence of economic culture (represented by a class of entrepreneurs)" [11].

After 1989, the major problems faced and still faces entrepreneurship in Romania were: poor infrastructure, privatization, agriculture, banking, economic subsidies in an environment disrupted both nationally and worldwide. A real socialist system development, economic literacy of a large part of society, both in knowledge of financial instruments of the modern economy and in terms of economic knowledge base correlations at the micro and macro. Failure of the grafted side was the great economic expectations of enthusiasm triumph of the revolution. Now as then, regardless of political orientation, almost all experts' opinions and not only converge on the idea that the strength and effectiveness of current

savings are represented by small and medium entrepreneurs.

### 3. Small and medium enterprises in Romania

European Union legislation, the enterprise means any entity engaged in economic activity, regardless of legal form of incorporation. Thus, the category of business can take: authorized individuals, family associations, business partnerships, associations of entrepreneurs. We note that while compliance with the ceilings on the number of employees is required, an SME may not comply with one of the two other criteria: year net turnover or on the total assets. It is not necessary to satisfy two criteria, and overcoming one of them lets you keep SME status. The period between 1990 and 1995 is characterized by annual establishment of a very large (between 50 000 and 130 000) of SMEs in all fields. Most of them have gone as easily as they occurred (70-80% of businesses have gone in 2-3 years) since their activity trying to exploit / exploit opportunities or favorable circumstances and experience in managing a small even small business. The period 1996-2000 was test time for new entrepreneurs and their businesses. Economic policy mistakes (lack of income tax for private businesses, financial imbalances and currency, inflation of 294% in 1993, depreciation of 100% in early 1997 compared to 1996) led to a strong rebound of private initiative (number and company fell to 30-40 thousand). Economic measures in early 2000 again induce the desire to invest, 2001-2006, largely pointing errors of the past. Thus, inflation of between 15 and 30% of private initiative became bearable and the exchange rate and tax advantageous for both entrepreneurs and the state budget. Number of small and medium increases up to 50 000, to create new jobs, their activity is stable partnerships with both large public companies and large multinationals as they have become contractors or subcontractors. Moreover, dynamic industry itself has been superseded by the services and construction boom. Labor shortages in agriculture was caused both by absorbing a part of the new jobs in services, industry and construction, labor migration to the West and exit of the active population of

a large number of elderly farmers [12].

Table 1. Share of main sectors of the economy during the pre-accession

		2000	2006
Agriculture and Forestry	% in employment	41,4	30,5
	% in PIB	11,1	7,8
Industry and construction	% in employment	27,3	30,6
	% in PIB	30,9	31,9
Services (including taxes)	% in employment	31,3	38,8
	% in PIB	57,8	60,3

Source: Kahl, Metzeltin, Ungureanu 2006: 46, 659; INS 2009: 18,45

Visible from a variety of indicators, Romania has managed a partial recovery of the differences that separate the EU average. The trend continued in fact and in 2007-2008, but most significantly to the GDP/capita.

Table 2. GDP per capita to the EU average (EU 27 = 100)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Romania	26	26	28	29	31	34	36	38	42	47
North-East	19,7	18,2	20,1	21,0	22,3	23,5	23,5	24,5	26,8	29,0
South-East	24,1	23,1	24,1	26,2	27,4	28,2	29,2	30,2	34,0	38,0
West	21,2	21,2	22,2	23,2	24,9	26,0	26,0	27,8	31,8	35,2
North-West	23,5	21,8	23,5	23,5	25,4	27,6	27,2	29,1	32,8	35,4
Center	30,0	26,7	29,7	31,7	34,8	38,8	39,4	44,2	48,8	51,0
North-West	25,0	24,2	25,8	27,8	29,5	32,5	32,0	35,8	40,5	41,8
Center	37,8	37,8	38,4	40,8	42,2	44,1	44,8	47,8	49,6	44,8
Bucuresti-Ilfov	44,4	53,8	59,2	58,8	62,4	68,2	77,5	83,5	93,6	114,0

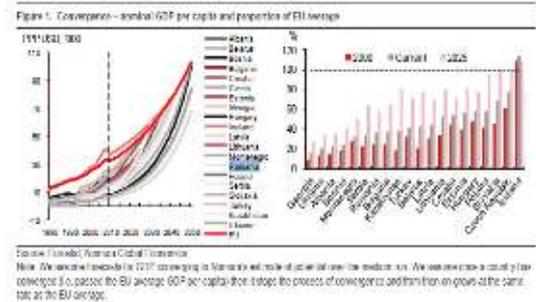
Source: INS 2009

The period from 2007 until now was marked by the accession to NATO and the European Union and the opportunities that these political decisions have made: the transfer of goods, capital and labor, information technology, managerial expertise and, European economic law, entrepreneurship education and permanent training. Further privatization of state and redistributing wealth are the most important economic decision economic changes, this is reflected in the average number of organizations established annual returns in the range of 30-40 thousands of companies, which maintain economic sustainability within Romania declared functional (able to ensure economic growth) and regarded as favoring the development of private initiative and entrepreneurial environment for small and medium entrepreneurs. In late 2009, in

Romania there were about 500 000 micro-enterprises and small and medium business in all areas of law. The global economic crisis was felt in Romania in the second half of 2008. Some was imported (reducing external demand and investment behavior of entrepreneurs hesitant foreign) domestic premises and another created, maintained or ignored economic policy (massive entry of foreign capital and "exuberant behavior on lending in foreign currencies", pro-cyclical fiscal policy "imprudent" and increased government spending in light of the 2008-2009 elections, which gave rise to irrational consumption in a time when the external deficit in the budget is completely unhappy) [14].

At the beginning of 2010, global perspectives begin to emerge out of the crisis, internal view of the Romanian economy is announcing more difficult. Even if it seems a solution Romanian exports with added value (cars, drugs, power equipment) [15] failed to overcome revenue shortfalls, the budget deficit to GDP, oversized state apparatus and associated expenses, increase in the number pensioners [16] and weak administrative capacity of the state. The combination of these factors was anticipated trend forecasts provided INS compression consumption and delay processes near the incomes and prices in the EU. According to International Monetary Fund (IMF), GDP per capita, adjusted for purchasing power of Romanians, this year will be equal to 40.2% of the EU. In 2015, Romania will have a GDP per capita of \$ 15,396 compared to 12,644 in 2008. Data is confirmed, given that, according to the National Statistics Institute (INS), the state regulated prices increased compared to 1990 even 37,000 times, respectively 2 to 10 times the inflation rate in two decades. Estimates show that Romania's GDP will grow much faster than most other EU countries. In 2025, GDP per capita will reach 60% of the EU, compared to almost 40% today. Slovakia and Poland are the first Eastern European countries will reach EU average living standards in 2025.

Figure 1. Convergence – nominal GDP per capita and proportion of EU average 2000-2025



Source: International Monetary Fund (IMF)

Romania ranks second in Europe, with 24.7 points, in terms of Romanian intentions to establish a business, the first being Latvia (by 24.8 points), according to the Global Entrepreneurship Monitor, conducted the 24 European countries. Behind us are countries like Poland, Hungary, Slovakia, Croatia, France and Lithuania, which shows that a large number of countries with a high index of intention to open a business are in the Central and Eastern Europe or the Baltic. On the other hand, among countries where very little people want to be entrepreneurs include Russia, Ireland, Germany, Denmark, Finland, Netherlands, Norway. Britain, Spain and Turkey. Romania is very large increase from 2010 when our country is in the middle ranking by 8.6 points. On the other hand, Norway is the first place two years ago, while in 2011 came to top end.

Table 3. GEM Report (2011)

Country	Entrepreneurial Attitudes	Opportunity Motivation	Ability Motivation	Need for Financial Support	Perceptions of Government Attitudes
Latvia	44.8	44.8	44.8	44.8	44.8
Poland	44.7	44.7	44.7	44.7	44.7
Hungary	44.6	44.6	44.6	44.6	44.6
Slovakia	44.5	44.5	44.5	44.5	44.5
Croatia	44.4	44.4	44.4	44.4	44.4
France	44.3	44.3	44.3	44.3	44.3
Lithuania	44.2	44.2	44.2	44.2	44.2
Romania	24.7	24.7	24.7	24.7	24.7
Spain	24.6	24.6	24.6	24.6	24.6
Turkey	24.5	24.5	24.5	24.5	24.5
Germany	24.4	24.4	24.4	24.4	24.4
Denmark	24.3	24.3	24.3	24.3	24.3
Finland	24.2	24.2	24.2	24.2	24.2
Netherlands	24.1	24.1	24.1	24.1	24.1
Norway	24.0	24.0	24.0	24.0	24.0
Russia	23.9	23.9	23.9	23.9	23.9
Ireland	23.8	23.8	23.8	23.8	23.8

Source: GEM

GEM study shows that Romania has progressed greatly in the last year promoting entrepreneurship in the media and the opportunities they see as suitable entrepreneurs to open a business. At the same time, Romania has recorded a slight increase in the perception they have about their abilities in the consideration of

entrepreneurship as a good career opportunity in the image of the Romanians have about entrepreneurs. However, Romanians fear becoming less to have failures. At this point, the Romanians increased interest in entrepreneurship is an effect of economic crisis. Those who have lost their jobs had to find other solutions than the one to be employed, and those who were employed and had experience in crisis need to identify good business opportunities, preferring to start their own business. Those who have founded a business or launch a business as a result of opportunities arising from the crisis (for example, people in finance who have opened businesses that help companies streamline their costs) or started a business focused a passion / hobby (for example, people in real estate and boutique stores have opened with bio). As the number of examples of success will increase, people will realize that there are still many untapped opportunities on the market, will increase interest in entrepreneurship and fear of failure will decrease.

## **5. Catching and economic integration of Romania**

Convergence policy requires high rates of saving and investment, continuous improvement of educational standards and labor (human capital), constant improvement of competitiveness, a tolerable level of social tension (considerable social cohesion), and most importantly, a constant and rapid increase overall productivity of production factors, with the flagship high labor productivity growth. An indispensable support entrepreneurial activity and safeguard its quality is the quality of institutions at national and European level. Such improvement requires coherence, consistency and thought out but and additional financial and human resources. Limited administrative capacity of the state attaching to the global economic crisis and lack of resources prevents the selection of priorities and implement proactive policies but accelerates the elimination of surplus state to prepare the necessary institutional reforms. This process is expected to grow by achieving economic recovery but he must be prepared, not expected, the quality and sustainability considerations.

On the other side, the European Union creates the perfect tool to support entrepreneurial activity is an example: : European Union Support. Programmes for SMEs 2012. The European Union provides support to European small and medium-sized enterprises (SMEs). This is available in different forms such as grants, loans and, in some cases, guarantees. SMEs can also benefit from a series of non-financial assistance measures in the form of programmes and business support services. The assistance schemes have been divided into the following four categories: *Thematic funding opportunities* (environment, energy and transport; innovation and research; education and training; culture and media); *Structural funds* (European Regional Development Fund [ERDF] and European Social Fund [ESF]); *Financial instruments*; *Support for the internationalisation of SMEs*; *Information on the Enterprise Europe Network*, which offers business support in the Member States and beyond.

Characteristics of SME in Romania are mostly common with similar organizations in developed countries regardless of cultural space which they belong. These are: are created by entrepreneurs, alone or in combination, are led in most cases even by those who created them, are impregnated and reflect personality-creative entrepreneur (intuition, education, training, experience, professionalism, intelligence, charisma, ability to create, maintain, build and capitalize on relationships) serve personal or group interests (who created the business environment), recover, usually local opportunities, exploit a competitive advantage as contractor or subcontractor, are flexible and adaptable to a changing economic environment and tend to associate with others in the same category so as to develop effective business relationships with potential "growth" are the beneficiaries of specific legislation, often favoring (tax benefits, administrative facilities), committed workforce prepared but not necessarily specialized, expensive and create a competitive environment that is conducive to the integration of technical progress and promote value added.

## **6. Conclusions**

The current economic differences accumulated over time and will require overcoming backwardness in real time one or even two generations. But the issue remains pending horizons Romanians who want to stage some measurements (eg functional economy) to be tangible for the greatest number of individuals, to be reflected in their daily life. Economic development is impossible without integration of the abstract world of economics and Nobel Peace but a complex problem that companies engage in efforts to timely, consistent, which leads, creates and transforms institutions and especially people, generations.

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# Performance in Public Administration. A Systemic Approach

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## Abstract

*There are two points of view on the performance of the public administration: an internal one, governed by the principle of the three “E”s and an external one, a measure of the public accessibility to the civil service. The problem with these two points of view in that, although they show the same direction they are of opposite bearings.*

*Even though the inherent purpose is ensuring the citizen’s access to the civil service, serving the tax payer with their problems thus serving the whole community in a most efficient manner, we cannot overlook the fact that the resources of the public administration are often more limited than those of private economic agents, especially when considering that the civil service usually involves very high operating costs.*

*In these conditions the performance of the public administration is defined as an optimum between the capacity to deliver the civil service towards the citizens and the associated costs of this capacity.*

**Key Words:** Performance; Civil Service; System; Management; Optimum

**JEL Classification:** G31, H11, H21, H61, H63, H72, M48, P17.

## 1. INTRODUCTION

The term of public service in Romania has evolved a lot in the past 20 years. On the one side, the problems of subjects for public service have changed, becoming more and more complex, on the other, the integration process into EU and NATO structures has demanded the modernization and transformation of the public administration. Before the 1989 revolution Romania had a planned economy, and the public administration was a public apparatus,

specialized in the satisfaction of a certain, somehow narrow set of needs. But, with the start of the transition process towards a market economy, the needs of the subjects have adopted an individual character, differentiating themselves from one case to the other.

This is why it was and still is necessary to define criteria for the measurement of the degree of satisfaction of the demands coming from the subjects, without neglecting the fact that the public administration is itself an socio-economic entity which obeys the restrictions imposed by the limited character of available resources.

In its status of socio-economic entity the public administration is an open system, which interacts on various levels with other socio-economic entities, being influenced by a very dynamic game between stake holders, meaning the interests of certain groups in defending their rights. For example, in the case of the local administration, the citizens have the right to access some public services like public lighting, whilst the city hall has the obligation to collect taxes from the citizens.

Thus, a modern public administration is an efficient one, which is at the same time flexible enough to solve the problems of its subjects. In order to guarantee this demand it is necessary to institute a legal framework which permits public servants to solve the cases that are presented to them, but it is equally important to manage public institutions according to imposed performance criteria.

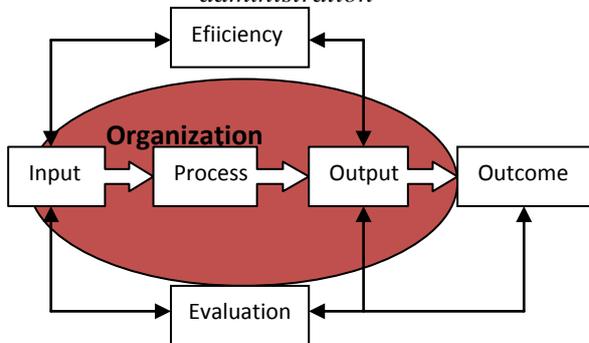
## 2. PERFORMANCE IN THE PUBLIC SECTOR

### *2.1. Defining performance*

From a linguistic point of view, performance can be defined as an extraordinary achievement in a field of

activity. From a systematic point of view, performance is defined as the best result of that system, in regard to one of its characteristics. This result must be understood here as the ratio of inputs and outputs of the considered system.

Figure 1- Performance model in the public administration



A simple performance model which describes the definition from above is illustrated in figure 1. Here, the internal processes which determine the relationship between inputs and outputs and the variables which measure the performance are being shown. It must be said, that performance is a somewhat abstract notion, which cannot be directly measured, but can be expressed by other variables like, in our case, efficiency.

## 2.2. Measuring performance

If in the case of private socio-economic entities can be measured fairly easily by expressing certain economic indexes like profit or cash flow, it is not so easy to express it in the public administration due to its non-profit character. On the performance of public administration there are two points of view:

- One of the subjects, whose interest is to have easy access to a high quality public service and;
- One, which takes into consideration the three “E” principle, Efficiency, Efficacy and Economy.

At a first glance, these two points of view have opposite bearings because a high quality service implies very high costs, like for example the sanitary system. Thus, performance in the public sector seems to be an optimum between or a “way between” these two points of view: performance could be defined as the degree in which the public administration satisfies the problems of the

contributors using as efficiently as possible the resources that it has available. However, this answer is not sufficient because it contains no engagement to deliver high quality services, and leaves room for excuses like “the service would be of a higher quality, if we had more funds at our disposal”, which is unacceptable. Also, in a fiscal system like the one in our country, in which the financial burden on the contributor is very heavy, it is equally unacceptable to increase the tax levels.

In order to exit this vicious circle, a new instrument is necessary in which should determine the development directions and criteria of the public administration. Help in this regard could come from the private sector, to be exact from large corporations, namely the corporate governance. Of course, in this case we can only talk of a stakeholder model for the governance. The stake holders or “key players” are in this case the contributors, the Parliament, the different groups defending different interests but most of all the subjects of the offered public services.

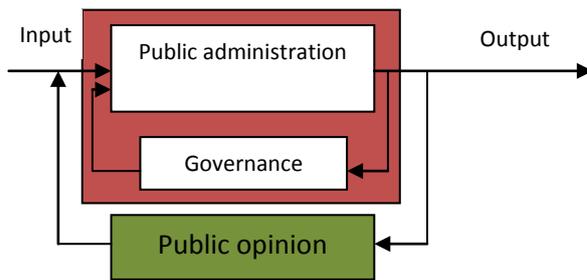
All these key players have a common interest, mainly to offer a set of high quality public services imposing to the public administration objectives that have to be reached, but also have the responsibility of following these objectives.

Under these conditions the performance of the public sector approaches the above mentioned conditions in the context of a systematic point of view, thus creating the proper framework for its continuous improvement and for the legal framework in which the activity of the public administration takes place.

## 2.3. Performance and public opinion

The above model of the corporate governance has a big shortcoming because it lacks a regulatory process to the current needs of its subjects. Continuing the analogy to the private system, in which this regulation is made by the market reaction to the actions of any company, we can say that this role is assumed in the case of the public administration by the public opinion, because the public opinion is the “market” of the public administration.

Figure 2 – Public administration and governance



The public administration has to adapt, just like any company, to the needs of the markets on which it is active. In order to reach this, it is necessary to have a very good communication with the groups the public services are addressed to, regarding the needs they have on the one side, and on the other regarding the degree in which the public administration reaches its set goals, meaning the satisfaction degree of its subjects.

The public opinion thus is the player that gives the feedback to the actions undertaken by the public administration.

### 3. SOME PROPOSALS

In order to guarantee the feasibility of the model presented at point 2.3. regarding the enhancement of the performance of the public system, some major changes within the public administration are necessary, especially concerning the relationship with its subjects, but also concerning the demands for efficiency, efficacy and economy.

Regarding the communication with the public opinion, we propose:

- Intensified preoccupations towards public marketing;
- The migration of the activity of the official spokesperson towards the preoccupations of public relations;
- The better information of the public opinion concerning the efforts of the public administration to ease the access of its subjects to the public services and/or to increase the quality of the offered services.

Regarding the efficiency of the public service, we consider the following actions to be utterly necessary:

- Building on the existing e-government platform a network of platforms is to be created between the different public institutions and

organisms of the public administration, in order to create a common information base;

- The extension of existing remote access platforms (via the internet) to public services;
- Extension of the legal framework of these platforms;
- The continuous education of public servants and their information regarding legal changes and new access possibilities of the public to the public services.

Finally, regarding the economy of the offered services the following steps are necessary:

- Massive investments in infrastructure, in order to decrease current costs of public services by decreasing the solution time of cases;
- Follow-up of the spending of public institutions in order to ensure an efficient allocation of resources;
- The reduction of duties of the personnel so that they can concentrate on the public service itself;
- The continuous preparation of the personnel and the presentation of the latest working methods to ensure the accomplishment of service duties in an efficient and professional manner;
- The increase of the importance of the role played by the internal public audit within the structures of the public administration.

### 4. CONCLUSIONS

A modern public administration has to be able to solve different issues in a professional and economic manner, using a minimum of resources. To ensure this, public institutions have to be oriented towards achieving performance. Also it is necessary that the development, modernization processes and the generation of a high performance evaluation system of the public administration activity continue within the public administration.

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## Research of the Training Needs and Requirements for the Competences and Skills in Tourism in the Counties of Braila and Constanta

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### Abstract

*The tourism activity is considered by most economists, and not only, as an activity that can contribute to the development and prosperity of the areas with tourism potential. To make the most of the opportunities offered by tourism, it is necessary that it should be a qualitative one that being achieved only through trained staff with excellent skills and competencies. The increase of competencies, knowledge and skills through training programs can improve the organization's position on a market with high competition as the services sector is. This paper examines, through quantitative research, the employers' perceptions on the training offer, the necessary skills and abilities for those who want to start or develop a career in this field in Braila and Constanta counties.*

**Keywords:** tourism, competencies, quantitative analysis.

**J.E.L. classification:** M31

### 1. Introduction

The training needs and requirements for skills and professional competencies/abilities in tourism have been represented a research topic conducted by authors in 2011, in order to identify the position and requirements of entrepreneurs in this regard. As a quantitative method of gathering information there was

used the direct survey, and the investigation instrument used was the questionnaire. The main indicators monitored were:

- the necessary for performance / skills of employers and future employees;
- categories of knowledge, skills and abilities acquired through training programs and covered by the employee in the tourism and trade sectors;
- criteria for selecting the staff to attend training programs.

### 2. The content of the questionnaire and the profile of the interviewed organization

The questionnaire comprised 28 questions and was made on the basis of “inverted funnel” principle. The first four questions had identification purposes, the other attaining the research objectives.

Of the 28 questions, 9 are scaled questions used to evaluate the intensity, the responses being ranked from the most favorable attitude to the worst one. The applied questionnaire covered issues such as:

- the criteria considered by employers for the staff recruitment and the difficulties encountered;
- the perception of the categories of training programs;
- the appropriate ways of training for the organizations in the area specified;
- the impact that the recruiting of the qualified staff has on the performance of the organizations;

- the necessary skills and the employers' requirements related to the skills, and abilities of employees.

The sample consisted of organizations in the tourism and trade sectors in Braila and Constanta counties belonging to the South-Eastern Development Region.

*The profile of the interviewed organizations can be sketched as follows:*

- 83% are owned entirely by the Romanian investors;
- 73% are limited liability companies;
- 47.52% have few employees, up to 9 people;
- 69.31% consider the qualification of staff as being of great importance because they recruited qualified personnel;
- the categories of activities performed mainly by the interviewed organizations are: accommodation 34.65%, food and catering services 42.57%, conferences and events 19.80%, tourism and travel 49.50%, commerce 25.74 %, transport 12.87%, tourist attractions 4.95%, tourist organization and management 5.94%, others 12.50%.

In any organization, regardless of the sector they work, all activities compete, to varying degrees, for achieving the goals wished. Therefore, the respondents were asked to present the *importance of the activities*, in an organization, that ensure its proper functioning. According to the responses there are considered as being very important the relationship with the public / customers (77%), as well as the activities of sales (69%), IT (65%), services (65%), marketing promotion (61%), supply (51%). If sales and services are activities that compete, par excellence, for achieving the main activity objective and promotion contributes to the knowledge of the organization in the external environment, we can notice the importance given to IT in both directions.

In general, the activities of the functional departments were rated as “important”: administrative 51%, human resources 47%, accounting 43%. It is noted that the interviewed organizations are aware that the administration and management activities shall contribute substantially, providing infrastructure to the operational activity.

As in every sphere of activity, in the analyzed sector as well, there are *difficulties*, which hinder the proper conduct of activity.

### 3. The problems of the analyzed sector

The main problems faced can be focused on three categories:

- the lack of qualified personnel in the area: “very much” for 37% of respondents, “more” for 27%, “medium” for 17%;
- difficult access to the European funds, “very much” for 35%, “more” for 32% and “very little” for 13%;
- insufficient means of promotion, including the promotion on the websites of local authorities, central agencies and tourism operators: “very much” for 30%, “more” for 25%, “medium” for 17% and “less” for 19%.

Other difficulties encountered in the activity were considered, in particular, the road condition, the current situation of the national economy, the high levels of taxation or the difficult access to information.

*The human resources issues* in the tourism sector are very complex and diverse, one of the key aspects being the recruitment of personnel. The research aimed the way the employers express their opinion on the ranking of the criteria they consider important for this activity. The following criteria were proposed: qualification/ specialization in the field, experience in the field, communication skills, foreign languages skills, computer skills, self-control in critical situations and availability for overtime or flexible schedule.

As it can be seen from Chart no. 1, 66% of the respondents felt that communication skills represent a very important criterion, which confirms that employers are aware that tourism is a field in which people provide services to people, so that the communication with customers is essential. 77% of the employers cite that, in an organization, public relations are very important. The training and specialization of each worker in tourism represent a very important criterion for 63% of employers, which concludes that in this sector there should be a focus on increasing the priority on training. The same percentage of 63% as much appreciates the experience in the field. However, for 51% of employers, availability for over time or flexible schedule is a very important criterion. (Chart no. 1)

Regarding the possession of computer skills, 45% of employers consider that this criterion is very important, while 34% think it just has importance. In the case of foreign languages

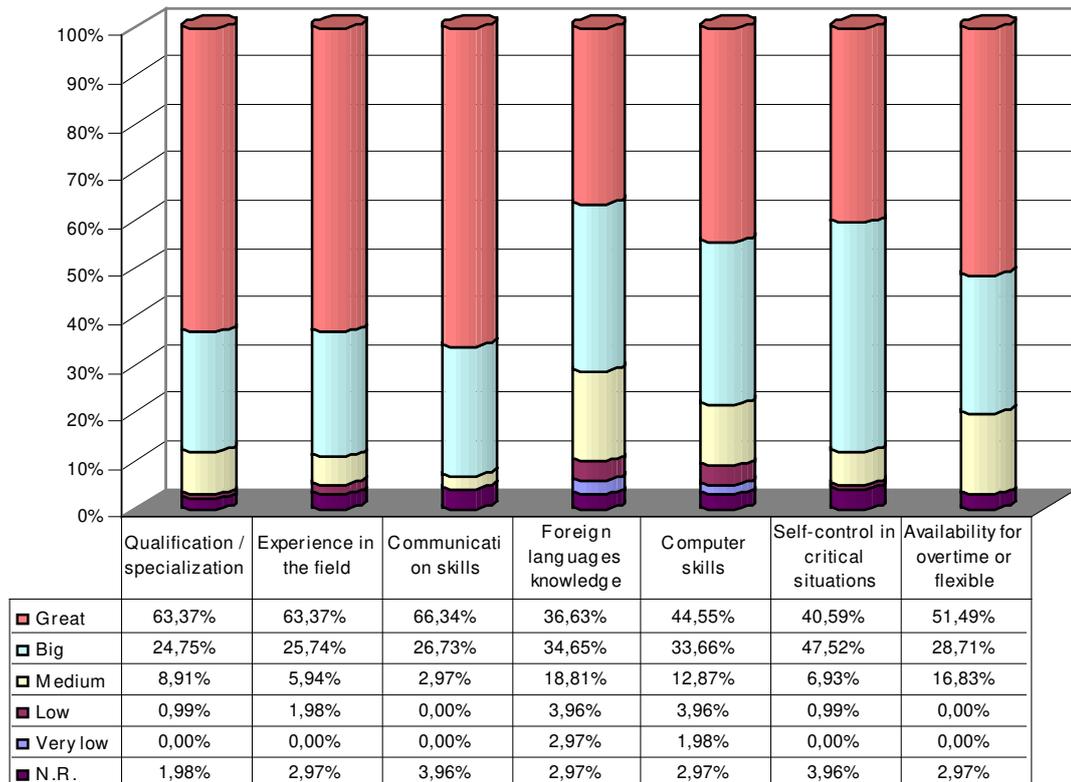
skills, it is as follows: 37% of employers consider it a very important criterion, while 35% think it just has importance.

Chart no. 2 shows that a 54% of the respondents had difficulty in recruiting qualified staff. But for the remaining 46% of the surveyed companies, recruiting qualified staff did not prove to be without difficulties. *The main difficulties*, grouped by profession, mentioned in the replies were:

- waiters: difficulties in service delivery, lack of training, lack of foreign languages

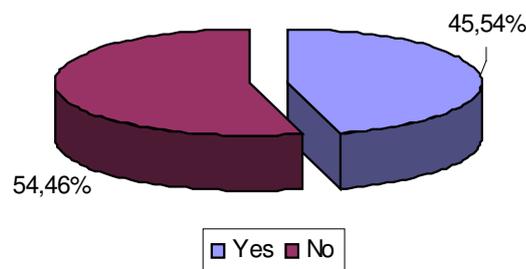
- knowledge, lack of interest;
- kitchen: negotiating of the tariff wage, lack of training;
- receptionists: compliance as employees, foreign languages knowledge, ability to coherently and completely present the existing tourism offer;
- sellers: no skills in the field;
- travel agents: lack of training, of experience and of foreign languages knowledge.

Chart no. 1. What is the importance given to the following criteria in the recruitment of personnel?



Source: created by authors

Chart no. 2. Have encountered difficulties in recruiting qualified personnel?



Source: created by authors

It can be concluded that the level of competence of employees in the analyzed sector is still low and the main categories of

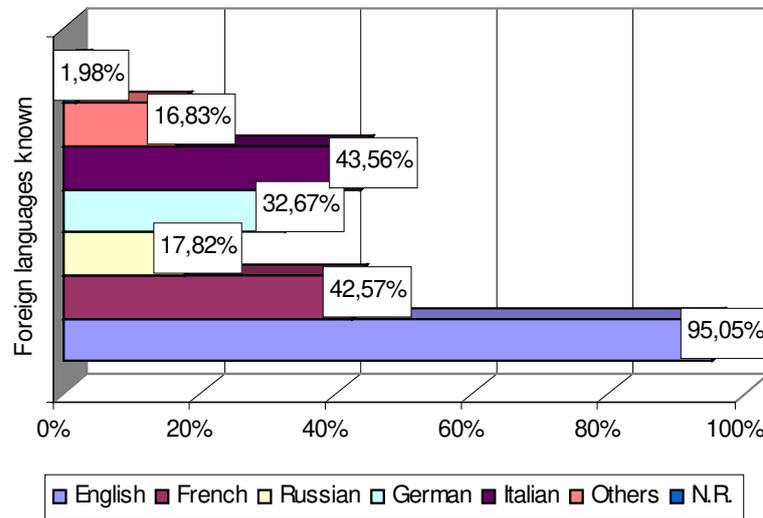
knowledge, skills and abilities to be improved are: the rules of services, the ability to coherently present the list of food products, the

proper preparation of the supporting payment documents (restaurant bills), the way there are made possible some variants to satisfy the demands of food products, the identifying of the factors that influence the quality of the hotel services, the hotel services realization in terms of quality, the ability to coherently and comprehensively present the tourism offer, the ability to permanently and convincingly promote the tourism product, communication skills with customers, self-control, mathematics knowledge, experience in the field, relevant qualifications, foreign languages skills, continuous training of employees, the ability to apply theory into practice, knowledge of the hygiene program and food safety (HACCP), skills and practical abilities, mobility and flexibility, the ability to customize the offer according to the customer’s requirements, skills in the computer use, optimum organization of the working time.

An interesting aspect revealed in the research is related to the *certificates of competence* attesting the computer skills and the ones of using a foreign language held by the potential employees. Although the computer activity is used in all organizations,

only 56% of the respondents believe that possession, by an employee, of a certificate of competence in the computer use is advantageous for the performance of the organization. 27% believe that such a certificate is only sometimes advantageous, while 15% do not think that having a certificate of this kind brings benefits for the activity of the organization. The answers are not surprising if we consider that a certificate of competence, especially in computer operation, fully proves its usefulness only if it confirms the real practical skills of the holder. For the employees in the tourism sector, knowledge of at least one foreign language is vital. Certainly, English is the foreign language which is the most important for the activity within the interviewed organizations (95%). The overwhelming percentage confirms, if needed, that English is the language of trade and travel. Other important foreign languages are: Italian (44%), French (43%), German (33%) and Russian (18%). The respondents pointed out that other foreign which are important for their activity are Spanish and Turkish (Chart no. 3).

Chart no. 3. What are the major foreign languages in the activities of your organization?



Source: created by authors

The knowledge of a foreign language increases the chances of a candidate for employment, given that many of the tourism sector firms have clients or foreign partners. Surprisingly, only 23% of the respondents require a certificate of language skills to the new employees, while 38% do not require such a certificate, and 38% requires it only sometimes.

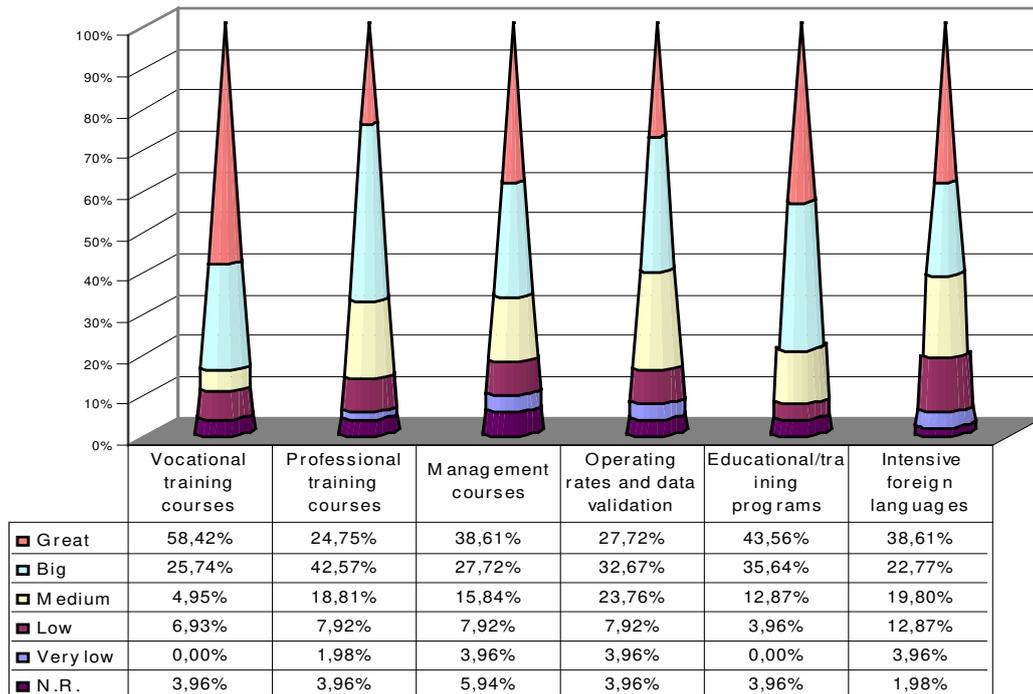
The possessions of a certificate of competency in the computer use or of knowledge of a foreign language are not enough for employers. Employees must show real skills and communication abilities in foreign languages with customers, real computer skills, and these are not always demonstrated by holding a certificate of language skills.

#### 4. The quality of the tourism training programs

A researched aspect was the one related to the way employers perceive the *quality of the tourism training programs*. It is found that 74% have a favorable opinion, considering that it actually contributes in increasing the skills and abilities of employees, about 20% believe that after the completion of such courses there has not been any increase in the professional performance and only 6% have an unfavorable opinion.

The high interest to improve knowledge, skills and abilities through training programs is supported by the fact that, for all the categories proposed for hierarchy; the “very high” and “high” degree of interest exceeds 50% in all cases. Of a “very high” interest to respondents are the following training programs: vocational training courses for basic occupations of the organization (58%), education/training programs for the employed staff (44%), courses in tourism and trade management activities (39%), intensive foreign languages programs (39%) (Chart no. 4).

Chart no. 4. Note the degree of interest in the following professional training programs



Source: created by authors

There is a “high” degree of interest for the professional training courses for career development (43%). In terms of the operating rates and data validation, there is a “high” and “very high” degree of interest for 61.38% of the respondents.

To identify the ways of training which the employers consider optimum, they were asked to achieve their own rank noting them from 1-8 (1 = very adequate, 2 = most appropriate, 3 = more appropriate, 4 = appropriate, 5 = adequate enough, 6 = less adequate, 7 = least adequate, 8 = inadequate).

The analysis of the responses to that question suggests that the very adequate way of training is considered the one of the training courses at work (#1 choice of the scale, 26% of the respondents). This method has the advantage that it does not involve

interruptions in the work program of the employees. In total, the percentage of the ones who placed this way of training in the first and second places amounts to 39%.

The courses at the workshop would be the most appropriate for 14%; for interpretation, this version was ranked the 2<sup>nd</sup> because it was chosen in the first and second places by a total percentage of 33% of the surveyed organizations. The rank continues as follows:

- courses of 1-2 weeks would be a more appropriate way of training, mentioned in 23% of the answers, this way being ranked the 3<sup>rd</sup>;
- courses of 2-3 days over several weeks are considered appropriate in 15% of cases positioning on the 4<sup>th</sup> place;
- courses by correspondence / online courses are considered an adequate

enough way of training, ranked the 5<sup>th</sup> place (14%), however, to gain real practical skills and abilities these ones prove their usefulness less. The interviewed organizations expressed an interest in this way due to the multiple advantages: greater flexibility in terms of schedule, reduced complexity, lower costs, movement of personnel is not required, the use of audio-video;

- weekend courses in another city are rated as a less adequate way of training, ranked the 6<sup>th</sup> in 19% of the responses due to the extra travel expenses (transportation, meals, accommodation);
- courses of 4-6 weeks are considered a least adequate way of training in 22% of the responses, because they require a longer period of time, it is ranked the 7<sup>th</sup>;
- courses of 3-6 months are considered inadequate (22%), the motivation being the same as described above, earning the 8<sup>th</sup> place.

*The funding* for vocational training courses and programs has three sources: the funds of the organization the own resources of staff and the combining resources of the employer's with the employee's ones. The statistical analysis of the responses reveals the following:

- 33.66% of employers have allocated financial resources for training these ones being, aware that such an investment ultimately has benefits from the expertise and the skills acquired;
- 29.70% of employers scored by their answers that the training was made with their employees own resources without the financial involvement of the company;
- 20.79% said that the financial resources invested in the skills / the raising of skills and abilities of the employees are from both the employer and the employee;
- the national funding (1.98%) and the international funding (3.96%) have low share;
- 7.92% of the respondents mentioned the international funding in addition to other resources.

There are employers who are not interested in their employees to attend training or professional training, the reasons being:

- can not give up the employees who should attend training courses, concluding that a major problem would be the training program that overlaps with the working hours of the employees (37%);
- insufficient financial resources (36%);
- profession can learn directly from work (24%);
- leadership is satisfied with the level of

employees' existing training (21%).

We estimate, as positive, that only 9% motivates the disinterest by the lack of local training providers, which means that the offer of training is present and sufficiently diversified to meet the demand.

## Conclusions

Service skills in the tourism sector both on the professional and the behavioral levels are still underdeveloped and require special attention. Also, the improvement of attitude and mentality towards the services are issues requiring urgent attention. The investment in the education and the continuous training of personnel in tourism contribute to providing competitive services to customers, which can be provided only by personnel with an adequate attitude, a correct mindset, and a appropriate behavior.

Employers in the tourism sector realize that the qualified employees are essential and the advantages of recruiting a qualified person are multiple: the increasing of the customer's satisfaction, loyalty, revenue increase from the accommodation activity, and the increase of the hotel management indicators, achievement in terms of quality services, higher degree of training, increased knowledge, skills and abilities, better yield than of a poorly trained person, awareness of its role in raising the company performance, individual performance improvement in activity; more fluent language and communication skills, keeping in touch with new practices.

The sector is emerging ever more the need for quality tourism, which is possible only through the contribution of some employees with excellent skills and abilities. The rapid changes in the economy and the strong competition increase the need for new skills for those who want to gain performance in this sphere of activity.

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# Internet as a Method of a Customer Relationship Management System Implementation

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## Abstract

*CRM philosophy is based on the fact that a long term relationship with customers can be one of the most important assets of an organization. CRM uses the Internet to facilitate interaction with the client. The fact that large western organizations are re-evaluated based on their sites makes that the Internet to break into management plans of Romanian organizations too, the benefits of the Internet being already well known. You can organize such databases on customer issues, customer-interaction sites for the company to meet all three client concepts.*

**Key Words:** internet, CRM, company, customer

**JEL Classification:** J5, J53

## 1. Introduction

This strategy is implemented using IT applications, and the new developments in IT can help an organization to adapt their strategies regularly. The main concept of CRM is relatively simple. For years companies have focused so much efforts on lowering costs and improving efficiency within the organization. They focused more on internal process, often automating their back office items functions such as production, logistics and finance. By contrast, management effort invested in

customer-related activities such as sales and marketing are often left behind.

As the market is consolidating and suppliers become more efficient in providing services or products, rival offerings are becoming increasingly difficult to distinguish. What is the most important difference between two toothpastes? At the same time, as services and products quality improves, increase customer expectations and demands. As long as the client is able to change his supplier, it is becoming increasingly difficult for a company to retain loyalty. It is therefore very important for a modern company to have a system to shorten response time to customer inquiries, providing quality support and services.

For many industries, the evolutionary process of how to do business is not new. Suppliers of consumer goods in large quantities fought over the years to create brands based on quality and price. But what changes is the impact of increased client's decision-making power, "his authority". Now, in an environment dominated by the Internet, where suppliers can change with just a few mouse clicks, the problem becomes more complex. It affects every organization, whether it focuses on the customer or business.

It turned out that maintaining old customers costs significantly less than the acquisition of new customers. Therefore, while companies are expanding their customer base, should not lose in sight of keeping and breeding the best of them. The

increase of "customer action" - in other words, the amount of business that each client offers - is as important as increasing market action. Through good management of customer relations can increase profitability. And this is essentially Customer Relationship Management.

## **2. Fundamentals of CRM**

Since the marketing methods used by small businesses (close personal contact between buyer and supplier and a good knowledge of customer needs) can not be used in a large company, CRM technology should increase the effectiveness of customer relationship management.

CRM philosophy is the recognition that a long term relationship with customers can be one of the most important assets of an organization, providing competitive advantage and improved profitability.

## **3. CRM operation**

CRM facilitates the interact with customers through the most efficient, faster and more sophisticated means of communication - the Internet. That's a solution that centralizes employees, processes and data from a company, so that they could better serve customers and increase their loyalty. Information can be structured, unstructured, conversational or transaction.

Spectacular growth and continuous review of organizations that use Internet websites have brought the Internet to the forefront of current management thinking. The Internet provides an infrastructure through which other organizations can interact with customers in the same way they interact on the phone, fax or e-mail. Complexity of interaction with customers through multiple channels indicates several areas where technology can reduce staff effort and money.

Generally, these responses are web pages containing answers to frequently asked questions (Frequently Asked Questions - FAQ). Complex systems analyzes the questions and is looking in "information base" for possible responses. In each case, the system must be constantly updated as new problems and solutions occurs. The

most sophisticated systems on the market "learns" automatically from the "solved" cases by adding in their database the needed information.

Because many users are skeptical about the concept of Web, much of the support systems on the Internet will provide various means to communicate directly with agencies, including the "chat". Most web-based service systems will also have a feature that will allow the customer to be contacted or to contact the agencies directly by phone, thus respecting the desire to provide the preferred communication channel. When this feature is enabled in an integrated system, contact center will be able to immediately identify and access the customer history of its interactions with the organization.

## **4. CRM - systems and technology**

Since some of this information is gathered by the company's resource planning systems, ERP databases are to be integrated with some aspects of the CRM database. Furthermore, CRM technology includes various aspects of information management, including integration with other company systems and methods that convert data into usable information. CRM utilizes technology, strategic planning and marketing techniques to build personalized relationships to increase profit and productivity. It is a business strategy that puts the customer at the center of company processes and practices. Implementing CRM software should come with a change of thinking of the company so that it can focus more on client.

The customer-oriented business philosophy is needed for supporting effective sales, marketing, customer service and placing orders. Some examples of CRM initiatives are:

- database specifically aimed at issues related to customer service;
- website that allows customers to find information about the company and interact continuously with it;
- collecting and storing data to build a database with necessary information for better understanding of the client;
- data collection of the visitors accessing the website, including name, e-mail, location and purchase preferences.

## 5. Companies benefits of using CRM

A professional CRM strategy can improve customer service by facilitating communication with them through several means:

- increasing the efficiency of interaction with customers through all channels of communication;
- facilitating the customer-supplier collaboration through the web, thus reducing the costs of customer relationship management;
- providing product and its use information, technical support on Web sites that are accessible at all times, 24 hours a day, 7 days a week;
- identifying how each client defines quality and then developing a strategy for services for each client based on its individual requirements and expectations;
- a fast mechanism for managing and scheduling the follow-up to find out the customer opinion from a purchase and to determine trends of purchasing new goods, the time and the frequency of purchase;
- a mechanism for tracking the points of contact between a customer and the company - does this thing in an integrated manner so that all types of resources and contacts to be included and all system users have the same image on the consumer, reducing the risk of confusion;
- participation in the rapid identification of potential problems before they happen;
- a friendly mechanism for registering customer complaints (complaints that do not reach the company can not be solved and become an important source of dissatisfaction for the customer);
- an effective mechanism for solving the problems and complaints (complaints that are resolved quickly, increasing customer satisfaction);
- internet use cookies to track customer interests and personalize product offerings;

- a mechanism for managing and scheduling maintenance and ongoing support repair, improving the efficiency.

## 6. CRM objectives in different departments

Departments main specific objectives are:

- **Customer Support** - obtain basic information about customers and their complaints, monitoring customer satisfaction and faster resolution of claims in order to enhance their retention, the increase of self-service efficiency will alleviate the need for personal assistance.
- **Marketing** - creating a dynamic segmentation of customers to initiate a communication strategy and better targeted campaigns, appropriate marketing campaigns, customer satisfaction by analyzing the segments, monitoring the feed-back generated by the campaign.
- **Sales** - Sales development by regions, customer history tracking, streamlining and efficiency of the sales and customer qualification based on past experiences.
- **Field service** - monitoring customer complaints history and their resolution. Reducing the defects by 5% can increase the profit rate from 25% to 95% according to Harvard Business Review.

## 7. Quantification of CRM success

Even if success factors are different, many companies choose ultimately ROI (return on investment) as the sole factor, although this method of calculation led to controversial discussions.

Sometimes CRM systems measures ROI only as a residual income or as a profit margin derived from implementing CRM technology. This is however only a limited application because it does not provides sufficient analysis to serve the decision-making. Also, it evaluates the problem only from a business perspective and considers the client only as a source of income, while

CRM ROI should integrate both revenue and customer satisfaction.

A study conducted by University Dayton researchers highlights four main indicators for a successful CRM: CRM's ability to influence corporate strategy - 25% of respondents, successful integration of technology - 23% of respondents; Enhancing strategic partnerships - 20 % of respondents; assimilation of technologies related to CRM - 18% of respondents.

Another financial indicator of success is possible customer lifetime value (CLV - customer lifetime value). It allows businesses to analysis beyond a period of time and combines both a client and cash flow with cost reduction based on activity, and real probability of a customer retention to help understand the impact of various scenarios of CRM. Profitability results of most likely scenarios that can be implemented to be compared to find the best way to increase overall profitability.

## **8. Conclusions:**

When a CRM is applied in a company, business objectives will be: increasing the number of customers and gain a fidelity from their greater feedback, more customers who come to visit the site. For a marketing service, such a strategy will help in organization of a better targeted campaign and in customer satisfaction. Sales department will benefit the automatic development of sales by region and customer qualification based on past experiences.

The CRM application benefits would be the fast identify of potential problems before

they happen, an effective mechanism for resolving problems and complaints, a mechanism for tracking the points of contact between a customer and company - getting basic information about customers and monitoring customer satisfaction.

Along with CRM, as management strategies using database organization is also found "Enterprise resource planning" (ERP), "supply chain management" (SCM), e-procurement and e-marketplaces. Although many companies have developed websites, experts estimate that the organizations that adopt strategies according to the old concepts will still have more to gain. The Internet will become a facility for feedback only and not necessarily an environment that will make sales of large companies. Hypothesis is supported by the fact that there are people that they are online documented about products, they choose online shopping, but they say they will not give up to go out and buy products from stores.

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# Impact of Economic Crisis on Buying Behaviour and Marketing-Mix Tools

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## Abstract

*International business environment is changing in the context of economic crisis. Consumers react by adapting their buying behaviour from impulse acquisitions to more prudent and rational purchasing decisions. As consumers are buying necessities and have a tendency to migrate to generics or cheaper brands, in recession many companies opt for an assortment selection strategy, withdrawing from the market those products and services that record a visible decline in demand. Price discounts are frequently adopted by companies in order to offset the negative effects of lower demand. Intermediaries with low performances are usually eliminated. Promotional budgets are decreased and mainly allocated to sales promotion techniques.*

**Key words:** marketing-mix, economic crisis, consumer, buying behaviour, loyalty.

**J.E.L.** classification: M31-Marketing.

## 1. Introduction

In the last years there have been many changes in the international business environment under the impact of economic crisis, the living standards of people and the development of various businesses being adversely affected. Economic crisis occurred because of excessive lending and over consumption and quickly became a phenomenon in almost all national economies.

Major consequences of economic crisis for most of the European countries can be summarized through a global feeling of citizens' uncertainty and economic

instability, due to higher levels of unemployment and inflation rates, an increase in the volatility of many currencies and higher financial risks. Therefore, governments of affected states have been forced to adopt different anti-crisis measures, aiming to achieve a greater control on the budget deficits, despite the negative impact on households' consumption and their purchasing power.

Individuals began to perceive increased risks of losing their jobs and because their future incomes became more difficult to estimate, peoples' level of trust in economic recovery has known an important decrease. The overall effects of economic crisis on consumption are difficult to estimate with high precision, if considering the uncertainties perceived at the individual level, since most consumers feel affected by the recession not only financially, but especially in psychological terms.

## 2. New patterns of consumer behaviour

In times of recession, many individuals show a decrease in their propensity to spend on products and services, especially on luxury or expensive articles and express a tendency to purchase smaller quantities of items that address their superior needs. Some industries, such as restaurants, air travels or car industry are probably affected in a larger extend then grocery or retail stores. Therefore, consumers are generally reacting by reducing wastefulness, spending less for dining out, leisure activities and for buying clothing or accessories [2].

Even in the case of those products and services intended for basic needs such as food, cloth, health-care or personal hygiene products the general trend showed by

consumers is to switch to cheaper brands, usually from better-known to lesser-known brands [14]. However, switching behaviour is less likely to occur for those goods or services with a high perceived risk or relationship ending costs, like financial-banking services. This is also the case of strong equity brands which presents more guaranties, providing consumers with a sense of security [9].

During an economic crisis, consumer purchase decision process become essentially rational, due to increased price sensitivity among almost all market segments. Therefore, the cost performance of the product is a main attribute that individuals take into account when choosing between alternative bids. Regarding shopping behaviour, consumer price sensitivity is highlighted into a higher purchase rate from discount stores or from large chain stores that usually apply promotional activities in the form of price reductions or other demand incentives. Individuals show also their preferences for neighbourhood stores, having the opportunity to decrease additional time, energy or travel costs [5].

Additional to the price element, other important selection criteria underlying buying decisions are considered to be the effectiveness and the durability of products. Because consumers are in search of a larger amount of factual information arising from aversion to risk and greater uncertainty avoidance, the buying decisional processes tend to be more complex and lengthy in times of recession [2]. Because of financial difficulties and uncertainty feelings, people tend to prefer more informative or factual promotional messages and in a lesser extent the image-based advertisements.

Consequently, changes occurred in the demand level of many products, in quantitative and value terms, have effects on the market position and on the competitiveness of the most organizations. Therefore, firms have to reconsider their marketing-management decisions so as to adapt to more difficult realities and to meet the demand of more rational consumers, whose budgets are increasingly planned.

### **3. Organizational priorities and marketing-mix tools during recession**

In times of economic crisis, businesses are determined to implement some adjustments at the level of their management and marketing strategies. Objectives and directions followed in economic growth periods cannot be often continued during economic crisis, considering the many changes occurred in consumer buying behaviour.

New behavioural patterns occurred in the consumer market have a decisive influence on the process of strategy development, in the context of a decreased demand and a low rate of customer retention.

Companies' reactions to the changes determined by the economic crisis vary significantly from one sector to another, being mainly influenced by organizational potential and also by managerial risk propensity.

Researches conducted by Shama [11] proved that those companies that succeed in a dynamic market are those that develop proactive strategies, being able not only to react to events occurring in the business environment, but even to be the factor that induces changes. Taking a similar point of view, other researchers have shown that proactive strategies can become, for some organizations, a way to turn the economic downturn into a number of advantages. Thus, companies that identify market opportunities during periods of economic crisis and invest additional resources in marketing activities will be able to benefit from significant advantages in times of recovery, which will result in improvements of specific business indices related to market share and profit [12]. These companies will continue to invest in expansion and diversification, hoping in favourable future results.

However, proactive strategies are not generally recommended, being a function of specific potential of a company in terms of its material, financial and human resources, industry evolution and organizational market share, intensity of competition, product category and so on. Due to all these arguments, many firms will consider the economic crisis as a significant threat and will consequently adopt a rather defensive attitude, based on cost cuts. By developing

defensive or rationalization strategies managerial decisions are focused on conserving a company's own resources [1].

According to Pearce and Michael there are four main strategic alternatives that companies can adopt during economic crisis [8].

Proactive strategies oriented towards external business environment involve making investments for penetrating new markets, business diversification, investments in sales and marketing, in customer acquisition and retention plans.

Proactive strategies oriented towards internal business environment aim to make investments in quality management, technologies, human resources, production and logistics, research and development.

Fortification or defensive strategies oriented towards external business environment are considering giving up to certain products or product lines, withdrawing from certain markets, reducing the costs of sales and marketing activities, selling some parts of the business to focus on core competencies.

Fortification or defensive strategies oriented towards internal business environment consists in the implementation of rationalization measures in areas such as: research and development, human resources, production and logistics, technology, administration.

From a marketing perspective, these strategic alternatives involve different tools of implementation. Because in times of crisis consumer demand changes and new preferences, requirements and behavioural patterns are emerging, organizations should have initiatives to adapt their marketing-mix instruments in order to avoid threats and to take advantage of arising opportunities.

As a response to more acute competition and reduced demand the market strategy of many companies will change in recession by withdrawing from markets in which they are weak in order to fortify markets in which they are a leader or a strong challenger [2].

According to researches conducted by Roberts [10], in times of economic downturn, brands that have the potential to develop or to maintain market share are either generic products or brands with a good reputation, offering consumers a sense of security.

Therefore, organizations with low product portfolio performances are likely to change their product tools by focusing on assortment selection strategies, involving a decrease in the size of the product range, usually by reducing its depth.

The process of portfolio analysis should underlie such a decision, by identifying each product contribution to organizational profitability, correlated with the life cycle stage of the analyzed products. Thus, shorter product lines become more manageable and companies can make better use of own resources by allocating them to products with a high profitability potential.

There are also firms that, despite economic difficulties, will aim to make additional investments in research and development activities in order to achieve long term profits [7]. In this case, brand strategies will focus on the launch of new products tailored to the current priorities of consumers, by incorporating new attributes related to economic performance, durability and functionality.

Another strategic program is the augmentation of the actual products with more guaranties. This is frequently applied by organizations that have a proactive approach in recession conditions. Consequently, product tools should be designed to fulfil the objective of gaining customer confidence, which are under the pressure of a low purchasing power and are focused on making rational acquisitions.

Although a less common strategy during the crisis, some companies will continue to innovate and will launch different versions of the existing premium brands, at a lower price. These are organizations holding consolidated positions in the market and which are seeking to achieve the loyalty of quality oriented buyers. Favourable effects of such initiatives are based on the positive association that consumers make between premium brands and second line brands, provided that the quality attributes of recently launched products do not affect the image of the previous brands.

Given the relatively high sensitivity of many customers to product costs, the price is the marketing-mix variable with the greater probability to be changed during economic downturn. Thus, companies can choose

between two main strategic choices regarding prices: to charge the same prices for products with quality improvements or to charge lower prices by maintaining the same quality standards at the product level [2].

Keeping the price level and improving the quality of products is usually adopted by companies that have opted for a concentrated market strategy and that have established as main objective to achieve the loyalty of high demanding customers, with a fairly high probability of losing unprofitable customers.

Increasing satisfaction and firm attachment among consumers that are less exposed to financial risks is achieved by providing additional value related to both tangible and intangible components of the product, with emphasis on durability and functional performance characteristics appreciated by customers.

By adopting this strategy, a company goal is to achieve long term image benefits by enhancing brand equity. Even though, this strategy has also risks that should not be omitted. For instance, the market share and the level of organizational profitability may be affected in the short-term. A certain business potential is therefore required for supporting the alternative, allowing the company to sacrifice short term profit results. Organizations are expecting more favourable effects in the post recession years, due to increased possibilities of extending the portfolio with certain products that may have superior profit margins.

The second price strategic option aims to maintain or expand market share, in spite of reduced profit margins for firms. It is an adequate choice in situations where the company has designed its marketing policy in order to target those customer segments that show high demand elasticity to price. This is a price alternative adopted especially in industries where it is more difficult to gain additional percentages of market share, the competitive pressure being particularly high [4].

Short-term benefits can be substantial, but companies that adopt this kind of strategy assume in the same time a number of risks, related to the difficulty of raising back the price in the years of economic recovery. A potential adverse effect on brand image is

also an expected outcome. Consequently, a better choice involving lower risks for future market activity would consist of planning a series of temporary price reductions in order to stimulate consumer demand.

A growing number of companies opt for the practice of low prices, while reducing the level of product quality, in those countries severally affected by the crisis. This price decision is motivated by the deteriorations of citizens' living standards, willing to make compromises when buying products, so as to not exceed the low budgets which they have [13]. Although it may generate substantial levels of sales in periods of recession, the strategy will be difficult to support over time and this is not a guarantee for business stability.

During recession many companies opt for decreasing marketing costs, especially those allocated to promotional activities, which is not always the best solution. Researches conducted in European markets show a much higher effectiveness of advertising during economic downturn, the favourable effects on sales and profits being multiplied especially in recovery years [3].

This situation is explained by lower costs of exposure in mass media, advertising agencies practicing relatively low rates in conditions of declining demand. Furthermore, individuals tend to remember more easily the received promotional messages, because of fewer competing campaigns, most players investing limited resources in advertising and other promotional activities.

Regarding communication channels, since consumers are becoming more rational and make purchasing decisions based on detailed analysis, an increased attention of the company towards press or Internet is expected, at the disadvantage of radio and television channels. Promotional messages are more and more informative, with emphasis on factual contents, based on objective arguments that are consistent with the attributes considered important by consumers in making buying decisions. So, messages that focus on elements like quality warranties, economy or product functional benefits are better appreciated by consumers than messages built around symbols or emotional issues. Moreover, advertisements

that emphasize practical experiences of consumption tend to be more trusted than those based on ideals and imagination.

Companies allocate a great part of the promotional budget to sales promotion techniques, especially to temporary price reduction, such as discounts, given the high sensitivity of consumers to the price element [2]. Special offers or loyalty programs are more effective in times of economic difficulties than promotional games or contests.

In the field of distribution, marketing decisions during economic downturn are especially focused on choosing appropriate commercial units that can guarantee a fairly high level of sales. Discount stores are most often included in this category. Providers tend to end business relationships with those intermediaries that underperform and to simultaneously identify cost-effective distribution alternatives [6]. Traditional channels of distribution can be supplemented by Internet or telephone transactions, in order to extend market activity to new customer types.

#### 4. Conclusions

As a concluding remark, economic crisis has a significant influence on both consumer behavioural patterns and organizational market activity. Consequently, companies need to adapt to major changes of the business environment by redesigning their marketing mix tools in order to meet new market realities and gain customer loyalty.

#### 5. Acknowledgements

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# Sustainable Water Pricing And Demand Management Issues In Romania

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## Abstract

*This paper aims to highlight some of the issues and challenges raised by implementing the most efficient approach for water pricing, to induce a sustainable water demand management.*

*Therefore, we define the concept and utility of water demand management, as one objective of efficient water pricing.*

*Next we briefly analyse some features of the water demand function and show some empirical evidence on the true correlation between the water pricing and the demand of water in Romania.*

*We end with conclusions and some personal recommendations on the actual opportunity, prospects, and challenges of sustainable water pricing.*

**Key words:** water pricing, demand management, price elasticity, sustainable

**J.E.L. classification:** Q21, Q25

## 1. Importance and benefits of water demand management

Scarcity of the water resource has become a concern in recent studies, reflecting the shift from the engineering perspective of increasing supply to satisfy demand to the economic perspective of also managing demand through price to efficiently allocate the existing quantity of water supply.

Therefore, in 2007, the European Commission adopted a Communication on Water Scarcity & Drought (WS&D) which identified several policy areas that had to be addressed if Europe was to move towards a water-efficient economy.

In order to address and mitigate the challenge posed by water scarcity and droughts, it is essential to improve water demand management in Europe.

Sustainable water demand management is defined as the development and implementation of strategies aimed at influencing demand, so as to achieve efficient and sustainable use of a scarce resource, namely water. Besides efficiency, it should promote equity and environmental integrity.

Demand management strategies mainly consist of non-structural measures such as economic and legal incentives to change the behavior of water users and the creation of the institutional and policy environment that enables this approach [1].

An improved water demand management may lead to an increase in the efficiency of water use and/or reduction in water consumption, with several very important economic and environmental benefits in the medium and long run, such as:

- reduced costs of water treatment and distribution system capacity (including the capacity of infrastructure for the collection and treatment of wastewater);
- savings in capital expenditures because of deferred or downsized new water supply projects;
- energy savings for heating water as well as for pumping and treatment;
- environmental benefits of reduced withdrawals of water from streams and aquifers which leave more water available to preserve the ecological resources of streams, wetlands and estuaries.

Sustainable and efficient water use represents one of the biggest challenges of the present and the coming decades.

Especially the last decade has produced marked improvements in the available “know-how” for planning and evaluation of demand management alternatives. Taking into account previous experience and stakeholder consultations, an integrated approach based on a combination of options is considered now in the EU as the most appropriate approach for addressing WS&D (water scarcity and droughts), compared to alternatives based on water supply or economic instruments only.

However, the first policy area to be addressed in the member countries is putting the right price tag on water [2].

Implementing a sensible system of water pricing is one of the major means for efficient water use and the first requirements for the promotion of such use are full-cost prices. This way, suppliers and regulators using charges for use, metering and educating by increasing the awareness of the user about water conservation, must reduce water demand toward a more sustainable level [3].

## 2. Characteristics of water demand

Water is an economic good not only used as an input, but also directly consumed. Consumer behavior is highly influenced by preferences (a way in which they internally value the good), the price of the good, and budget constraints.

All of these factors will shape what is known as the willingness to pay for a good, which is the basis for a downward-sloping demand function, relating price to quantities demanded.

Thus the demand function relates the quantity of commodity (water) that a consumer is willing to purchase, to price, income and other variables. Demand may be typically expressed as a function of different variables, with a general form:

$$q = f(x_1, x_2, \dots, x_k) + \varepsilon$$

where  $f$  is the function of variables  $x_1, x_2, x_k$ ,  $\varepsilon$  is a random variable describing the joint effect on  $q$  of all the factors not explicitly considered by the variables. The most important factor determining demand is the

price: the lower the price, the greater the quantity demanded.

The price elasticity of demand for water measures the willingness of consumers to give up water use in the face of rising prices, or conversely, the tendency to use more as price falls [4]

Normally, in the competitive markets, supply and demand for a good will interact to form an equilibrium price, which leads to optimal allocation of resources.

However, given the many public good features of water, this classical competitive market is seldom feasible for the operation of water services. Thus, water provision is often supplied or regulated by the State, and the price formation will not be an automatic result of supply– demand market interactions.

Notwithstanding the lack of markets, the production of water services still requires the use of scarce resources, and costs will be incurred. If the price paid for the use of water does not cover the costs (which should reflect an efficient provision of the water services; costs related to non-efficiencies and rent seeking in water provision must not be considered as part of a full cost recovery approach to water services), we would have troubles assuring the provision of water in the near future.

Therefore, the pricing of water is actually a most important factor determining water demand (water use and consumption) and water supply as well; although the water demand function should also take into account other specific variables (income, specific climate features, etc.).

## 3. Empirical evidence on the correlation between the water pricing and the demand of water in Romania

According to a previous detailed study [5], in Romania, the economic instruments for water management and protection have developed and include fixed service charges, various water charges, taxes, penalties and allowances. Their major aim is to have a rational and economical management of waters to ensure that users respect the quality limits for water discharges, to prevent the depletion of the water resources, to avoid quality damage and favor resource conservation.

Indeed, in the case of Romania, at least in the last about 15 years, we were able to observe, from a time series analysis of correlation and regression, the important role of water pricing in (determining) actually reducing the excessive, unsustainable and inefficient use and consumption of water from the public water supply.

We used for the time series analysis the latest data available, for the period 1998-2009. The evolution of these variables, as well as that of the water pricing, is presented in Table 1:

*Table 1- Dynamics of the variables considered for analysis, in Romania, 1998-2009*

Variable	Years in the time series					
	1998	1999	2000	2001	2002	2003
1.GDPS (%EU27=100)	27	26	26	28	29	31
2. UWPS (Millions m3)	2800	2770	2609	2462	2225	1989
3.PWAT (indices %, previous year=100)	182,9	154,4	174,6	142,7	140,7	127,7
Variable	Years in the time series					
	2004	2005	2006	2007	2008	2009
1.GDPS (%EU27=100)	34	35	38	42	47	47
2. UWPS (Millions m3)	1765	1686	1070	1088	1122	942
3.PWAT (indices %, previous year=100)	123,5	125,8	123,09	115,82	111,82	114,40

*Table source: Raw data from Eurostat (variables 1, 2) and from the Romanian Statistical Yearbook, 2010 (variable 3).*

It is interesting to note that we got to test for this insight by noticing the fact that there is a negative correlation between economic growth (expressed by GDP per capita in Purchasing Power Standard, as EU-27=100, a variable named GDPS) and the use of water from public water supply (a proxy variable for water demand, named UWPS).

For the purpose of our analysis, we also derived a series of the relative price of water (PWAT), in the considered period, by using and computing the data provided for the

Consumer Price Indices of the Water, sewerage and sanitation services.

By computing and processing these data, in different combinations serving the research objectives, we came to the following regression equations and correlation relationships:

(In the following approach, the LN function represents a natural logarithms procedure used to normalize the variables. The brackets below the estimated coefficients show the values of their t-Statistics)

a) In the first correlation considered, the dependent variable is GDPS, while the exogenous independent variable is UWPS. The regression equation estimation output is:

$$\text{LN}(\text{GDPS}) = -0.521 \text{LN}(\text{UWPS}) + 7.403$$

$$R^2 = 0.9370 \quad (-12.199) \quad (23.156)$$

The coefficient of determination  $R^2$ , which takes a value close enough to 1, as well as the attached statistical tests for regression coefficients and Durbin-Watson test with a value close to 2, statistically and mathematically validate the regression equation (a).

In terms of economic analysis and significance, as seen from the above equation, in Romania, in the considered time-period, the determined variable GDP/capita was inversely correlated with water consumption from the public water supply.

This does not necessarily imply that a public water network is not important for economic development but can also mean that in this period, the restructuring and reforms of the water sector in Romania, have reduced the water waste and water losses from the network, so practically they increased the economic efficiency of water supply networks, nationally.

Well, a most important economic reform in the water sector was the continuous and important increase in the pricing level of the public water services, as it may be noticed from the data in Table 1 above.

It should be pointed out that, before the process of transition to a market economy in Romania, the price of water (utilities) was extremely low (state regulated), close to zero, this situation leading to water waste, low efficiency and overuse of the poorly developed water supply and sanitation infrastructure, with unsustainable prospects.

The process of reform, restructuring, regionalization of the Romanian water sector,

(still in progress) has the ultimate objective of implementing sustainable development and the sustainable water management principles.

The pricing of water seems indeed to have been an important lever of the reform for sustainable water management in Romania, as we shall try to show from the outcomes of regression b):

b) In the second correlation considered, the dependent variable is UWPS, while the exogenous independent variable is the price of water PWAT.

The regression equation estimation output is:

$$\text{LN(UWPS)} = -0.385\text{LN(PWAT)} + 10.181$$

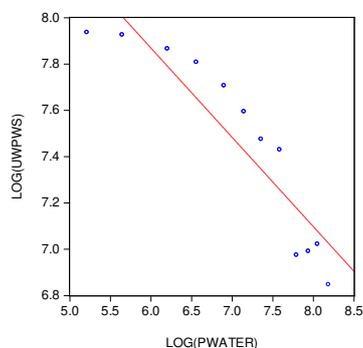
$$R^2 = 0.8400 \quad (-7.248) \quad (26.940)$$

The coefficient of determination  $R^2$ , which takes a high value, as well as the attached statistical tests for regression coefficients, statistically and mathematically validates the regression equation (b).

In terms of economic analysis and significance, as seen from this above equation, in Romania, in the considered time-period, the determined variable UWPS (the use of water from the public water supply) was inversely correlated with the price of water PWAT.

The increase in the volumetric price of water has determined the dramatic decrease of water use (demand) in Romania, which was in 2009 nearly three times (-66%) lower than in 1998.

*Figure 1 Water demand as a decreasing function of the water price (tariff) in Romania*



Source: own computations and correlation analysis.

Of course, these outcomes are quite normal, confirming the neoclassical theory of

a downward sloping demand function of the pricing for a good.

The estimated parameter of -0.385 for the price elasticity means that an increase in water price of one percent results in a decrease in water demand of 0.385 percent. Water demand is fairly elastic of the pricing in Romania, but the parameter fits within the results of other sophisticated research studies, such as the meta-analysis by [6], who found an average price elasticity of -0.41, and a median of -0.35 for a standard deviation of 0.86.

On the other hand, in the more developed EU states, the price elasticity of residential water demand is sensibly lower, with an estimated level of -0.22 in Germany and between -0.12 and -0.17 in Spain [7].

A more interesting and complete insight of the water demand function in Romania may be found in the last part c) of our research :

c) In the third correlation considered, the dependent variable is UWPS, while the exogenous independent variables are GDPS (as a proxy for income per capita) and the price of water PWAT.

The regression equation estimation output is:

$$\text{LN(UWPS)} = -1.402\text{LN(GDPS)} - 0.099\text{LN(PWAT)} + 13.082$$

$$R^2 = 0.9474 \quad (-4.289) \quad (-1.337) \quad (18.327)$$

The coefficient of determination  $R^2$  takes a higher value, while the attached statistical tests for regression coefficients are not very satisfying, suggesting the fact that there is a strong correlation between GDPS and PWAT (indeed, the regulated evolution of the price of water was correlated with economic growth).

#### 4. Conclusions and recommendations

Anyway, as a first conclusion, based on the empirical evidence above, we may state that in Romania, water pricing was and will continue to be a strong economic instrument for water demand management.

Still, considering the vital importance of water and all the incurred water benefits and services for people and communities, we consider that the estimated water demand function is quite steep in Romania; respectively the price elasticity of demand for water and the willingness of consumers to

give up water use, in the face of rising prices, are quite high.

Although we may find some explanatory issues (poverty, poor economic and environmental education of population), this trend may somehow jeopardize sustainable development prospects, at least those of water supply and sanitation (WSS) services in Romania.

Since, as we argue in [8], water is a vital and quasi-public good, and currently in Romania only about 50% of the population has access to public water supply, sewerage and sanitation, (due to the underdevelopment of water infrastructure), the pricing of water should not prevent Romanian people and businesses from consuming the right amount of water needed for a modern and civilized lifestyle and/or technological purposes.

Instead, the efficient and sustainable water pricing should reduce and prevent the waste or loss of publicly supplied water, by ensuring, at the same time, the continuity, further development and maintenance of the water and wastewater services and utilities.

Ideally, a sustainable water pricing should:

- reflect true costs and therefore induce efficient water production and consumption;
- promote the achievement of least-cost solutions for the provision of water service (optimization of water infrastructure and operation);
- be equitable in terms of incorporating cost-sharing practices as needed to enhance affordability of the water service;
- ensure the long-term viability of the water utility.

The prospects of development of the water and wastewater infrastructure in Romania, as imposed by the requirements to comply with the EU Water Directives, eventually with the WFD, impose a further increase of the water pricing, tending to implement the full cost recovery principle [8].

However, a Cost Benefit analysis recently carried out by the Romanian Water Association in relation to water pricing affordability in Romania revealed, as stated by the RWA President [9], that there is little chance for implementing the much-vaunted full-cost recovery principle, at least in the short-term.

Therefore, we believe that implementing sustainable water pricing in Romania, able to

provide an efficient and effective economic instrument for a sustainable water demand and supply management is still quite a challenge, though there may be two circumstances that would ease the burden of higher prices for water consumption in Romania:

- i. Whether there will be a sustained economic growth, able to increase consumer purchasing power;
- ii. Whether the expected unification of the charge for water services, implemented at the newly created regional water operators, would allow for regional cross-subsidization of the tariffs [10].

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# The Modalities to Resolve Conflicts of Interest between Stakeholders

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## Abstract

*The corporate governance is a complex system of relations and interactions, between various interest groups within and outside a company, aiming to maximize its own expectations. This paper discusses the relation between stakeholders and the means of resolving the conflicts between them. We intend to present main types of conflicts emerging within a company, such us: the shareholders-managers conflict, the shareholders-creditors conflict and the conflict between shareholders. Finally, we also intend to present the modalities to resolve the conflicts of interest between stakeholders.*

**Keywords:** Corporate governance; conflicts of interest; stakeholders.

**JEL Classification:** G32, D 23.

## 1. Introduction

Corporations have become a powerful and We may claim that corporate governance is a fairly recent subject. It defines a wide array of senses. Although there are many definitions for corporate governance, the most inclusive of them, so far, is that given by the Organization for European Cooperation and Development (OECD). Personally, I think that corporate governance is a complex system of relations and interactions, between various interest groups within and outside a company, aiming to maximize its own expectations.

The need to regulate the relation between stakeholders (shareholders, managers, employees, creditors and other stakeholders), as well as that of resolving the conflicts between them, has become an issue of incentive for investors, as well as the general public.

Under these circumstances, the pioneering role of the OECD is commendable, seeing as how it managed to synthesize the basic tenets for applying corporate governance in 1999. These principles are meant to support the government efforts to perfect the legal framework and regulate corporate governance, on a national level.

## 2. Relations and conflicts between stakeholders

### 2.1. The relations between stakeholder groups

The term „stakeholders” was poached from Anglo-Saxon scholarly literature and marks all the agents partaking in a relation with the company or holding a stake within the company. In the category we include: shareholders, managers, employees, creditors, suppliers, competitors, central and local tax authorities, unions, the community, in its broadest sense, that includes: the civil society and opinion leaders.

### 2.2. The conflicts between stakeholders

The main types of conflicts emerging within a company are: the shareholders-managers conflict, the shareholders-creditors conflict and the conflict between shareholders.

**a. The shareholders - managers conflict** According to the company’s management theory, managers seek by all means to expand the advantages they might obtain as benefit to their position within the company, without hesitating, for instance, to resort to speculative diversifications in order to increase the size of the company (and as such, their own prestige) or to limit themselves to their subordinates’ initiative, centralizing all major decisions (Berle and Means, 1932).

Likewise, in his „free cash-flow” theory, Jensen states that managers are most often remotely motivated to distribute dividends to

shareholders, opting to reinvest outcome, even in projects with low profitability, in order to maintain control over important resources (Jensen, M.C., 1986). Jensen and Meckling declared that one of the essential references of the agency theory involves the managers' behavioral manifestation in terms of the capital share he holds. The higher the stake, the more interested he is in managing with the objective of maximizing the company's value (Jensen and Meckling, 1976). However, this conflict does not include the need for separation of property and governance. The legitimacy of shareholders, authorizing managers to make decisions, is confirmed, even if agency costs may become a reality.

The conflict of interests between shareholders and managers has always existed due to the fact that competitiveness is not a powerful enough restriction on the goods and services market, so as to motivate managers to work in favor of the shareholders. Moreover, in large corporations, there are numerous shareholders who, individually, do not own important shares of the company's equity. That being said, every shareholder is interested in leaving it to others to control managers, taking into account the associated cost of this responsibility.

Thus, the necessity of protecting managers is even more transparent. They will not accept to effectively execute value generating, dominating investments, if they are not capable of ensuring rent control – remunerations of their management capital (Charreaux, 1997).

In this surmise, managers are nothing more than common stakeholders, whose protection is vital to the existence of the coalition of interests that is the corporation.

**b. The shareholders - creditors conflict** Creditors are only partially protected by the contract signed with the company, because they face a two-fold dilemma. Before the contract they only dispose of a partial disclosure of information and have no guarantee of the validity of the information imparted onto them. After signing the contract, creditors may find themselves in the situation where shareholders will make decisions out of line with their interests and, thus, be subject to a veritable “*moral hazard*” (Diamond, 1984.). Also, creditors

are often incapable of properly understanding the risk of the loan. Creditors will determine their remuneration demands based on the average risk of the loans that raises the issue of adverse selection, because eligible corporations (less risky) are fined by this procedure that benefits companies prone to higher risks.

Four sources of conflicts can be identified between shareholders and creditors:

1. *The dividend allocation policy*: the value of the risk debt is fixed and it is assumed that the company maintains its dividend allocation policy. If the dividends grow, the value of the debt will decrease. As a consequence, the dividend installments contribute to the growth of the average risk of company's assets and of the creditors' reimbursement default risk.

2. *The debt dilution risk*: previous debts were assessed and it is presumed that no other debt will be contracted in the future. If the company contracts an additional, equal or higher degree debt, the value of the previous debt will diminish. Older creditors that lent to the company will sense the risk of bankruptcy depending on the growth of indebt.

3. *The substitution of funds*: the debt is used to finance a riskier project, which leads to a transfer of wealth from the creditors to the shareholders. The latter have the interest of investing in risky projects because they hold an option to buy the economic asset of the company, when the debt expires. By comparison to the options theory, the more important the risk of the investment projects selected by the company, the higher the value of this option. Furthermore, the reimbursement default risk grows for creditors, which signifies a decrease of the debt value.

4. *Subinvestment*: the company might tend to reject positive current net value projects if the sole beneficiaries would be the creditors. Under the assumption that there is an informational asymmetry, the shareholders have no interest of executing such projects that only allow the reimbursement of debt without generating any income.

**c. The conflict between shareholders**

It was discovered that among the company's shareholders, some own important shares of the equity, and other hold

a limited number of shares. That being said, important shareholders who own the majority of voting rights can nominate favorite managers in the context of opposing to the interests of minority shareholders. For instance they may sell the assets to a structure they only partially control, the transfer occurring under auspicious financial terms for the buyers.

There is also a potential conflict between old and new shareholders, which manifests itself during the issue of new shares or hybrid securities. As a consequence, the issue price determines the terms for new shareholders' participation in the company's capital. The latter are only partially informed of the real performances of the company, as they do not dispose of inside information. Moreover, managers act on behalf of the older shareholders' interests, who will not issue shares if their currency is under evaluated. Empirical studies show that the simple announcement of the issue of shares leads to a decrease in company value, which suggests that the financial market perfectly integrates the idea of over evaluating the course of action at the moment of issue. This is why settling this type of conflict between shareholders generally entails a sensible limitation of the use of capital growth and favoring, as an example, debt financing.

### **3. Means of solving conflicts between stakeholders**

#### **3.1. Solving the shareholders – managers conflict**

The separation of the decision making and ownership duties births a constant doubt in respect to the managers' behavior, even if, as previously stated, nothing bars managers from being equal “victims” of the shareholders' decisions, in certain circumstances, or “rooting” strategies from being incompatible with the value generating process.

The solutions to such a conflict can be found by identifying the internal and external mechanisms of the corporation, that aim at inciting and motivating managers into acting exclusively for the interests of the shareholders:

- **The managers' performance-based remuneration system**

For Fama, the existence of a labor market is a way of controlling managers, and in relation to this, we reach a labeling of remunerations based on their performances (Fama, E., 1980.). The means of stimulating managers according to their performances are:

a) **Options** for managers to buy company shares at a certain moment in the future, at a price set in the present. Such a solution is relevant if the price of shares will grow in the future, in comparison to the fixed price of the present. The rationality of this practice lies in the fact that by granting the manager the possibility to buy shares in the future with a price set in the present, managers will do their best to maximize the value of the shares in the future. This practice is used in the period between the 1950's and 1960's, so that later on in 1970 they are proven unprofitable.

b) **Management incentive plans** through performance shares, which consist of offering shares to managers, based on the measure of the performances realized by the company. Three indicators are considered: earnings per share (EPS), the return on assets (ROA) and the return on equity (ROE). This way, the improvement of the company's performances will determine the growth of the shares' price.

c) **Bonuses** granted to managers based on the profit achieved.

- **The administrative power of the Board of Directors**

The Board of Directors is the direct result of the shareholders' vote and disposes of important prerogatives when it comes to controlling managers. In some countries, the Board of Directors has right of veto over certain decisions and preserves the power to revoke its president. For Fama and Jensen it is fundamental that administrative and control powers not be put in the hands of the same persons, which entails the presence of independent external managers (Fama and Jensen, 1983). If this condition is met, agency costs are brought to a minimum and managers are effectively controlled. Much criticism was brought against the Board of Directors, namely against its ability to control managers. On the other hand, managers don't have an obvious direct interest in the company's performance, because their majority only rarely owns a

high percentage of the equity. Sometimes, they are members in various Boards of Directors and don't dispose of the time necessary in order to fully take on their mission. Lastly, they can hold an interest and maintain good relations with the company's management to avoid being exposed to the risk of losing the associated advantages of their position.

- **Voting by proxy**

If the Board of directors is not equipped to effectively control its managers, shareholders will appoint a person to represent them in fulfilling this role. To this extent, if the appointed shareholder considers that the current managers show no signs of high performances, he will resume to propose the changing of the management team, to the other shareholders.

Practically, this operation is difficult to execute, as only one shareholder will have a hard time convincing the rest of the shareholders and gathering enough votes in the General Assembly of Shareholders. It is often found that in such operations the person involved is generally a shareholder holding a low percentage of the equity. The gathering of the major shareholders will benefit from the subsequent benefits of this operation, excepting the case when the shareholder by proxy keeps the advantages appointing a new company management team, for themselves. Furthermore, the replacement of the management team is done in the context of a quasi-total lack of information.

- **The existence of reference shareholders**

The existence of a shareholder holding a significant part of the equity is an effective way of controlling managers. Managers must avoid the diversion from the conduct preset in the contract. Moreover, a reference shareholder cannot lack interest in the company he invested important sums of money in and to this extent, it may be considered that the pressure exerted over managers is a powerful one, so that they might carry on their activity in the interest of the shareholders.

However, the existence of one or several reference shareholders with ownership over significant equity shares will not solve every conflict. The reference shareholder is mainly interested in the advantages associated to the diversification of the portfolio or obtaining

maximum profitability for a given level of risk. Agency conflicts between shareholders occur because important shareholders can influence management decisions to their favor (risk reduction).

- **Public Purchase Offers (PPO)**

Public purchase offers represent a threat to incompetent managers, as they are an effective mechanism for obtaining profit for shareholders. They are also called *hostile takeovers* and occur, mainly, when the company's capital is under assessed, due to bad decisions on the managers' part. Subsequent to the hostile takeover, managers are generally fired, or if kept, they will lose the autonomy had before the takeover. This interests managers in making decisions that will maximize share prices.

The public purchase offer threat is also limited by various factors. In the beginning, certain minority shareholders might be tempted, if they actually believe in the operation's success, not to declare their notes so as to subsequently benefit from a new management team. They reduce the chances of a successful offer. The public purchase offer notice also has consequences on informing other investors about the interest of buying back the company, which may entice offers higher than the tendering price, which in turn diminishes the expected benefit of the operation or even dissolves it.

The company's management disposes of various ways to counter-balance a public purchase offer. Before the offer, it may decide on a particular allocation of the voting rights (multiple voting rights; limiting the voting rights granted to one shareholder; redefining a new position within the board of directors; cumulative vote; the need of obtaining a majority, qualified to authorize a merger etc.), or use the *poison pill* tactic, meaning the obligation for new shareholders to reimburse the debt within a very short time span. After the offer, the company management may decide the majority of the equity to a *white knight*, susceptible of buying shares, and thus launch a counter-attack on the hostile public purchase offers.

- **Choosing a specific financial structure**

This is a way of constricting managers to act in the shareholders' interests. Using debt financing motivates managers, who, in order to repay the debt and avoid bankruptcy, have the obligation to guarantee the quality of the

decision-making process and obtain important results. The financial market capitalizes on the necessity of the indebted company to achieve higher performances, the only means by which it can guarantee the reimbursement of the debt owed to corporations.

In terms of the financial information of the company's external investors, debt signals the fact that managers consider the company capable of assuming on a debt, in the context of the high returns on investments, estimated for the following periods (specifically, managers are very well informed on the company's perspectives for development and dispose of privileged information).

### 3.2. Solving the shareholders – creditors conflict

In order to solve this type of conflict additional protection clauses could be introduced in loan agreements, which will limit the abnormal behavior of shareholders or managers. These clauses refer to:

- **The financing policy:** There are three types of financial decisions that restrict the future behavior of the indebted company:

- a) Creditors request of shareholders, by contract, that in case of bankruptcy, the debt should have the same level of priority as other current or future debts agreed on by the company.

- b) Creditors limit, through certain clauses, the possibility of offering future real notes that might diminish the ability of repaying the debts already contracted. Other, more sophisticated clauses, may deny a new issue of bonds, increasing the company's debts, if the company cannot handle current payments.

- **The dividend policy:** The payment of dividends is not denied, as opposed to their indexing, according to the level of profit obtained.

- **The operation and investment policy:** Certain clauses may impose limitations on the investment policy, the use of assets or mergers, confirming the preservation of a certain asset structure. Creditors want to limit any action of the shareholders or managers, that seeks to replace risk assets with risk-free assets.

- **Information disclosure clauses:** These clauses request the disclosure of financial information from companies, as integrated

part of debt agreements. Regularly, the documents requested for disclosure are financial and tax statements, audited by an independent forensic accounting office.

- **Early repayment clauses:** certain clauses within the contract allow creditors to request the early repayment of all or a certain share of the receivables, before maturity, as a consequence of non-compliance to the commitments made to the creditors in the contract.

- **Convertibility clauses and the use of hybrid securities:** convertibility clauses infer the issue of hybrid securities such as bonds convertible into shares, or bonds repayable in shares. Creditors own a bond with a fixed interest rate or an option to buy company shares, which allows the conversion of their notes into shares. Thus, if there is a wealth transfer made in favor of the shareholders, creditors will equally benefit by exerting their option. Furthermore, the convertible bond offers a lower remuneration as opposed to a classical bond, with the same level of risk.

Hybrid securities may be classified into three categories: quasi-shares, notes offering one or several options and quasi-debts.

The first category of hybrid securities, *quasi-shares*, results from a modification brought to the basic components of an ordinary share (voting right and remuneration right). We distinguish: investment certificates, priority dividend shares and shares with double voting right.

The notes that include an optional component contain at least one asset and one option. There are numerous combinations for this: convertible bonds, share subscription bonds, bonds repayable in shares etc.

The third category “*quasi-debts*”, integrate, beside loans from shares, two categories of repayable notes: buy-in notes and indefinite-term subordinated notes.

Widely used in the 1980's, hybrid securities allow for numerous conflicts to be solved between various equity stakeholders. These instruments result from deconstructing and putting back together simple assets, as they can be adapted to the needs of the investors and companies. Their intermediate character determines their exclusion in debts or equity.

#### 4. Conclusion

This review presents the main types of conflicts of interest involving a company and their ways of solving.

Conflicts of interest between shareholders and managers have always existed, because competition in the goods and services is not a strong restriction to induce managers to work for shareholders. Resolving such a conflict finds solutions to identify internal and external mechanisms enterprise, namely: the managers' performance - based remuneration system, the administrative power of the board of directors, vote by proxy, the existence of reference shareholders, public purchase offers and choosing a specific financial structure.

Conflicts of interest between shareholders and creditors arise because creditors have only a partial information and have no certainty about the reliability of the information communicated to them. The sources of these conflicts can be: the dividend allocation policy, the debt dilution risk, the substitution of funds and subinvestment.

To solve this kind of conflict may introduce additional protection clauses in credit agreements relating to: the financial policy, the dividend policy, the operation and investment policy, information disclosure clauses, early repayment clauses and convertibility clauses and the use of hybrid securities.

Conflicts of interest between shareholders occurs first because some have a large share of capital, while others are owners of a limited number of shares and on the other hand there is a potential conflict between old and new shareholders, which is when issuing new shares or hybrid securities. Setting this type of conflict between shareholders involves minimizing the use of capital growth and favoring, for example, debt financing.

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## Attitudes in Romanian Firms’ Organizational Behavior Regarding Government Environmental Programs

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### Abstract

*The huge challenges for ensuring future energy supplies needed to global development imposed the initiation of a series of drastic changes to cope with diminishing conventional energy resources, which tends to endanger the mankind socio-economic development. In this context a shift of energy policies towards the use of green renewable technologies can be noted. At a national level, Romania’s Energy Security Strategy emphasizes more than ever the importance of this type of technologies, public authorities wanting more than ever to encourage their rapid adoption both at the individuals and economic agents’ level. The present study evaluates the actual impact of one of these programs, called Casa Verde and analyzes the weaknesses of its implementation in three counties located in southern Romania: Arges, Olt and Teleroman. First, a comparative analysis between these counties is presented and then the results are examined in view of the nationwide implementation of the aforementioned program.*

**Key words:** global economic crisis, economic development, renewable energy, energy security of the country, funded programs.

**J.E.L. Classification:** M31

### 1. Introduction

In the last century, intensive use of energy from fossil fuels (oil, gas, coal - by burning) cause significant environmental degradation being the most important source of carbon dioxide emissions (gas causing the greenhouse effect), which prevents radiation dispersion and contribute to global warming and the thinning of the ozone layer.

In the modern world of XX and XXI centuries, the thirst for energy from fossil fuels derived from oil is one of the major causes of global and regional conflicts. A global movement focusing on sustainable energy (solar, wind, hydro, wave, geothermal, bioenergy, biodiesel) was born in order meet world’s growing energy needs. This new methods of obtaining energy produce far fewer emissions, reduce chemical and thermal pollution and are available virtually anywhere in the world.

Average annual solar radiation in Romania ranges from 1100 and 1300 (kWh / m<sup>2</sup>) for more than half of the country [4]. Solar thermal potential is estimated at 1400 (ktone / year). Solar radiation on the horizontal surface of Romania is about 200 million (GWh / year).

The atmosphere is optically speaking, a turbid medium, where besides the constituent gas molecules, there are many particles of different origins [5]. Entering into such an environment, direct incident solar radiation undergoes extinction due to the following factors:

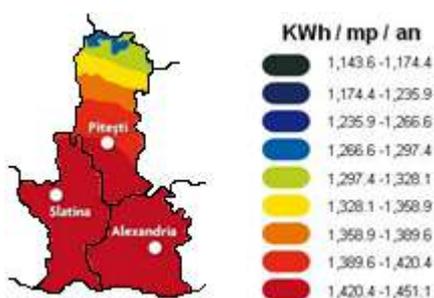
- extinction induced by of aerosol, meaning, natural or anthropogenic dust and water

droplets suspended in the atmosphere;

- molecular diffusion in atmospheric gases;
- selective absorption due to permanent gases having constant concentration;
- absorption in water vapors;

Atmospheric opacity is expressed by the opacity factor called LINKE. This is calculated from radiometric stations in the network, 6,9,12,15,18 hours in true solar time, when direct measurements of solar radiation are made on normal surface, in clear sky conditions (sky completely cleared of clouds or up to 3 tenths clouds provided the clouds are at a distance of at least 5 ° from the solar disk).

Figure 1: Solar radiation map in the counties used in the current study



Source: [8] –authors

The study of solar radiation shows that from a total of nine levels of radiation, six are present in the Arges County, divided as follows:

- about 1/3 of the territory (north county) is a radiation from 1266.6 to 1358.8 [kWh / m<sup>2</sup> / year];
  - about 1/3 of the territory (mid county) has a radiation from 1358.9 to 1420.3 [kWh / m<sup>2</sup> / year];
  - about 1/3 of the territory (south county) has a radiation from 1420.4 to 1451.1 [kWh / m<sup>2</sup> / year];
- To better outline the solar energy potential of Arges County, meteorological data were used, regarding [6]:

- global solar radiation flux intensity [kW / m];
- average monthly solar energy [kWh / m<sup>2</sup> / day];

Olt and Teleorman Counties receive the maximum possible radiation in Romania which ranges from 1420.4 to 1451.1 [kWh / m<sup>2</sup> / year];

Global solar ultraviolet radiation, regardless of time of year, has a diurnal

evolution in intensity from morning to noon, when it usually peaks. In the afternoon, ultraviolet radiation has downturn evolution.

In Romania, for financing the investments in energy from renewable sources producing facilities, the Environmental Fund can be used. The national strategy on energy security takes into account all possible forms of energy. This can take the form of national resources that must be exploited rationally and also imported resources. Under these conditions, developing a law package aimed at providing country's energy security for the medium and long term becomes a necessity.

According to the latest research, published by Eurostat [7], the proportions of energy sources used in Romania has changed significantly in the last ten years. Romania's energy balance is composed of 36.1% natural gas, 28.5% oil, 20.8% coal, 3.4% hydroelectric power, 3.2% nuclear energy and the difference of 7, 6% of other energy sources.

Among the programs funded from the Environmental Fund it can mentioned:

- National incentive program for car fleet renewal;
- program for installation of heating using renewable energy, including replacement or addition to traditional heating systems (The "Green House" - Individuals, The "Green House" - Companies)
- The program to reduce the impact on the atmosphere and air quality control;

The second program which is specifically addressed to individuals provides fixed amounts financed from the Environment Fund budget, depending on the type of installation [9]:

- up to 6,000 lei to install solar panels;
- up to 8,000 lei for installing heat pumps;
- up to 6,000 lei for thermal power plant based pellets, briquettes, wood chips, scraps and vegetable waste, agricultural, forest, forest;

## 2. Research Methods

The role of the present study is to assess the degree of promotion, implementation and feedback from the public and traders for the informations regarding Casa Verde program for individuals and businesses transmitted by

the Government respectively the Ministry of Environment through Environment Fund Agency.

The study was performed using a simple random sampling method because the sample construction is done without imposing any prior restriction; each component was extracted from total community. That result in a sample which tends to have a distribution of the studied characteristics similar to that of the existing community.

S.C. Black Sea Suppliers LLC was established in 1996 in Constanta, as a limited company with a capital of 5,960,540 Lei [10].

Currently the company has 31 branches in Romania and neighboring countries: Bulgaria, Moldova and Ukraine.

The annual turnover of the company for the Romanian market, was around 80 million, also it has over 540 employees and a fleet of over 270 cars (cars, trucks, forklifts). S.C. Black Sea Suppliers LLC holds an ISO 9001 certified since 2005.

The company has over 250 suppliers' worldwide, main ones being located in:

- Europe: Italy, Turkey, Czech Republic, Germany, Greece, Austria, France, Lithuania, Spain, Netherlands, Bulgaria, Yugoslavia;
- Asia: China, South Korea and Taiwan;

The product range consists of:

- strategic products: boilers, heating boilers, radiators (steel, iron, aluminum), towel radiators, copper pipes, boilers, air conditioning;
- related products: solar systems, pipes and fittings: iron, steel, copper, multilayer, PPR, HDPE, PP, PVC, circulation pumps, water pumps, expansion tanks and reservoirs, valves and fittings of iron, batteries and sanitary;

The targets of the current study are the company' clients, active between 2005 and 2010, geographically located in the Arges, Olt and Teleroman Counties.

The study was conducted on a sample with the following characteristics:

- Size: 82 active clients (56.16%) randomly selected from a total of 146 active clients;
- A turnover between 2005 and 2010 above 15,000 lei;

The study was conducted from 4 to 15 April 2011.

Data was collected with the aid of a questionnaire at S.C. Black Sea Suppliers LLC offices in Pitesti and at the customer's location. In completion of the questionnaire, study subjects were assisted by a sales agent or technical commercial representative resulting in a better accuracy of the collected data.

The length of interview period was 2 weeks and the average completion time of the questionnaire was 10 minutes.

The analysis of county level data shows the following:

*Table 1: Counties ranking by allocated amounts*

		Applications			Allocated Amounts [12]
		Submitted	Approved	Rejected	
AG	I.	15	24	5	3.311.140 lei
	L.	10	13	18	3.471.994 lei
OT	I.	23	20	41	2.482.367 lei
	L.	24	19	15	3.862.281 lei
TL	I.	33	33	32	2.212.205 lei
	L.	27	28	16	1.030.230 lei

Sursa: [11] –authors

The rejected cases by individuals in the county of Arges are explained by:

- Lack of knowledge about the documents required to complete forms
- Believe that the applications will be approved even with incomplete documents
- Seek to circumvent the law (they don't own the properties or have not paid their taxes);

It can be noted that in the counties of Teleorman and Olt individuals:

- Do not have enough financial resources to pay a minimum difference;
  - Believe that funds are accessible only if you're politically involved.
- The legal entities of Olt County (12th place in the overall country ranking) are very interested in implementing green technologies, a fact which is explained by the amount that was approved. Arges

County firms' interest in green technologies (14th place in the overall country ranking) is close to that of the individuals. For Teleorman County (27th place in the overall country ranking), looking at the total amount of funds obtained, a total lack of interest (individuals and companies) to promote these technologies can be noted, although the region has a very favorable geographical position to implement them (similar to the neighboring county of Ilt).

### 3. Main findings

Analysis of the results was made taking into account the three different methods of completing the questionnaire: the questionnaire completed by administrator - 49, questionnaire completed by the delegate employee from the firm part - 33, generally completed questionnaire.

A first observation is that employees can identify better than the management the environmental problems facing our country. About 73% of the companies are supporting and believe in the benefits of using renewable energy systems with low pollution. They have heard about The Green House Program (funded by government grants) that applies to individuals, businesses and public institutions.

Sources of information about this program were, in order of their score: Press - 34 pts, Internet - 33 points, TV - 32 pts, other - 21 pts, Radio - 13 points, Magazines - 9 points. 20 firms did not respond. Although 73% of companies know about The Green House Program, only 58% have the same knowledge about the procedure for submitting the document for obtaining the grant. This can be noted as a weakness for this companies, as competing firms, knowing how to access the funds, can capitalize on this lack of knowledge by better explaining the advantages of the scheme to their customers.

It can also be noted that the company's staff has competent knowledge about the technical characteristics of green equipment that they sell.

Regarding the individuals, it can appreciate that level of interest in renewable

energy is medium. At a national level those more interested in using renewable energies are the individuals from Bihor County. They have completed a total of 796 applications, 676 of which were approved, resulting in a ratio of 84.92%, between submitted and approved applications.

Looking at the same ratio for the counties used in the present study, the situation is as follows:

1<sup>st</sup> place: Ilt - 97.94%;

13<sup>st</sup> place: Teleorman- 89.52%;

41<sup>st</sup> place: Arges - 62.35%

Only 37% of the individuals who are interested in renewable technologies know the amount of grants they can receive. A better score could be achieved through an aggressive advertising campaign by the Romanian Government which is absent to the present day. This claim is support by the fact that the number of applications filed nationwide, between July 1 and December 31, 2010 for individuals is 10,266 of which 8,627 were approved, with a success ratio of 84.36%.

Firm's customers consider that the presentation made by the engineer or sales agent was made in a professional manner, both in terms of the equipment characteristics and benefits (profits) that they can achieve by buying them. These benefits are further enhanced by the current global economic crisis which influenced the consumers purchasing decision towards systems with high energy efficiency and low consumption costs.

### 4. Conclusions

Romanian State institutions, namely the Government, Environmental Protection Agency, the Environment Fund Administration and National Environmental Guard should promote and educate the people and businesses in order to encourage purchase and use of renewable energy sources, to act wherever possible to minimize pollution and severely punish those who do not want to adopt such technologies.

The responses received from S.C. Black Sea Suppliers LLC customers show that the individuals, legal entities and state institutions are very reticent in purchasing and using these systems. In a population of 21,680,974 inhabitants, about 7,226,991

families (considering a family size of 3 members) 10,226 applications were filled in a six months period; so a 0.014% interest rate.

Taking into account the grants subsidies, interest must be at least the extent size of these funds (amounting to 110 million lei for individuals) and for businesses to an extend of 80% of the total investment, the total approved value being 109,412,379 lei. The procedure for allocating grant amounts for individuals, for each county was based on the following reasons:

a) The amount of 110 million lei was divided to the Romanian population of 21,680,974 inhabitants, resulting in a sum of 5.073573 USD / capita;

b) This value was multiplied by the number of inhabitants of each county, obtaining the actual amount allocated for that county;

From study results it can be noted that the approval of application and the amount of the actual grants are not influenced by the political affiliation of municipalities or county councils, especially regarding businesses. This indicates the concern of all political parties to encourage purchase and use of renewable energy sources.

In the first two weeks after launching the Green House Program, three counties had the highest rate of funds absorption: Bihor, Covasna, and Harghita because of the UDMR direct implication in promoting the program. Also from 2011 the Green House Program will be extended to public and religious institutions [13].

Table 2: Estimated value of an installation for domestic hot water

Value	Capacity (persons).	Complexity and quality levels
5.300	1-2	<b>medium</b>
6.000	2-3	
8.300	3-4	
11.000	4-6	
14.000	6-8	
6.30	1-2	<b>high</b>

0		
7.200	2-3	
9.300	3-4	
13.000	4-6	
4.000	3	<b>low</b>
4.500	4	
7.000	6	

Source: S.C. Black Sea Suppliers LLC

The structure of individuals who access the Green House Program is comprised of people who have worked or are working abroad and who are informed about the operation and advantages of alternative technologies; individuals who are seeking to reduce their bills by purchasing this equipments; people who believe that alternative technologies are always a saving solution opportunity.

An example of public disinterest for Green House program is reflected by the following situation: the budget for Iasi county was reduced by more than 50% due to the fact that there hasn't been a sufficient number of applications requests and funds were redistributed to other counties [14], with higher applications numbers: Bihor (doubling the funds, from 3 mln to 6.3 mln), Giurgiu (three different increases of funds), Brasov (two increases of funds), Salaj, Arad, Valcea.

People must realize that the money going to the businesses that sell this equipments can help them overcome the crisis and the economic recovery as a whole even for a short a period. This results in more wealth coming back to every citizen of Romania, decrease pollution and a present socio-economic growth without compromising the perspectives of future generations for development; in other words, a sustainable development.

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## Intermediate Products' Trade and Supply Chains

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### Abstract

*It is known that the intermediate products trade, as part of the global trade, is growing due to the international externalization. Companies divide the production activities and develop networks based on comparative advantages on a large scale. For that purpose, they take into account the legal situation in the target-countries for externalization. Therefore they analyze the intermediate goods trade structure trend versus other types of goods for the EU-27 countries in the last decade. Based on the common descriptive analysis methods in the specific economic literature, the analysis stress the intermediate goods trade models that lead to an extension of the intermediate goods trade.*

**Key words:** intermediate goods, supply chain, international trade, externalization

**J.E.L. classification:** F14

### 1. Introduction

Multi-national nature of products is not only a specific feature of high-tech products such as mobile phones or cars. It is rare that a product is manufactured entirely from components or inputs in the country where it is assembled and sold; at least some components or services involved are often purchased from abroad. This is the case of direct inputs, wherein companies buy intermediate components for production from domestic or foreign markets. A component of a particular country may already include other components from other countries, and they are subsequently used indirectly in production. In another cases, companies send high-tech components in countries where the final product assembly takes place. The

complex nature of supply chains at individual products level was documented in a series of case studies for different products such as T-shirts (Rivoli, 2004), Barbie doll (Tempest, 1996), computers (Kraemer and Dedrick, 2002), iPod (Linden, Kraemer and Dedrick, 2007, Varian, 2007) and Boeing (Grossman and Rossi-Hansberg, 2009).

The purpose of the above mentioned studies and our analysis is to highlight the relative importance of intermediate products trade within the world trade for the EU-27 and individual groups of countries, its specific structure, and its trends over time. Therefore we shall try to answer the following questions: What is the share of trade with intermediate products in the overall trade, both exports and imports? Have the share of trade in intermediate products changed in time and if so, was it caused by changes within sectors or between sectors? We will analyze the patterns of specialization regarding the trade with intermediate products of the countries. We will also analyze the amount of the two-way trade and geographical structure of intermediate products over time.

The importance of intermediate products trade as for industries that use them is analyzed from different points of views: What is the size of intra-industrial link within certain industry groups, including service industries, and - most important for the present study - what is the size of the imported intermediate products into these industry groups and how much has it changed through time?

The economic crisis had a serious impact on trade flows, and perhaps the intermediary products trade might have played a special role. The impact of the financial crisis on intermediate products trade is further analyzed, addressing the following questions: To what extent intermediate goods trade was

more affected than other product categories? Greater impact on intermediate products trade results from commercial decline of industries with high levels registered in terms of inputs and components trade, or was there a rift that led to disruption of the overall supply chain?

These questions must be addressed on different levels of analysis: the global economy, for certain industries or groups of products, and finally, the individual companies or products. Aggregated to higher levels, the complex nature of international relations is reflected in particular in business models that reflect the aggregate supply chain. Therefore, this study contains analysis on different levels of aggregation, using detailed trade information, statistics and information from input-output. Each of these sets of data are important. Detailed trade data per product enables product differentiation in terms of their use as intermediate components, industrial goods or consumer goods.

However, the single use of trade statistics does not provide a complete image of supply chains. In particular, it does not reveal industrial differences regarding the structures source. The reason is that imports of intermediate goods cannot be attributed to industrial people who use trade statistics. For example, even there is information on imports of a specific product; the commercial information can not indicate which industries have imported products, or the extent to which imports are used in the production process. This issue can still be studied using information from input-output tables as discussed in detail below. Regarding specific products, supply chains and strategies companies can be revealed using detailed case studies analyzing source structure, national or international, for each individual component of the product.

One can distinguish patterns of trade in intermediate products. Production structures adapt and adjust quickly to the source structures and to international production networks from abroad. This is a prominent feature of globalization. Therefore, it is shown that the intermediate goods trade as share of global trade is increasing due to international outsourcing. Companies distribute their production activities and develop their supply chains in different

locations depending on comparative advantages in a broad sense. The legal situation of potential target countries for outsourcing is taken into account as well. Thus, these trends in intermediate products trade are analyzed versus other types of trade for EU-27 countries over the last decade. Descriptive analysis is based on common methods and specialized literature, with emphasis on patterns of trade in intermediate products leading to the extent of intermediate products trade.

## **2. Intermediate products' trade quota in total international trade**

To support with documentation the relative importance of trade for the EU-27 and individual Member States, Table 1 shows the products' shares imported and exported in total imports and exports amount for each of the four categories of products in 2008. Share of intermediate components imported for the EU-27 is 53.7%, with the largest share of imports. Consumer goods represent the second category, with 22.6%, followed by industrial goods (17.6%). This large structure of imports is found in most countries, with few exceptions. Along with Germany, Slovenia, Poland, Czech Republic, Hungary and Slovakia have the highest share of intermediate products. One explanation could be that these countries are specialized in manufacturing and industries of these countries find production networks from abroad as important. This will be discussed in detail below.

Table 1 shows that exports of intermediate products represent an important part of trade for all countries. Models of intermediate products exports are compared with other categories of goods. Rates for different categories of products for the EU-27 are very similar to those for imports. Intermediate goods represent more than a half of exports, with a rate of 53.7, while exports of consumer goods and industrial goods represent 22.6%, 17.6% respectively.

Large shares of imports and exports of intermediate products in nearly all countries show that a typical distinction between outsourcing and target countries is not useful, so that such classifications must be made carefully. In addition, this indicates the existence of a significant intra-trade amount,

an aspect that we shall discuss in detail below.

Table 1. Import and export quotas for end-use categories in 2008  
%

Country	Imports				Exports			
	Intermediate product	Consumer products	Capital goods	Mixed category	Intermediate product	Consumer products	Capital goods	Mixed category
AT	54.2	22.0	17.8	6.0	55.7	18.1	21.6	4.6
BE	55.4	24.8	12.2	7.6	55.8	25.6	10.6	8.0
BG	52.4	19.6	21.5	6.5	61.9	24.6	8.4	5.0
CY	45.7	29.2	12.9	12.2	34.8	48.0	11.6	5.7
CZ	59.5	17.7	19.7	3.1	55.0	15.2	21.9	7.9
DE	58.0	19.3	17.8	4.9	49.0	16.0	23.8	11.1
DK	48.2	27.4	19.9	4.5	41.8	35.7	20.9	1.6
EE	51.9	21.7	15.0	11.4	58.0	20.9	11.6	9.5
ES	55.2	23.6	14.3	6.9	50.2	24.5	11.9	13.4
FI	51.8	19.2	21.6	7.4	53.0	7.4	33.9	5.8
FR	52.6	25.0	16.0	6.4	49.1	25.6	19.0	6.2
GB	46.8	28.1	17.3	7.7	50.7	22.8	17.3	9.3
GR	38.7	34.5	20.2	6.7	54.5	35.3	9.6	0.6
HU	60.8	15.4	19.5	4.3	46.7	19.5	26.6	7.3
IE	44.5	25.8	24.4	5.3	53.0	30.9	16.0	0.1
IT	54.7	22.9	14.3	8.2	50.2	26.8	19.4	3.5
LT	46.7	24.7	20.2	8.4	52.4	22.2	12.0	13.3
LU	43.8	15.9	32.0	8.3	50.6	9.5	37.8	2.1
LV	46.2	27.3	18.5	8.0	56.6	26.5	13.6	3.3
MT	59.4	26.4	9.6	4.6	68.2	22.2	8.2	1.4
NL	51.1	20.3	24.7	3.9	52.1	20.3	24.1	3.5
PL	57.5	17.4	20.2	4.9	51.8	28.6	13.0	6.6
PT	50.7	26.0	16.5	6.8	53.3	28.4	11.5	6.8
RO	53.9	18.7	21.4	6.0	57.8	21.8	12.8	7.5
SE	55.1	21.7	17.9	5.2	58.1	15.4	19.9	6.6
SI	56.6	16.7	16.2	10.5	51.7	22.8	12.7	12.8
SK	62.3	17.1	15.8	4.8	47.7	23.9	11.1	17.4
EU-27	53.7	22.6	17.6	6.1	51.2	21.6	19.6	7.6

Source: Eurostat COMEXT, The Vienna Institute for International Economic Studies (WIIW) calculation

So far, analyzes have focused on the situation in 2008. Public and academic debates on trade with intermediate products focused on changes in the importance of intermediate products trade and the relative importance of production networks across the borders. In this regard, Table 2 presents an index of nominal import and export values

for 2008, expressed as an index value in 1999 was equal to 1. Those amendments on rates are expressed in percentage points for the four categories of end-use between 1999 and 2008.

Table 2. Changes at import and export levels and of import and export quotas for end-use categories for the EU-27

Index 1999=1		Change item In percentage points.							
		Intermediate product	Consumer products	Capital goods	Mixed category	Intermediate product	Consumer products	Capital goods	Mixed category
Imports		1.85	1.82	1.55	1.49	2.75	0.74	-2.38	-1.12
Exports		1.87	1.84	1.64	1.69	1.99	0.46	-1.94	-0.51

Imports of intermediate goods rose faster than other categories of goods by 85 %, followed by imports of consumer goods, which increased by 82 %. This resulted in a higher share 2.75 of intermediate goods in 2008 compared to the year 1999, consequently, shares of industrial goods and mixed products category declined. However, some individual countries have registered higher growth in terms of import value of this intermediate period, for all products. This group of countries consists mainly of EU-12, wherein the growth tends to be over 3 percent. Imports increased for these countries in terms of other product categories. Therefore it could be more important to consider whether the structure of imports has changed over time, as indicated by the rates.

Interestingly, the share of imported intermediate goods fell for a number of countries. This group also includes some countries from Member States, for example: Romania, Hungary and Bulgaria, along with EU-15 countries such as Britain and Finland. Another group of countries recorded growth rates of intermediate goods. This group includes Germany, Spain, Austria, Italy and Sweden, if we mention only some of the EU-15, but also Slovakia, Slovenia, Czech Republic and Poland. Thus, although there was a general tendency towards a higher share of imported intermediate goods, almost half the EU-27 countries experienced a decline in terms of share of imported intermediate goods and the extent to which these changes were significantly different in these countries. It may be noted that these general trends are the result of the economic crisis that hit the world economy in 2008.

A similar pattern, though of different scales, can be found in case of changes between 1999 and 2007. Exports of intermediate goods in the EU-27 exhibited the highest growth rate, followed closely by exports of consumer goods. Rates of exports were higher than those of imports, although the difference is relatively small for intermediate goods and consumer goods in particular. Specific patterns of individual countries in terms of product categories are rather mixed. It should be, however, noted that growth rates for EU-12 are often large for the groups of products other than intermediate goods. This group of countries started from a relatively low level, what partly explains the high growth of rates. In the EU-15 exporting countries such as Germany have registered increases slightly higher than the EU-27 average in terms of product categories. However, higher exports to other countries like Britain, France, and Italy have increased in average growth rate. Finally, the table presents the average of differences between industrials regarding these patterns. Table 3 shows the share of intermediate goods imported and exported in total imports and exports amount by industry sector of EU-27. Imports of intermediate goods vary from almost zero for the tobacco industry and clothing, up to very high rates of up to 100 percent for industries producing base metals. It seems that these models are relatively stable over time and quite similar. Correlation analysis shows correlation coefficients for all cases above the value of 0.8 and in most cases above the value 0.9. Export structures are very similar to those for imports, as it is shown in Table 3.

*Table 3. Shares of imports and exports of intermediate industries achieved in 2008 for EU-27, in percents.*

No.	Products	Imports	Exports
15	Food and beverage	22,5	17,0
16	Tobacco	0,9	0,4
17	Textiles	50,8	62,5
18	Garments	0,8	2,3
19	Leather	12,3	14,4
20	Wood products	95,2	97,9
21	Pulp and paper	83,4	80,1
22	Publishing	26,7	30,7
23	Coke	92,5	77,1

24	Chemicals	69,8	63,5
25	Rubber and plastic	72,7	73,4
26	Other non-metallic products	90,0	91,1
27	Basic metals	100,0	100,0
28	Metal products	80,3	81,5
29	Machinery and other equipment	43,6	39,7
30	Desk/ office items	17,4	19,0
31	Electronic equipment	75,7	73,3
32	Radio and TV	37,6	32,6
33	Tools	16,1	15,4
34	Vehicles	37,7	35,1
35	Transport equipment	46,4	36,2
36	Furniture	19,0	18,4

*Source: Eurostat COMEXT, WIIW calculation*

### 3. Origin and destination of intermediate goods

Intermediate goods may come from different countries or groups of countries worldwide. Table 4 provides information about groups of countries from which intermediate goods come, and about the countries where they are exported. Considering the overall EU-27 situation, one can observe that most of the intermediate products are from EU-15 countries origin. As for other countries, like the advanced OECD countries, they have recorded 11.1 percent, EU-12 and BRIC countries recorded high rates as well, 8.7, while Asian countries registered only 3.8 percent. For the other groups of countries, variation in the EU-27 countries is even higher. Thus, in 2008, nearly 70 percent of intermediate goods came from the EU-27.

Source structures for intermediate goods are somehow different from those in other categories. Groups EU-15 and EU-12 record 70 percent of imports of intermediate goods, consumer goods and industrial goods, and even a greater share for the category of mixed goods, 84.6 percent. But there are some differences in terms of other countries-source partner for example. BRIC countries recorded 13.5, respectively 13.0 percent for consumer goods and industrial goods, but only 8.7 percent for intermediate products. On the other hand, advanced OECD countries have relatively high rates, 11.1 percent for intermediate goods and industrial supplies 13.7 percent.

Table 4. Import structures, end-use categories, and partner states for EU-27 in 2008, in percents.

	EU15	EU12	OECD advance	Asia	BRIC	RoW
Imports						
Intermediate	60,9	8,7	11,1	3,8	8,7	6,7
Consumer goods	59,0	8,8	7,8	3,7	13,5	7,3
Industrial goods	55,1	6,8	13,7	7,7	13,0	3,7
Mixed category	73,9	10,7	8,8	2,2	1,1	3,3
Exports						
Intermediate	58,1	10,1	11,6	3,3	5,9	10,9
Consumer goods	62,8	8,4	13,4	2,1	4,3	9,0
Industrial goods	48,6	9,2	12,8	3,7	9,9	15,7
Mixed category	57,0	6,9	18,2	1,2	5,3	11,4

Source: Eurostat COMEXT, WIIW calculation

Similarly, most of the exports of intermediate goods in the EU-27 countries are destined for the EU-15 countries. EU-15 share is 58.1 percent for the EU-27 and thus it is slightly reduced compared to imports. EU-12, advanced OECD countries and the rest receive a tenth each EU-27 exports. Share of EU-27 exports to the BRIC countries is 5.9 percent, while only 3.3 percent of EU-27 exports are destined for Asian countries. In addition, the share of exports from EU-12 countries to other EU-12 countries is also very high in most cases. Along with results of import structures, this suggests that there is also intra-regional trade in intermediate goods between EU-12 countries, indicating that outsourcing is important not only between advanced and less advanced economies, but also between countries with a similar development.

A comparison of geographical patterns for EU-27 exports to the four categories of products indicates that exports of consumer goods to the EU-15 is high, 62.8 percent, compared to 58.1 percent of intermediate goods and industrial goods 48, 6 percent. EU-27 exports and industrial intermediate goods to EU-12 countries are higher than other goods. This pattern is reversed for advanced OECD countries. For other groups of countries, exports of industrial goods are more important, especially the BRIC countries and rest of world category.

Below it is considered whether this model is stable. Table 5 provides information for EU-27 over the period 1999-2008. EU-15 and advanced OECD countries experienced large declines in the market shares of total

EU-27 imports, -4.6, -5.3 percentage points respectively, while the EU-12 and BRIC countries have gained market share, 3.9, 4.9 percentage points respectively. Considering the EU-27 countries, there is a significant change in imports from the EU-15 imports from the EU-12. Again, there is a considerable difference on geographical patterns changes. A common feature is that the EU-12 and BRIC countries have gained market share in all countries, while the advanced OECD countries have lost market share.

It remains to consider whether these changes are similar for all categories of products or if a specific model for intermediate products. EU-15 countries have lost market share in all categories, but they were significant for industrial goods and mixed goods category. Similarly, advanced OECD countries have lost market share in terms of industrial goods, -9.52 percent, and intermediate goods, -5.32 percent. BRIC countries have gained market share especially in terms of industrial goods 9.64 percent, this percentage is similar to the size of the decline in OECD countries. Market share of BRIC amounted to 5.21 percent for consumer goods and 4.94 percent for intermediate goods. Finally, EU-12 countries rank second in terms of market share, with 5.98 percent for mixed goods category and 3.18 percent for consumer goods.

Thus, in this period there was a significant change in the market in Europe, the EU-15 to EU-12 countries as suppliers of intermediate goods. However, EU-12 countries have started from a relatively low level of exports. It is interesting to note that these increases and losses were of the same size. In the same time, there was a significant shift in the BRIC countries against advanced OECD countries. Thus, one can observe a shift in EU structures and source for EU external import models.

Table 5. Changes at import and export levels and for end-use categories for source region and for the EU-27, 1999-2008 (in percent points)

	EU15	EU12	OECD advanced	Asia	BRIC	RoW
<b>Imports</b>						
Intermediate	-4,57	3,87	-5,32	-0,81	4,94	1,89
Consumer goods	-3,06	3,18	-1,93	-2,49	5,21	-0,90
Industrial goods	-5,31	4,22	-9,52	-0,23	9,64	1,20
Mixed category	-5,87	5,98	-2,16	-0,46	0,67	1,84
<b>Exports</b>						
Intermediate	-5,06	3,90	-3,42	-0,62	3,09	2,11
Consumer goods	-3,86	3,82	-2,86	-0,06	2,46	-0,50
Industrial goods	-10,95	4,59	-3,95	0,02	6,11	4,17
Unclassified	-14,50	3,98	-1,38	0,49	4,75	6,66

Source: Eurostat COMEXT, WIIW calculation

#### 4. Conclusions

As it is shown above, the geographical pattern of exports to EU-27 has changed in the last 10 years. EU-27 export quotas to the EU-15 advanced OECD countries and Asia have declined, while the EU-27 export share rose to EU-12, BRIC and Rest of the world. With few exceptions, these models can be identified for individual EU-27 countries. Considering the EU-27 change in the geographical structure of exports for product categories, it can be noted that exports to EU-15 show big declines for industrial goods and mixed goods category. Export quotas have increased for these categories. Changes are similar to the types of products for EU-12 countries, advanced OECD countries and Asia.

These changes in market shares can be related to changes in unit values reflecting the relative cost advantages of emerging or increasing quality. This problem is analyzed through changes in unit value ratios and market shares between 1999 and 2008. Analysis indicates that the EU-12 countries have improved the quality of goods exported to EU-27 markets; a similar pattern is seen for BRIC countries, although with a less pronounced improvement in quality. These models are similar to product categories and appear to be more pronounced in advanced technology industries (high tech) in general.

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## Comparative Advantages of the Intermediate Products’ Trade

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### Abstract

*Intermediate goods trade analyzes indicate their relative importance compared to other product categories and their dynamics over time.*

*The industry size means specialization models, outlines general patterns and volumes of intermediate goods trade for individual countries.*

*The results indicate that intermediate goods trade can serve as an important vehicle for trade integration in world markets and allow countries to overcome adverse initial patterns of specialization, thus allowing dynamic changes in the structures of comparative advantage through learning effects*

**Key words:** comparative advantages, intermediate goods, international trade, supply chain

**J.E.L. classification:** F14

### 1. Introduction

Financial and economic crisis hit the international market quite strongly in terms of intermediate goods (including spare parts and components), totaling a loss of about 50% of international market. It had also disrupted some of the established international supply chains (e.g. the automotive industry) and resulted in some changes in the sources of the strategies of multinational corporations and shift to domestic suppliers. If confirmed, this may have lasting consequences - at least temporarily restricting the internationalization activities of certain companies in certain industries and may

delay recovery of certain industries.

EU companies R&D and innovation activities, especially in high-tech industries are still predominantly national, but turn increasingly more in internationalized corporations, as the need to adapt products to the requirements of foreign markets brings product development standards closer to local markets.

Public programs may be required to provide additional funds for start-up and early stage finance.

Creative industries have great potential for strengthening economic growth and creating for new jobs. They have been for a long time among the sectors with the largest growth in the EU, playing a key role in global value chains and drive innovation. In addition, the number of creative occupations is increasing within and outside the creative industries, for example, spread and creative occupations in other sectors. EU is a world leader in exporting the products of creative industries. However, their importance is not just of economic order - it can facilitate structural adjustment in regions in decline and can stimulate the social cohesion and inclusion enhance.

### 2. Trade in the EU supply chains

We analyze trade in the EU supply chains by looking at the relative importance of intermediate trade with EU-27 and individual countries. The question to be answered is: what is the percentage of these products in global trade of import and export, which are changes that occur over time, what factors drive these changes and what is the geographical structure of trade in intermediate goods? We shall examine the extent to which intermediate trade was

affected by the economic crisis (including a comparison with another category of products) and how the crisis has affected the supply chain of EU. The aim is to study the comparative advantages of trade with intermediate goods, semi-finished products, bi-factorial trade, research and development issue for foreign corporations and their impact on innovation in the European Union.

Thus, the main objective is to provide an intelligible presentation of the comparative advantages of trade in intermediate goods, semi-finished products bi-factorial trade, innovation performance and competitiveness of creative industries, together with their relative size and economic performance in EU-27. To explore what produces the development of creative industries and their impact on the economy in various forms: direct contribution to the economy (employment and several measures to expand); the spread in the general economy, direct contributions, but less quantifiable, of the creative industries to innovation, and their role in improving quality of life.

The described patterns indicate the comparative advantages of trade in intermediate goods, countries or groups of countries that tend to specialize in the production of intermediate goods are compared to other product categories. It is not easy to differentiate only on descriptive analysis grounds whether certain countries or groups of countries have tended to specialize in the supply of intermediate goods compared to others and to what extent this has changed over time.

The present analysis clarifies this issue using the comparative advantages of end-use categories and groups of countries.

In the theoretic and specialized literature, different measures of variable comparative advantages were proposed, such as Balassa (1965), Vollrath (1991). Greenaway and Milner (1993) provided debates upon the proposed theories. In the figure above is used the third measure of revealed competitiveness of Vollrath is used.

$$RCA_j^c = \ln \frac{X_j^c / \sum_k X_j^k}{\sum_n X_n^c / \sum_{k,n} X_n^k} - \ln \frac{M_j^c / \sum_k M_j^k}{\sum_n M_n^c / \sum_{k,n} M_n^k}$$

Where, X and M show the imports and exports and j means an index for products

category taken into account and c represents an index for country. The first term show the relative advantage of exports, which is analogue to the Balassa index, and the second index stands for the relative advantage of the import. The index ranges from minus infinity to plus infinity and is symmetric around 0. A positive value reveals a comparative advantage. One explains the double-counting by excluding the country concerned in all countries and product categories in total of products. The index was calculated for a group of 40 countries that comprise a significant part of world trade.

Table 1 shows the results of this analysis for all countries included in the exercise. On the figures in 2007, it is interesting to note that the set of countries with comparative disadvantages is rather heterogeneous. On the EU-27, this set includes economically developed countries such as Germany, Denmark, and Italy on the one hand and EU-12 countries, e.g. Slovakia, Hungary, Poland, Slovenia and the Czech Republic on the other. It should, however, not be interpreted as a disadvantage or advantage on factor endowments or productivity, but it rather should reflect the national structure of industries or specializations within industries.

Many countries that have revealed comparative disadvantage in the intermediate products show a strong comparative advantage in other categories: e.g. Cyprus, Hungary, Lithuania, Poland, Romania, Slovakia and Slovenia have a comparative advantage in consumer goods. In all cases the group of other advanced countries shows a positive index for intermediate goods, but negative for consumer goods, contrary to the model discussed above. With the BRIC countries, except Russia, they seem to have an advantage in producing consumer goods, such as relatively large importers of intermediate products in producing final goods. The exception is Russia, for which primary commodities are included. Regarding the group of other advanced countries, they seem all to have a comparative disadvantage, as they have comparative advantage in exports of goods supplies, although there was some shift over time.

Table 1. Revealed index of comparative advantages, 1997 and 2007

	Intermediates		Consumer goods		Capital goods	
	1999	2007	1999	2007	1999	2007
EU-27	-0.061	-0.028	0.138	0.024	0.088	0.164
EU-15						
Austria	0.31	0.07	-0.26	-0.23	-0.16	0.08
Belgium	-0.09	-0.05	0.15	0.20	-0.21	-0.29
Germany	0.12	-0.13	-0.60	-0.37	0.42	0.51
Denmark	-0.35	-0.14	0.57	0.41	-0.09	-0.16
Spain	-0.40	-0.20	0.43	0.26	-0.53	-0.54
Finland	0.10	-0.01	-1.22	-1.12	0.51	0.61
France	-0.15	-0.06	0.01	-0.01	0.09	0.02
Great Britain	0.13	0.20	-0.27	-0.29	0.04	-0.14
Greece	-0.03	-0.02	0.81	0.34	-1.73	-1.27
Ireland	0.11	0.19	0.40	0.06	-0.24	0.00
Italy	-0.41	-0.26	0.65	0.30	0.07	0.27
Luxembourg	1.11	1.16	-0.40	-0.49	-1.00	-0.58
Netherlands	-0.29	-0.20	0.30	0.17	-0.02	0.19
Portugal	-0.43	-0.15	0.81	0.36	-0.87	-0.54
Sweden	0.01	-0.01	-0.36	-0.30	0.19	0.11
EU-12						
Bulgaria	-0.45	-0.01	1.18	0.48	-1.21	-1.22
Cyprus	-1.24	-0.45	1.18	0.54	-0.76	-0.15
Czech Republic	0.09	-0.20	-0.08	-0.11	-0.50	0.04
Estonia	0.34	0.47	0.15	0.05	-0.66	-0.65
Hungary	-0.50	-0.42	0.58	0.21	-0.06	0.27
Lithuania	-0.32	-0.05	0.57	0.35	-1.29	-0.85
Latvia	0.88	0.84	-0.02	0.02	-1.65	-1.01
Malta	0.14	0.72	0.28	-0.13	-0.37	-0.65
Poland	-0.32	-0.11	0.91	0.67	-0.78	-0.80
Romania	-0.78	-0.06	1.35	0.54	-1.04	-0.89
Slovakia	-0.43	-0.77	0.15	0.46	-0.63	-0.57
Slovenia	-0.10	-0.04	0.62	0.44	-0.72	-0.56
Other advanced economies						
Australia	1.08	1.13	-0.15	-0.27	-1.93	-1.91
Canada	0.37	0.76	-0.17	-0.57	-0.48	-0.55
Japan	0.19	0.14	-1.51	-1.67	0.85	0.67
USA	0.49	0.31	-0.85	-0.84	0.13	0.15
BRIC countries						
Brazil	0.13	-0.14	0.78	0.81	-0.76	-0.34
India	-1.23	-0.77	2.91	1.99	-1.23	-1.49
Russia	1.36	1.78	-2.28	-2.11	-1.76	-2.16
China	-1.61	-1.19	3.07	2.42	-0.41	0.10
Other						
Indonesia	-0.11	0.37	1.41	0.93	-1.39	-1.35
South Korea	-0.95	-0.62	0.67	-0.69	0.52	0.61
Mexico	-0.69	-0.47	0.93	0.66	0.12	0.08
Turkey	-1.01	-0.95	2.40	1.63	-1.46	-0.65

Source: Eurostat COMEXT, The Vienna Institute for International Economic Studies (WIIW) calculation

Note: UE -27 include trade UE - intra.

The analysis so far might have concealed the fact that exists - as in the total trade – bi-factorial trade, e.g. countries that are both exporting and importing semi-finished products and other categories. The following analysis examines the magnitude of this phenomenon in details and the way it has evolved over time. This analysis is done by applying the Grubel-Lloyd index to the categories of products.

To measure bi-factorial trade most common method is Grubel-Lloyd index (Grubel and Lloyd 1975). The analysis in this study uses a version of this index for imbalance trade (see Greenaway et al., 1994) which is calculated as follows:

$$RCA_j^c = \ln \frac{X_j^c / \sum_k X_j^k}{\sum_n X_n^c / \sum_{k,n} X_n^k} - \ln \frac{M_j^c / \sum_k M_j^k}{\sum_n M_n^c / \sum_{k,n} M_n^k}$$

This index is used for the product and country groups in the 8-numbers CN. The index has a scale of 0-1 and can be interpreted as trade bi-factorial share in total trade category. Whenever an export or import value is reported missing but does not correspond to import or export value of the partner country, it is rated from 0 although it is not possible to know if the value is missing and therefore should be positive or zero.

Alternative to skip those observations result in an indication of bi-factorial trade but the conclusions would still be the same.

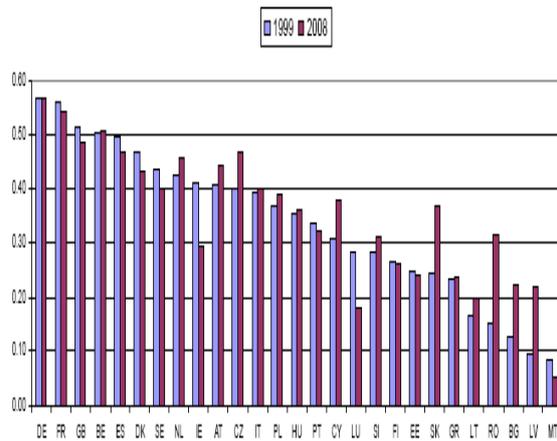
In general, the index tends to be higher for consumers and capital goods compared to semi-finished products. Taking the average of countries, the index in 2008 is 0.35 for semi-products, 0.40 for consumer goods and 0.39 for capital goods. However, there seems to be no clear pattern, although countries with a higher index value in one category also tend to have higher values for the other categories. This may be due to country specific factors such as country size or per capita income, the most important determinants items for internal trade. A fact even more striking is the large variation across countries. This is shown graphically in Figure 2. for semi-trade, which also indicate changes in the index between 1999 and 2008.

The share of trade with semi-finished products varies from more than 50 percent in Germany and France in less than 10 percent in Malta. As one could expect; larger and

more developed countries regarding the per capita income tend to have a higher index. Interestingly, the index declined for a number of countries between 1999 and 2008. This was the case of France, Great Britain, Spain, Denmark, Sweden, Ireland, Portugal, Luxembourg, and Estonia. But there are also a number of countries where the semi-finished products trade increased. This was especially the case where countries bi-factorial trade was lower in 1999. Bi-factorial trade increased more in Latvia, Bulgaria, Romania, Slovakia, and to a lesser extent the Czech Republic.

Although, despite its potentially different nature, there is a considerable amount of bi-factorial trade that occurs semi-finished products trade blurring the distinction between producer and recipient countries which is still high. (Stehrer et.al, 2010)

Figure 1. Bi-factorial trade with semi-finished products, 1999 and 2008.

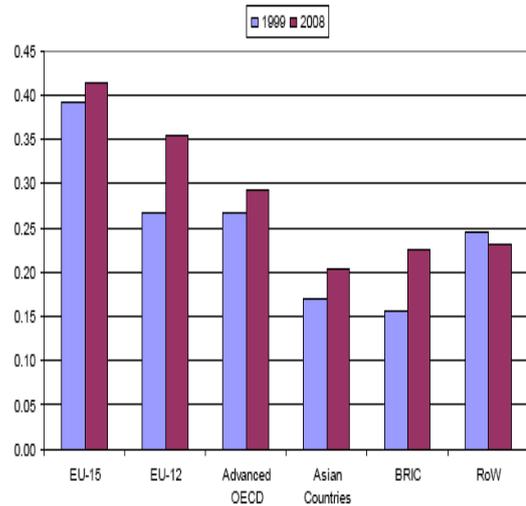


Source: Eurostat COMEXT, WIIW calculation  
Note: Image based on CGLI measurement

The intra-UE trade with semi-finished products is characterized more by the bi-factorial trade than by the extra-UE trade. Bi-factorial trade with semi-finished products rose in all regions, except for the countries which are considered “The Rest of the World”, where it has fallen down gradually.

The bi-factorial UE-12 trade has grown by a third between 1999 and 2008, what can reflect some inadvertences among UE-15 and UE-12 industries.

Figure 2. EU-27 bi-factorial trade with semi-finished products per regions, 1999 and 2008



Source: Eurostat COMEXT, WIIW calculation  
Note: Image based on CGLI measurement

Intermediate goods trade analyzes indicate their relative importance compared to other product categories and their dynamics over time. The imports of intermediate goods trade in total EU-27 is about 55% of total trade. Trade in intermediate goods is not very different from other product categories despite its relative importance and nature.

The study shows that the share of imported intermediate goods in total trade is rather stable for each industry, and there is a correlation between these rates in the industry in the country. This suggests that patterns of specialization may play an important role in explaining differences and changes over time. Analyses indicated that there is a general tendency towards increasing trade in intermediate goods shares over time. Slightly higher growth of trade in intermediate goods compared to other categories of products is largely due to modification by industries related to knowledge/science in imports of intermediate goods are more important than another industries.

Some important changes in intermediate goods trade have emerged over the last decade about the geographical structure of trade. Considering the EU-27 imports in the first place, a common trend is that the EU-15, advanced OECD countries and Asian countries have lost market share in all product categories, while EU-12 countries and BRICs have gained market share. A

surprising aspect is that these changes can be observed in all industrial categories. In particular, import quotas in the BRIC countries have increased relatively more for high-tech industries at the expense of EU-15 advanced OECD countries, while EU-12 have gained market share especially in high-tech consumer goods. Changes are similar to those in other industrial categories but less stressed. A similar pattern can be observed for EU-27 exports, with growing export shares observed for EU-12 and BRIC countries.

Overall, the analysis suggests that the trade with intermediate goods pattern and changes over time are not very different from other product categories, despite its complex role as input in the production process. As such, it seems that there is no requirement for specific or different policies regarding different product categories. These findings are suggestive to the importance of international supply products used in production processes to be considered in any policy of bilateral measures. Another conclusion is that industry size, *e.g.* specialized models, outlines general patterns and volumes of intermediate goods trade for individual countries. In some cases, the results indicate that intermediate goods trade can serve as an important vehicle for trade integration in world markets and allow countries to overcome adverse initial patterns of specialization, thus allowing dynamic changes in the structures of comparative advantage through learning effects. Countries such as China (and others) present a dynamic model for high technology industries or products, not only regarding the consumer goods, but the intermediate products as well.

Analyses indicate that most countries are both exporting and importing (which means that the two-way trade share is quite high) even at the industry level. Smaller economies, namely the EU-12, are relatively more specialized in trade of intermediate goods compared with other economies. Again, these patterns of specialization can be found both for imports and exports.

Using symmetrical domestic and imported input-output tables, analyses of imported intermediate goods share in total intermediate goods made by industry have been performed. Analyses were performed for both manufacturing industries and services.

Intermediate goods are most important tech industries with an import quota of about 55%. Imports of intermediate goods are also important for medium-advanced technology industries, the import share is 50% and 48% for medium-low technology industries and low technology industries only 30% of goods are imported. Again, there are significant differences between countries showing higher rates for small savings. These differences seem to be more pronounced in high technology industries. These rates, with few exceptions, have increased over the period 1995 to 2005. On service industries, imports generally play a much less important role, from 16% in trade and hotel industry and about 26% in transport services. Differences in service industries are small in comparison with manufacturing industries.

Analyses indicate an increase of links between industries and countries over time. The increase of inter-industry means that an industry, which is experiencing increased demand requires more goods (inputs) from other industries to meet demand. Industrial links between countries mean that demand for goods industry is satisfied by suppliers in another country. Calculations multiplier output (production) of input-output tables indicate that there is an increase in the output multipliers for EU-15 economies, but shows a decrease for the EU-12 economies, thus demonstrating the inter-industrial linkages are stronger in the first group of countries. When analyzing the multipliers internal/domestic, the first group indicates more or less constant multipliers, suggesting that higher imports of intermediate goods are the trigger mechanism for binding in terms of multiplier effects.

Given the complexity of production and its international relations, it is possible that aggregate commercial information not be the best source of information when pursuing a detailed analysis of the supply chains of companies or products. In this case, details of separated supply chains - a particular case Nokia 95 - have been used to address these questions in detail. It seems that, on average, Europe has registered 55% of total value added. N95 was assembled both in Europe and China. When the device was assembled and sold in Europe, for Europe share value rose to 68 percent. Even when it was assembled in Beijing and sold in the U.S.,

Europe recorded 51% of value. Final assembly, although important, is only a fraction of the total value added of a high-tech and mobile. Capturing value is detached from the physical flows of goods in the supply chain. Major portion of the value assigned to design, R&D, brand, marketing and distribution, and management of these functions. Estimations based on trade statistics and national accounts tend to provide inadequate and subjective picture of how added value is widespread geographically. The only way to clarify this issue, given the availability of statistical information, is to conduct case studies. The black box must be open to understanding the nature and consequences of cleavage production. The case study indicates that an analysis that takes into account flows of services and use information based on value added comes to different conclusions on global trade flows than analyzes using gross flows of goods. This suggests that concerted efforts must be made to develop trade statistics based on value added. The current system was developed for globalization “old paradigm”, the international economy to trade and specialization based on comparative advantage of sectors. Value added information based on trade flows are needed to enter further into the consequences of global trade.

### 3. Conclusions

Finally, when analyzing the impact for EU-27 trade flows, there have been offered a number of explanations for the collapse of trade in the winter 2008/2009. The growing role of intermediate goods trade plays a central role. The first reason is that a higher share of intermediate goods trade share has increased elasticity income of trade, which was confirmed here for the EU-15 trade. One of the major results of the analysis is that parts and components were also a category of badly affected objects by the crisis, registering 62% of the height of the crisis of September 2008. As a result, the relative importance of parts and components in the EU-27 decreased, post-crisis share parts and components in EU exports decreased by 2% and in imports by 1%. This decline seems to be rather small, but when considering it

within individual industries, changes become more pronounced for countries with a high share of trade in parts and components, reaching 7% for the share of parts and components exports to EU-27 in the electrical machinery industry. This result supports the hypothesis that some of the international supply chains created during globalization have been affected due to the fact that changes of in sourcing strategies of multinational companies have responded to a commercial environment less friendly.

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## Special Features of Premiums for Teamwork

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### Abstract

*Although initially the system was first applied to individual work performed by employees, he was subsequently extended to work group or groups, where for a particular job requires more operators contest. The system is actually the first application in a form evolved and adapted to modern conditions, the systems used in the past, in which a contractor, hire a subcontractor who, in turn, pay the amount received by all workers use.*

**Key words:** premium, incentive, salary, premiums for teamwork

**J.E.L. Clasification:** M52

### 1. Introduction

The premium may be granted and paid staff as time worked. Size depends on first achieving a pre-set schedule. In some sectors, in addition to general premium individual bonuses are granted, such as: raw coal economy, mileage bonuses, bonuses for accident-free activity, raw accuracy, premium economy electricity, raw crew for military campaign and so on.

Introduction of any premiums must meet a set of principles, such as:

- to be understood by staff;
- to be established in a trust;
- to promote rapid and accurate variables that should serve him;
- appear distinctly in payroll.

#### 1.1. Setting premiums

Establish a premium serve masking not a chaotic and disorderly remuneration policies or notorious injustice to hide in the distribution of mass labor. Premiums should not lead to the promotion of paternalistic policies that would give free rein arbitrariness and favoritism.

For the premium incentive produce their effect, are required to have the following conditions:

- represent an important part of basic salary (10% to 25% or more)

- to vary significantly correlated with the activity of each employee;

- payment to be rapid and it even more as it descends the hierarchy;

- periodicity payments to be even shorter as the first is a greater proportion of income;

- the calculation is simple enough to be easily understood by the concerned.

If the premium scheme is well designed and applied, especially when applied to teamwork, they are included and productive workers and the auxiliary, then provides:

- a better climate in the relationship between management and staff;

- it promotes social and technical groups which contribute to the smooth operation of the company;

- boost the productivity of each of these groups, so any increase in salary to have the mandatory counterpart, increasing labor productivity;

- contributes to the creation of a personnel management tool that proxy media management and control, contribute to improving working conditions and so on.

The premium system on groups, is applicable in cases that meet one of the following conditions:

- a. there is a community of interests between members constituting the group;

- b. the nature of work performed is impossible to determine the precise contribution of each group member.

The most striking of the community of interests within the group is working on the assembly tape. Work to be performed in many specialized tasks and split equally. Overall achievements of the group depend on the extent to which each individual to fulfill the specific task in good conditions. Moreover, in this case, the application of individual premiums can not produce any effect, since the cadence of work can not be changed.

In other cases, such as in shipbuilding, the maintenance work, inability to measure individual benefits requires the use of group incentives.

## 1.2. Benefits of the premium system

Major advantages of the team premium system are:

- a. fostering team spirit that fosters collaboration among team members in good conditions;
- b. reduced need for supervision;
- c. decrease training time for operators;
- d. indirect employment can be included in the work group and controlled by him;
- e. simplify time spent;
- f. the fair distribution of wages.

Instead, pay premiums on the group the following major drawbacks:

- a. penalizing workers with exceptional skills;
- b. lack of control of individual achievements;
- c. difficulty clocking for unfinished work at the end of the payment;
- d. inability to control the time for individual work rules;
- e. the difficulty of finding the right person for the position of leader of the group.

Practically pay premiums on the group system is an adaptation of individual premium systems.

Although you can use any of these systems, the pay is spread on paper (part). Time overruns are collectively calculated and payment amounts are distributed among all team members, after a "key" that can be, for example, individual wage rate or work performed. Collective premiums distribution may give rise to difficulties that teams are not homogeneous in terms of skill and labor efficiency. And if the first distribution is made according to individual basic salary, the salaries of any existing inequalities within the group tend to increase or to perpetuate.

Teamwork usually inserted, as I stated, an unjust disparity between directly productive staff that can measure performance and ancillary employment for which work can not be measured directly.

The first condition is that the team is not more than 20-50 numbers of workers, above this level is difficult to manage.

Staff remuneration objectives can only resolve pay staff and pay them to avoid distortions in the productivity of workers.

When referring to a section of tracks, it comprises productive workers (workers trained) working on cars, their work can be standardized and paid by individual or team performance.

In the same section there and auxiliary workers, consisting of adjustable, unskilled workers and quality control. These workers can be paid: by hours worked, overtime after combined with fixed or variable premium, with remuneration calculated on a notional average yield, the neighbor of productive workers.

Difficulties include the problem solving methods have led to other principled basis to say:

- department or workshop is considered a homogeneous whole in which all staff is a joint production determined and imposed;
- station or studio needs and auxiliary workers, that every productive worker must be a very precise number of people with clearly defined functions of auxiliary workers category. If these proportions have not been met, resulting dispute will be changed.
- the principle is to pay all department personnel on the achievements made only productive workers. Under these conditions, auxiliary workers have an interest in production to make the best possible conditions, because any delay would risk the objectivity and would decrease the average department.

## 1.3. Conditions for the application

Conditions for implementing these principles are:

- for every productive worker working series receives a note that says labor and time for time worked.
- end of work calculated average wages of workers from machine (A) as follows:

$$A = \frac{\sum \text{times`gives`productive`worker s}}{\sum \text{times`worked`by`productive`worker s}}$$

This indicator is calculated across departments.

Defined and required an index ("i") which will be the ratio of working time of workers and productive work time for all workers (also productive and auxiliary).

Index "and" reflects the evolution workshop organization / department in relation to the principle defined in the organization studied.

Sizing of "i" is the first decrease in section index "and" may decrease mainly by

increasing the number of auxiliary workers, precinct workers (workshop) have interest to increase the number of auxiliary workers or to reduce it.

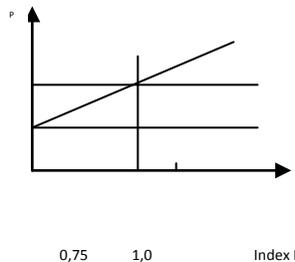
On this basis, it will define a production index "I" will consider "and" section and the average activity (A), achieving:

$$I = A \cdot i$$

Will be defined in this way a first workshop, establishing a relationship, they choose between linear and attenuated production index premium and "I". Thus, for a premium ranging from 0.60 to 1.20, we have an index "I" varies between 0 and 0.75.

Whole personnel department will then qualify for a premium P as seen in Figure. 1.

Fig. 1. The variation of premium with productive index



Source: Mullins, J. L., "Management and Organizational Behavior", Pitman Publishing, London, 1996

The second step is determining the individual salaries of the staff department. And this step is essential for good workers to work not for the weak.

Individualization is necessary for staff salaries, professional assessment of the value of each worker (v) in salary as time worked under its classification in the hierarchy of workers.

Hourly wage will be:

$$s = (s_0 + v) \cdot P,$$

where:

P = first defined above;

$s_0$  = only basic salary for a profession, but variable from one category to another. The basic salary is commensurate with the hierarchical factor working personnel;

v = is a value expressing RON value of employee training and vary within certain limits set by the direction of the company.

## 2. Conclusion

Advantages of remuneration "team uniform" are:

- ensure equitable workforce auxiliary
- reduction of auxiliary labor surplus;
- possible individualization of wages;
- determining a first applies to an entire section;
- easy understanding of the system by which workers at the end, the index output section is shown in the previous month.

Drawbacks of the system of remuneration "team uniform" would be:

- calculate the index "I" is relatively complex;
- difficulty moving workers from one team to another for the first coefficient may be different;
- the system requires that all workers be trained in their job, you need to take account of newly arrived workers, unusual with their workplace. In such cases, appropriate working times will be multiplied by a factor of a lower (e.g. 0.75).

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## Specific Issues Incentive-Based Pay Systems

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### Abstract

*To elaborate or project an adequate wage system it is necessary to take into account: the market for which the company works, technology and manufacture factors that is using, labor market context and socio-cultural environment.*

**Key words:** collective premiums, individual premiums, hourly wage, premiums for teamwork

**J.E.L. Clasification:** M52

### 1. Introduction

According to the conceptual boundaries drawn by some authors (1), incentive-based systems can be classified into four categories:

- raw systems that reward individual performance directly
- systems of collective premiums awarded for achieving production and productivity at the team level, division, department organizational level;
- premium collection systems provided for profit (profit sharing, equity participation);
- payment systems performance driven performance measurement (or pay for merit).

I. Remuneration with bonuses suggestion

Remuneration with bonuses suggestion may be individual and collective.

Gross premium includes the cost of achieving the suggestion.

The net premium is divided into three parts: part (P) staff distributed as individual premium, the inverse function of the number of months of depreciation, a part dedicated to lower selling price, and the third part, equal

to part two, for improving products technology, working condition and investment financing.

The individual premium is calculated differently depending on whether the suggestions result in quantifiable savings, according to the suggestions that improve safety or working conditions. In the first case to take account of originality of idea, the potential number of applications, hierarchical coefficients, the ratio of the position of the author and suggestions.

In the second case, the first volume is set against a scale type.

The collective premium are equal to the difference between P (sum of the first) and the first individual. First be paid in two parts: a low flat-rate premium, a premium commensurable with the expected results.

Establishment of the premium suggestion requires a psychological climate of trust and participation of staff in business life.

The premium can be hard drawn from usage, unless included in wages based on the results of the last 10 to 12 months.

Introduction of any premium is subject to a number of principles, such as:

- premium must be understood by staff;
- premium must be established in a trust;
- to promote rapid and accurate variable parameter that should serve him;
- to appear separately in payroll.

Establishment of the first should not be used:

- masking a chaotic and disordered remuneration policies;
- to hide the notorious injustice in the distribution of wage bill;
- the promotion of paternalistic policies that would give free rein to arbitrariness and favoritism.

For the first to produce their stimulating effect, are required to the following conditions:

- be an important part of the basic salary (minimum 10% to 25% or more);

- to vary significantly correlated with the activity of each employee;
- payment is fast and it even more as it descends the hierarchy;
- periodicity of payments to be even shorter as the first is a greater proportion of their salary;
- the calculation is simple enough to be easily understood by the person concerned.

It should be added that the introduction of any system of performance-based remuneration must be accompanied by payment of an initial minimum term of the running system.

## II. Determination of premium (bonus) individual contractors for main systems of wage

The premium or bonus means the difference between the hourly wage received (s) and pay the contractor if it was paid as overtime, ie s<sub>0</sub>.

It is understood here that the total salary schedule (s) depends on the performance or contractor activity (A), namely:

$$s = s_0 f(A),$$

in which:

s<sub>0</sub> – the basic hourly wage corresponding output/activity, ie A = 1;

f(A) - is the function of activity / performance that makes the first to be different depending on the pay system adopted.

On this basis, the function f(A) reflects the distinctive characteristics of major payroll systems in individual agreement, namely:

salary by hours worked (the director)

$$s = s_0 \cdot 1, \text{ so } f(A) = 1;$$

- wages piece:

$$s = s_0 \cdot A, \text{ so } f(A) = A;$$

- Halsey wage:

$$s = s_0 + s_0 \cdot \frac{A-1}{2} = s_0 \cdot \frac{A+1}{2},$$

$$\text{so: } f(A) = \frac{A+1}{2};$$

- Rowan wage:

$$s = s_0 \cdot \frac{2A-1}{A}, \text{ so: } f(A) = \frac{2A-1}{A}.$$

The difference between total pay, ie s<sub>0</sub> · f(A) and the basic salary corresponding activity A = 1 is written as:

$$s_0 \cdot f(A) - s_0 = s_0 \cdot [f(A) - 1]$$

So the prime can be written: P = f(A) – 1.

From the above, we can write the premium (P) for each major pay systems:

to pay as time worked:

$$P = 0$$

- for wages piece: P = A – 1

- for Halsey wage (m = 2):

$$P = \frac{A+1}{2} - 1 = \frac{A-1}{2}, \text{ means } P = \frac{A-1}{2}$$

- for Rowan wage:

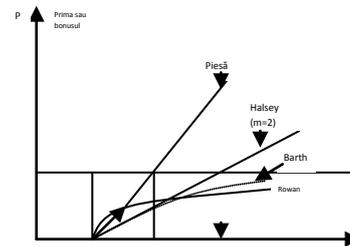
$$P = \frac{A-1}{A}$$

- for Barth wage:

$$s = s_0 \sqrt{A} \text{ so } P = \sqrt{A} - 1$$

Visual representation P (fA), premium (P) on the ordinate as a variable outcome and f(A) on the abscissa as a variable factor, the following hierarchy results for the main graphics of the premium P payroll systems listed (Figure 1.)

Figure 1. Graphical representation of the premium for major systems salary



Source: Kessler, I., Purcell, J., *Performance-related pay: objectives and applications*, Human Resource Management Journal, vol. 2, No. 3

Graphical representation is particularly illustrative of hierarchy premium each pay system:

- salary by hours worked has no premium (P = 0), identify in the abscissa;

- the systems Halsey, Rowan and Barth earnings growth (premium) output growth is lower.

- all three pay systems with premium curves right below that indicates the premium part the salary system.

- finally, the piece shows that the premium salary (earnings) is proportional to yield.

From here you noticed that when output goes from 1-2, first multiply by 2.

The conclusion to be drawn is that the pay systems have a different impact on the cost of production due to different sizes of the first (bonus) obtained in the performance (activity) A.

### III. Premiums for teamwork

Although initially the system was first applied to individual work performed by employees, he was later extended work group or groups, where for a particular job requires more operators contest. The first is actually a form application evolved and adapted to modern conditions of systems used in the past, in which a contractor, hire a subcontractor, which, in turn, pay the amount received all workers use.

If the schemes are well designed and implemented, especially when applied to the teamwork, you are included and productive workers and the auxiliary, then provides:

- an improved climate in relations between management and staff;
- itself promotes the social and technical groups that contribute to the smooth operation of the company;
- foster productivity, each of these groups, so that any wage increase as a counterpart to have compulsory labor productivity growth;
- contributing to the creation of a personnel management tool which proxy media management and control, contribute to improved working conditions, etc.

The first group is applicable in cases that meet one of two conditions:

- there is a community of interest between group members comprising;
- nature of work performed is impossible to determine precisely the contribution of each group member.
- the most striking of community of interest within the group is working on the assembly tape. Work performed should be decomposed into many specialized tasks and equal. Overall achievements of the group depends on whether the individual meets their specific task smoothly. On the other hand, in this case, application of individual premiums can not have any effect, since the pace of work can not be changed.

In other cases, for example, in shipbuilding, the maintenance, the impossibility of measuring individual benefits requires the use of group incentives.

Major advantages of the system first team are:

- a. fostering a team spirit that fosters collaboration among team members in good condition;
- b. reduce the need for supervision;
- c. reducing training time for operators;
- d. indirect labor can be included in the work group and controlled by it;
- e. simplify time consuming;
- f. equal distribution of wages.

Instead, the group premium payment the following major drawbacks:

- a. penalty exceptional skill workers;
- b. lack of control of individual achievements;
- c. difficulty clocking for uncompleted work at the end of the payment;
- d. unable to control rules for individual work;
- e. difficult to find the right person for the position of leader of the group.

In practice, pay for the system with raw group is an adaptation of the award of individual systems. Although you can use any of these systems, the spread is paid to work (play). Time overruns are calculated collectively and payment amounts are distributed among all team members, after a certain "key" can be, for example, individual wage rate or work. First collective distribution may give rise to difficulties if teams are not homogeneous in terms of skill and labor efficiency. And if the first distribution is made according to individual basic salary, the remuneration of any existing inequalities within the group tend to increase or to continue.

### IV. Salaries with bonuses awarded for profit collective

Unlike collective incentive schemes to group and team incentive schemes scale plant, company, institution applies to all sizes of businesses (small, medium, high). This pay award is an additional formula which stimulates all staff, increases loyalty to the organization and also focusing on improving business (2).

Involves profit sharing profit sharing made between the organization and employees. If the profit exceeded the minimum set in early, the surplus is divided between the organization and employees or as a fixed

amount for all employees or salary percentage based. The amount accruing to employees is usually located between 5-20% of company profit (before tax).

After Joseph N. Scanlon (3) the incentive system used with success in small businesses and has several components, including:

- a. system of incentives throughout the company;
- b. system to encourage suggestions from employees;
- c. a profit sharing plan.

The company's incentive system is based on the activity (output) overall work of all employees. The overall efficiency of employees can be evaluated based on the ratio of the total cost of salaries (wages) and the commercial value of production achieved during a period (one month), compared to the same report for a base period considered over several years. The economy is divided employees achieved 75% and 25% is business.

To avoid variations in the size of these incentives, due to possible variations of monthly production, is set aside rate of 25%. Reserve is fully distributed at the end. The whole system of incentives is managed by a committee composed of representatives of business and trade unions (employees). This system, in addition to salary savings achieved, leading and promoting better relations between management and employees.

As shown, the global stimulation system in the company also includes bonuses and compensation of employees suggestions.

Bonuses not based on the amount of benefits beyond the reach of influence and control of employees, but production costs that have contributed in some degree. Therefore, here we understand that employees can receive bonuses even if company losses. However, employees do not receive bonuses if the company derives profits, even assuming that labor productivity - dependent employees - not done.

## V. Performance-related pay

Performance pay can be defined as a system in which wage growth depends solely or mainly by the appreciation of individual merit or (4). Performance indicators are not only those related to productivity, but also

quality, flexibility, ability to work in teams and ability to achieve goals.

Performance is strictly linked to the outcome of the activity. Thus, in order to have control over labor costs, related to investments and profits earned, organizations associated with performance pay (5).

Employees see such salary more convenient than other systems in terms of security that gives the basic earnings. There are many reasons why managers would want to implement such a system, one of which would be attractive salary, which would lead to recruitment and retention of suitable employees, namely those who want to work in terms of performance. Will be discouraged however only those that the organization would be happy to do without.

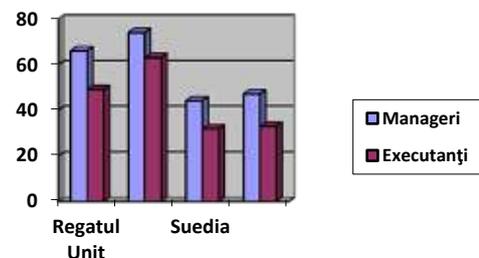
This payment would facilitate changes in organizational culture, the purpose of directing a performance by emphasizing flexibility, dynamism, entrepreneurship and care resources (6).

However, by implementing this payment system would result in weakening the bargaining power of unions, as the assessment focuses on the individual, it feels increasingly involved in the making.

The role of line managers would increase, they are the ones who should communicate with employees and be able to make appropriate assessments.

In European countries surveyed by Price Waterhouse Cranfield in 1991, application of performance-related pay has acquired a large (7). As shown in Figure 2, performance-pay mostly applied in France and the UK.

Figure no 2. Comparison between performance-payment application for managers and executives



Source: Beardwell, I., Holden, L., Human Resource Management. A contemporary perspective, Second edition, Pitman Publishing, 1997

All of this graphical representation that the pay system is mainly applied to managers, but we can not see that there is a extension of this system and has no staff positions.

Causes for organizations to pay to performance werw different. For example, in France the payment system was used to restore hierarchies and differences, while in Sweden was used as a solution to regional labor market difficulties.

## 2. Conclusions

It is difficult to salary based on performance and most Romanian companies do not pay that. In Romania there are very few organizations that implement performance - bonus - only large firms do so.

Bonuses generally are expected as the 13th month, with no connection between money and performance (8).

According to a local business enviroment conducted by Deloitte in 2009, one in five executives of large companies in Romania recognizes that there may or may not know how to reward employees based on performance.

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## Change Management and the Economic Crisis

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### Abstract

*The change as a form of response to the everyday challenges of the society should be achieved differently, according to its amplitude and nature. The difficult periods, such as the economic crisis, are moments that require the implementation of major changes in order to prevent, mitigate or offset the adverse effects. At the same time, these periods are not specific to the deep structural changes involving dissolution and the restructuring of systems.*

*The following paper aims to highlight the aspects of the change management and, also, the resistance to change and present partial results of a study of four focus groups on four changes proposed and implemented in Romania throughout the 2009-2011 period, during which the European economy was strongly affected by the economic crisis.*

**Key words:** change management, socioeconomic systems, economic crisis

**J.E.L. classification:** M10, I20, Q58

### 1. Introduction

Taking into consideration, the current economic crisis faced by most of the world countries, EU and The United States being the most affected by the actual economic state, is required both an organizational and structural implementation of a series of protective measures (under the condition to be taken before the phenomenon), adapting measures (if these measures are the result of unbalances generated by the phenomenon) and recovery measures (if these come after the manifestation of the phenomenon as a form of organizational recovery, the returning to a balanced stat). The key

questions in this context are those related to how deep must be the change be in these moments, whether the made structural changes, that are elements of which they are based on, and the role of the state in these changes.

From this perspective, it is more than evident, that under this economic crisis situation the state's intervention is more than welcomed and necessary under the condition that the measure, implicitly the changes induced in the socioeconomic system, to be taken with the single purpose of reducing the negative effects of it.

Romania, in its latest years, constitutes an interesting study case concerning the implementation of change, the resistance to change and the effects of change.

### 2. Change management

The society of the explosion of technological and information, every second induces social change, personal or environmental and, by default, organization. A. Tofler said "The only certainty is that tomorrow will surprise us all." Charles Darwin's theory confirms that only those who survive can adapt quickly and effectively to changes. This finding can be translated from the individual, in society or organizations.

Every organization faces today and change managers say that change is a reality in the organizational learning. Most times, the change in an organization is in response to changes that occur in the environment. These changes can occur within the organization, be minor changes, of some structural links or change the entire organization. For these reasons, it is absolutely necessary to know the change process to be masters, and, through good management, to ensure the organization, efficiency and effectiveness.

The change problem has always been a concern, almost obsessive, the sociology of organizations, because of the uncertainty of applying conventional methods of forecasting (eg extrapolation) or the difficulty of change. Organisations should give up lure "certainty" and managers must understand the organization for which they are responsible can go from one state to another, in a difficult way to predict and operate and in unpredictable environments, there is no balance but a dynamic balance.

Given these arguments, in recent years, many scholars have helped managers with a rich literature, the intention to help them understand the change to correct decisions. Analyzing a small part of this literature, you may encounter the following definitions of change:

- a) "A radical transformation process or marginal structures and skills that emphasizes development organizations" [6];
- b) Change is the acceptance Mc Calman and Paton "an ongoing process of confrontation, identification, evaluation and action";
- c) "Replacement [2], modification, transformation in form and / or content of an object, process or phenomenon."

After analyzing these definitions, we can appreciate that change is not an end in itself, but an opportunity, a means of adapting the organization to the external environment through a continuous process of confrontation, identification, assessment and transformation in form or content of the structures and powers emphasizes development in order to improve performance.

Given the provided definitions, it means that change is the development and management of the organization structure and the transformation of cultural and human elements (values, norms, behaviors) of this can be addressed as a permanent form of development and adaptation to environmental changes. In other words, change in organizations can be considered a necessary process of transition from quasi-static equilibrium state to another.

To cope with these changes, P. Drucker's entrepreneurial thinking requires that a person's capacity to implement their ideas, through a management based on creativity,

flexibility, adaptability and risk taking (5). In an educational organization, for example, entrepreneurship practiced in one form eduprenoriat, trying to become a solution to the changes that are provided. Entrepreneurial thinking is defined as the search response and change operation considered as an opportunity, but do not forget that sometimes a lack can lead to regression analysis and change can be considered as a threat. Change is a factor with an impact on management functions, especially those planning and organization.

In this context they have imposed new management principles [8]:

- a) Multiple rationality that any organization must meet the needs and interests of various interest groups, conflict is natural and necessary for life and development organizations.
- b) Pro-Special offer for new means of intervention in reality and not just react, or how to support real change of environment.
- c) Replacement of management focused on control, with management based on "implicational commitment" (R. Walton).
- d) Focusing on communication strategies, participation, motivation and training, conditions considered in the development organizations.
- e) Constructive approach and removing barriers to change.

### 3. Patterns of change analyzed

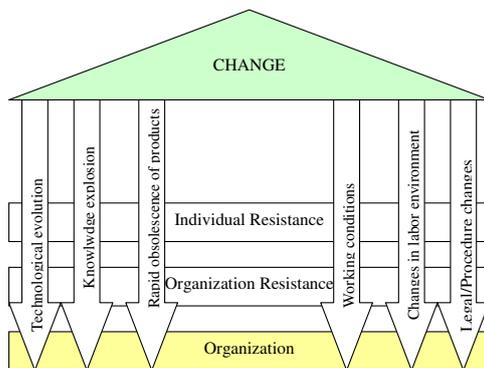
Change as the ability to continually adapt (1990 – the beginning of the millennium): organizations seek lower costs but at the same time increasing their competitiveness, change is performed by external pressures and constraints are perceived as strategic actors are forced to develop their creativity and to change behaviors in order to achieve a certain goal.

Crisis situations require, in our opinion the occurrence of unplanned changes (occurring spontaneously, the manager must be rapid and, if serious consequences are unlikely to limit the negative consequences and maximize opportunities), change improvement / enhancement (aimed at improving functionality without changing the organization's current strategic concept),

reactive changes (occurring in response to a threat), anticipatory changes (which, in fact, preparing the organization for the future), change in behaviour (are designed to reduce employee resistance to change in preparation for the actual change), changes of harmonization (aimed elements harmonize the organization taking into account anticipated future changes), adaptive changes (assumed one responds and changes already produced) [4].

In contrast to strategic changes (basic aims of the organization system, including the power), macro-changes (organization aimed at all aspects - strategy, market vision, mission, organizational structure and culture, information and decision systems, etc. .), structural change (is to increase work efficiency by restoring the organizational structure, job requirements or authority relations) or changes to the shift (strategy considering changes depending on the specific area held events), changes redesign them (used when threatened existence of the organization and is in urgent need of significant changes made to the organization's size) involve partial or total dismantle the system and its reconstruction along new the needle is motor itself [4].

Figure 1. Sources of pressure for change



They have very well thought out and analyzed before implementation, any simulations or experiments can be made to eliminate possible malfunctions pilot.

#### 4. Pressure sources to change

Continuously manifest pressure on organizations to this to change, either in whole or in the organizational elements.

Sources of pressure for change may be those represented schematically in The Figure 1.

It is the human nature to prefer the safety and certainty. Very few people accept without reservation the change and all that it is involved in its implementation. Generally, change is for most members the job insecurity of the future or relationships with others. Resistance to change is the main obstacle that we face in change. It can occur on two levels:

- a) at the individual level (individual resistance to change);
- b) level of organization (organization resistance to change)

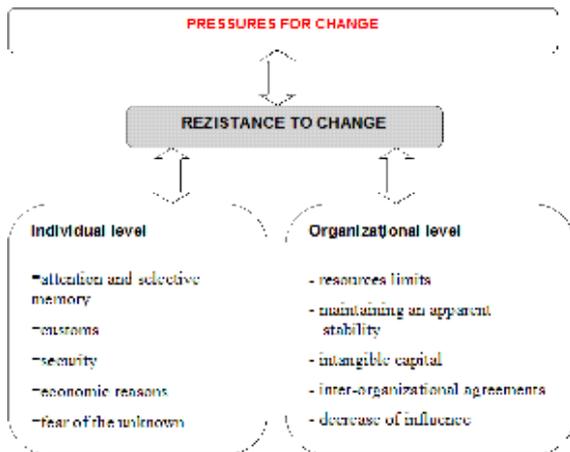
The resistance to change can take at least two forms: open or explicit resistance (late at work, negligence in work) and resistance hidden or implicit (absenteeism, low morale, lack of motivation). Managers must understand that adapting to change is gradual, individuals and organization crossing it in several steps.

According to Hellriegel [4] major causes that generate organization resistance to change are:

- a) lower level of influence and power of some members of the organization;
- b) maintaining organizational stability and continuity apparent (especially for highly formalized organizations with strong hierarchy);
- c) limiting resources / need for investments in resources (may also arise when organizations desiring change but lack of resources-human, financial, information or time - can not apply timely change);
- d) intangible capital: investment in physical assets or render impossible the organization's staff to accept change quickly;
- e) ongoing inter-agreements.

Briefly, the whole phenomenon of resistance to change can be represented as follows:

Figure 2. The Resistance to change



### 5. Objectives and research methodology

The conducted research proposed to make an analysis to determine the opinion of the socio-economic actors on two distinct categories of changes: deep structural changes (SSP) versus adaptive structural changes (SSA) and whether their implementation in some contexts such as the economic crisis.

Four focus groups of 7-10 people have been created for this purpose, as follows:

- a) G1-SME - 8 representatives of business (managers of SMEs);
- b) G2-EDU - 10 representatives of education;
- c) G3-ADP - 7 representatives of central and local government system;
- d) G4-CIV - 10 people from civil society.

With each group were held six meetings and debates within 2 -3 months (September 2010 - February 2011) in which they discussed their views on the following changes:

- a) S1-EDU - Education National Law no.1/2011, published in Official Gazette Part I no. 18 of 10 January 2011;
- b) S2-SAL - Framework Law no. 330/2009 on wages paid staff unit of public funds;
- c) S3-VAT - GEO 58/2010 - Amendments to the Law no. 571/2003 on Fiscal Code and other fiscal measures, published in Official Gazette on June 28, 2010, on increasing the standard VAT rate from 18% to 24%;

- d) S4-INF - GEO 34/2009 published Official Gazette 249 of 14 April 2009 on amending the tax code by introducing flat tax for companies.

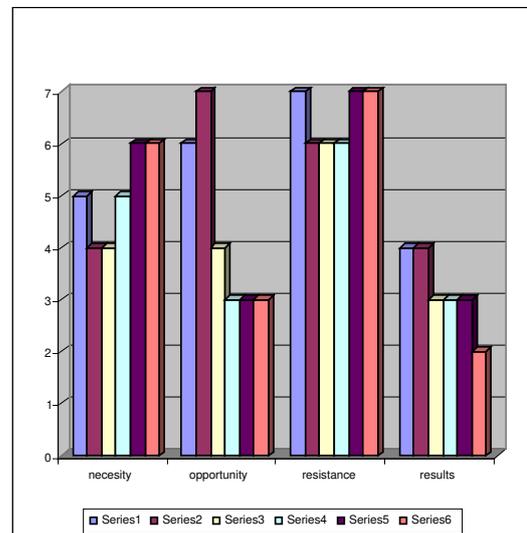
Issues that were discussed were: (1) need the change, (2) whether its implementation during the economic crisis, (3) resistance to implementation difficulties, (4) assessment results. After discussions on the available information at the time of the meetings was to note the number of positive options for members, that change is necessary to promote appropriate time, resistance to change was measured has good results.

### 6. Research results

From the results we present the evolution of views of the four groups on changing specific group.

From Figure 3 it can be seen that subjects in excess of 50% throughout the research considered necessary to change the tax system. Need to adjust tax rates of companies in crisis conditions is initially considered appropriate.

Figure 3. G1-SME about S4-INF

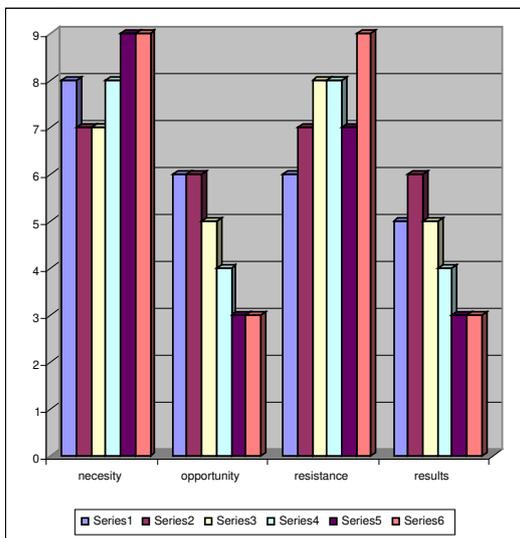


Introducing flat rate tax measure is then considered inappropriate for most subjects. Resistance to change is high, over 75% of subjects expressing this view it was manifested by extensive protests by professional organizations and business associations, media comments, interventions in parliament, views expressed by experts in various forms, in court actions.

Flat tax implementation results initially credited with 50% of the options show a significant decrease of 25% placing it in the end. This is because the effects of this change led to the closure of over 100,000 companies, is just one of them had no business and had no effect in stimulating business purposes.

With regard to national education law nr.1/2011, G2-EDU group shows that over 70% consider necessary to change the educational system, increasing their share to 90% as conduct research. Reasons for the increases are that law in the deconstructed and education is essential to profound changes in the system to restore balance.

Figure 4. G2-EDU about S1-EDU

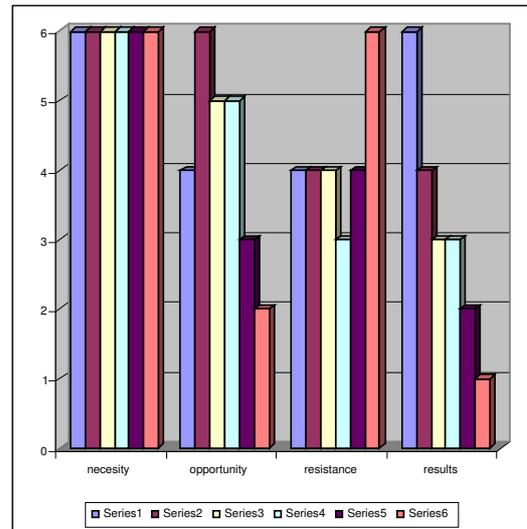


Opportunity implement national education law changes related to the economic crisis is confirmed by 60% of subjects initially that ultimately falls to 30%. Unlike resistance to implementation is credited initially to 60% of all options and increase to 90%. Resistance takes various forms of street protests, strikes, union petitions, open letters, the views of specialists, demobilization existing teachers, depopulation scheme by starting staff, altering climate, dissatisfaction pupils, students and their parents, etc..

The results range from 50% change in option subjects and decreased to 30% probably because the system itself educated effects occur over a longer period of time, and during this period were found only shortcomings, inadequacies, discrepancies and disharmonies law.

Group deems necessary civil servants a wage in the public system at a rate of 85%. Appropriateness of this change in this period is placed initially at 57%, climbing to 85% and then gradually decreases to 29%. This is because initially reluctant subjects then hope that a system will be designed to give the possibility to access, even if not immediately, at a salary level consistent and comparable with other European countries (Figure 5).

Figure 5. G3-ADP about S3-SAL



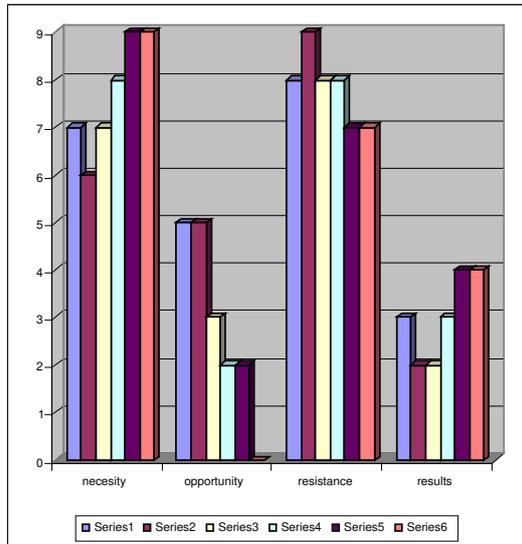
It further demonstrates that the only purpose of this measure is split categories concerned and capping salaries as abusive reductions resulted in fact with a series of processes, many already won in court and in its execution.

For the same reasons implementation is growing resistance from 57% to 85%.

The results change decrease from 85% to 14% of these are not well reflected in the failure of the administration, leaving staff, lack of interest of young people for careers in administration, etc. poor performance.

Changing the VAT rate from 19% to 24% has been a topic of interest to all citizens. Need for changes in the rates of VAT registered 70% of options for further increasing to 90%. The subjects considered necessary because such a change, the more that we currently VAT undifferentiated and differentiated that the identification scheme can serve as incentive for the consumer business, and social protection.

Figure 6. G4-CIV about S2-VAT



The opportunity of these was started with 50% of options and decreased to 20%. Resistance to implementation to critical positions expressed by civil society, trade unions, professional organizations, employers, etc. and was above 70%.

The results showed that change rates between 30% and 40%.

## 7. Conclusions and further developments

From discussions with the four groups were the following conclusions on the four analyzed changes:

- Changes are necessary to enable adapting to new socio-economic challenges;
- Opportunity to implement a fundamental change of its nature depends, if deep structural or cyclical adaptive. Thus, S1 and S2 EDU-SAL were found to profound structural changes which opportunity is not in conditions of economic crisis. While the S3-S4-INF VAT and were considered effective safeguards and adaptation to the economic crisis and thus the opportunity for higher.
- Resistance to change and the results show just the lack of guidance in the implementation of timing and content changes.

Based on the data collected will be several types of analysis to show how perception

changes and peculiarities of different environments.

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# The Importance of Leadership in Sustainable Business Performance

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## Abstract

*This study attempts to describe the relationship between leadership and performance based on concepts, theories, national and international research in this large field.*

*In this context, by reviewing the literature in the field, I present an overview of the state of the art in the field of leadership and business performance, as well as some paradigms, limits and difficulties in the field.*

*I will further offer a large perspective on effective leadership based on concepts, theories and national and international research in this large field.*

**Key words:** leadership, business performance, economic organization, leadership theories

**J.E.L. Classification:** M10

## 1. Introduction

Investigations on the ability to lead, that is the deliberate influence others to achieve a goal through collective action, show, that over time, leadership proves to be vital, not only for economic organizations, but for the entire world.

Thus, leadership is present every day, everywhere in society and along the history. The leader has now become a vital element of a successful business. The organization may have all the advantages: financial resources, market position, cutting-edge technology but if it fails to leading chapter, they are simply lost and the organization goes down. [13]

This study describes the relationship between leadership and performance based on concepts, theories, national and international research in this large field.

The universe of research is the economic

organization. The studied concepts are both leadership and the organizational performance and especially the relationship between leadership and performance as established by the current literature in the field.

## 2. The importance of leadership from the scientific, technologic, socio-economic or cultural point of view

The problem of this scientific paper is a relevant and topical issue, in terms of scientific, cultural, and socio-economic aspects, and it is located in an area where changes are frequent, disturbances are persistent, the trends of globalization are increasingly sharp, the global economic crisis grows in complexity, all of which determine the importance of the scientific research on the role of leadership in organizational change and performance. “The economic environment, constantly evolving and developing, requires companies a great flexibility. One of the biggest challenges of a company’s management is to adapt its activity to the changing requirements of the business environment. Given the fact that technological progress is accelerated, replacing obsolete equipment, launching new products, increasing production capacity of the enterprise, creating subsidiaries or the acquisition of financial holdings are just some of the objectives that an effective leader has to take into account. of an organization.” [12]

In Romania as a EU Member State, leadership’s role has grown in intensity more than ever. Business performance is now seen as a result of the confluence and merge of several factors, among which leadership often plays a decisive role. The ability to lead can take economic organizations towards performance and efficiency. The need for leaders is the basic condition of progress

towards a modern world, which is currently trying to reinvent the effective leadership.

This study addresses precisely this issue of effective leadership in national economic organizations, based on concepts, theories and national and international research in this large field.

At a socio-economic level, most of the world's activity is conducted within or through economic organizations, thus, I intend to cover a number of issues related to the leadership manifested in economic organizations. Leaders and the ability to lead are important organizational behavior topics that have been extensively investigated. People were interested in the ability to lead from the moment they started to come together in groups, in order to achieve goals.

Concerning the importance of leadership, organizations have experienced the intense need to develop a new generation of leaders capable to prime the mechanisms of development, learning, change and performance.

### **3. The connection between leadership and business performance**

Business performance can be defined by using a series of concepts, theories and definitions. The approaches range from the performance in terms of profitability, from Goldratt's definition, which stresses that "the purpose of any business organization is to make money", to those of other TOC theorists or to that proposed by total quality management up to that of Ken Blanchard and Marc Muchnick, who analyzes the success of a business by evaluating three basic parameters, such as: the favorite supplier; the favorite employer; the favorite investment. [3]

Numerous research papers, theories and articles in the field state the value and the importance of leadership and also the existence of genuine association between leadership and performance. The connection is described by both classical leadership theories or current researches in organizational management and human resources management, such as: Theory X - Theory Y developed by Douglas McGregor; the social relations at work developed by Elton Mayo; the need for achievement and affiliation, developed by David McClelland;

Maslow's needs pyramid; Likert's leadership styles; Warren Bennis studies that have attempted to transform leadership into practice; a research study on human motivation conducted for more 10 years by the U.S. Sirota Group; J. Pfeffer's research; Romanian researches and many others.

Worth mentioning Romanian researches such as: Project Liderom, developed by professor Năftănăilă; Nicolescu and Verboncu, who defined the "symbiotic leadership"; professor Vagu's, D. Popescu's; Lefter's researches in the field; the Human Synergics research on leadership, which defined several types of leaders and validated the results by statistical analysis.

All these theories and studies have developed a particular and important influence on the assumptions, concepts and interpretations of this today's leadership and organizational performance study.

### **4. The difficulty elements of the problem**

The importance of the relationship leadership - performance is clarified by literature, but the relationship itself and its implications are not fully clarified. There are plenty of difficulties, controversial elements and discussions over the existing leadership paradigms, as well as discussions over indicators used to measure the ability to lead and their determination. Also, many problems and difficulties arise in the existing studies of the leadership over the performance measurement criteria used.

Despite the widespread acknowledgement of the importance and value of leadership, when studying the leadership literature, it is striking that the concept of leadership lacks coherence and agreement. [14]

Most of leadership literature fails to make clear distinctions between leaders and non-leaders, effective leaders and ineffective leaders, as well as overlooking the organizational level at which leadership occurs, the context or differences between formal and informal leaders.

When referring to management we can list without any controversies the management functions and processes, we know aspects such as the manager's role within the organization, management levels, the source of its authority - the power of position and many others. As for leadership, its functions

vary from author to author, leadership manifests at every organizational level, leaders' sources of power range from the expert or the reference to the position. And if leadership occurs at all levels within the organization, when discussing the issue of “leading the organization towards performance”, to which of these leaders we are referring?

### **5. The limits of the current approaches in the context of the state of the art in the field**

Despite the increased research into the leadership theme, many gaps and unanswered questions still remain in the existing studies.

Some theories focus heavily on social relation leaders - adherents, thus excluding other leadership features and some organizational variables (vision, learning, quality, etc.) as well as some external variables (customers, suppliers) considered crucial to the relationship between leadership and performance.

Many researches are focused on the positive effects of leadership on relations with adherents, but few have analyzed the connection of this relationship with organizational performance, showing it and explaining why and how leadership affects performance. Furthermore, there has been limited research that has specifically addressed the relationship between leadership and organizational performance.

It should be emphasized that, in determining business performance and establishing a causal relationship between leadership and performance it is very important the quality of the indicators used to measure performance. When selecting the measurements of performance, previous researchers have employed either financial measurements or non-financial measurements, rather than employing both kinds of measures in order to enhance the validity of the research. This provides a narrow measurement of the performance. [14]

Findings of researchers on identifying behavior and leadership style that facilitates efficiency and performance are different, and literature provides a theoretical framework, but it still incomplete.

### **6. Conclusions**

Research and leadership paradigms are not conclusive especially regarding the relationship leadership-performance, there are many unanswered issues and also methodological problems that limit most existing studies.

Also, in Romanian articles and study papers there have been only few research studies in the field, some of which inconsistent in analyzing the performance of companies, others inconsistent in analyzing the leadership – performance connection.

To conclude, I plan during future study papers to extend the limit set by other researches and to adopt a progressive approach of the research that allows me to present my views and personal contribution in each stage of work study: the state of the art in the field, the diagnosis of leadership in the national economic reality and finally proposing of an effective working model for the Romanian leaders.

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## Network Marketing and Global Communication

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### Abstract

*The distribution in a direct sales system is carried out using its specific channels, from person to person or from producer directly to the consumer, instead of being carried out classically by shops. Network marketing represents the main force of the direct sales, as it relies on the use of a network marketing system, made up of independent enterprising people to find consumers and to move the products towards the clients.*

*From the perspective of the consumption goods distributed, most companies produce their own products or at least control their production. Given the specifics of distribution, the road between the production place and the consumer is shortened, through the creation of a relation producer-distributer-consumer or producer-consumer, which facilitates the possibility of a fast reaction to the consumer's desires. The demand and the offer take on specific forms, advantaged by the closer and more personalized contact between consumer and producer.*

**Key words:** communication, marketing, globalization, network, business

**J.E.L. Classification:** M3

### 1. Introduction

Network marketing has evolved as a form of the direct marketing and can be included within the general marketing context. So, we can say that:

- According to the profile of the economic activity, it could belong

with all of the three types of marketing: *production goods marketing, consumption goods marketing and service marketing* – the difference being made by the company practicing the respective type of marketing;

- From the perspective of the geographic criterion, it lies within the area of the *international marketing*;
- According to the economic organization level, it is part of the *micro-marketing*.

Multi level marketing (MLM), also mentioned as Network marketing, is a business distribution model allowing a company to sell its products directly to the consumers by means of **direct sales**.

At present, direct marketing is an essential part of the marketing activity. The key principle is that a part of the communication exchanged with the clients should be direct – oriented towards the above-mentioned clients. Starting from this simple principle, a whole new discipline has developed, which also includes network marketing.

Direct marketing has to reduce the large number of messages that people get every day, so that, wherever it is necessary, the clarity, the relevance of the message and personalization (customization) may reach the consumers for which they were meant. As this thing consumes time and resources, direct marketing needs to be cost-efficient, measurable and sure as functioning. Technology has helped achieve this goal, facilitating the direct communication with the clients.

## 2. Network marketing and globalization

“Let us imagine a non-place where we all live and the entire world’s wealth is produced. It is exactly such a fiction that has come to light during the Internet explosion at the end of the 1990s. The Internet’s growth was so dramatic that it began to question even the meaning of space and of space relations.”

The progress in the domain of information technology and in the management science has led to the decrease of the costs for international transport and communications. In their turn, they triggered the commercialization of an increasingly number of goods and services, which were impossible or hard to sell before that. At the same time, the production and service internationalization was very much accelerated.

The financial institutions had very much to win following this processes. We can say that the financial transactions had to bear a very significant impact. Now, companies have an immediate or a much faster access to the conditions of the markets worldwide and can make the detailed calculations needed to identify profit opportunities through allotment of capital in different areas of the globe.

The extension of the financial and business mass-media, the acceptance of the English language as international business language are part of the main factors that have facilitated financial globalization.

In order to establish and support public and socio-cultural relations in this globalization framework – the geographic distances lose some of their importance. These things lead to “ricochet” effects such as changes in mentalities and administrative structures; yet they can also lead to demographic, security, ecological and social deficits.

The international financial market – getting developed – leads to the circulation of more products in commerce, to the appearance of transnational companies. At the same time, the integration of progress in the economic world leads to the improvement of the environmental quality, to the increase of the revenues, the improvement of the respect for human rights and the right to efficiently use the resources.

In the context of globalization, the interdependences between the economic agents grow. The creation of a network provides the opportunity to distribute risks and uncertainty. The network, being based on a good communication and cooperation, represents a new and dynamic form of organization, giving each partner the chance to attain their goals. In this way, the supply costs go down, the access to resources increases, the distribution and marketing costs decrease, and the products’ distribution is made much faster. “The richest people in the world build networks.”

Network marketing is one of the fast developing industries, well integrated in this globalization concept. It is a people communication business, so that any technological novelty leads to an industrial increase. The use on a large scale of the new technological discoveries such as *digital telephony, internet and satellite communication* will lead to the unprecedented development of the network marketing industry.

„Network marketing continues to develop faster than the franchise or traditional business domain.”

Marketing and distribution businesses totally depend on the local culture. If a business functions in America, it does not mean that it will function, without any adjustments, in any other country. In reality, these businesses need to adapt to the local conditions in each country. The only true measure of success in business is **sustainability**. In Romania, there are a lot of foreign firms, adapted to the local conditions, which develop every year. The international experience will be successfully implemented in Romania, providing a viable alternative to the governmental programs meant to raise the standard of living. “The Industrial Era is over and now we are entering the Information Era. Big Businesses, such as General Electric are Industrial Era businesses. Franchises such as McDonalds represent businesses of the transition from the Industrial Era to the Information Era. Network marketing businesses are the true franchises of the Informational Era, because they function almost exclusively based on information, without relying on lands, plants and employees. Many years ago, people laughed at the idea of network marketing. At present,

all the transformations taking place in the world turn the future of the network marketing into an increasingly promising one. Many companies have a network marketing department.”

The best solution for the successful development of any industry is a severe economic legislation. So, illegal operators can be detected and punished, and consumers and beginners will be protected. The Government fights against illegal operations, starting a campaign to eliminate corruption, bank criminality, trading offences and forbidden trading practices. In their turn, the Commerce Chamber and the Free Trade Associations try to harmonize the Romanian legislative regulations with the EU legislation, in order to facilitate the entrance of Romania into the large family of the old continent.

More often than not, network marketing companies have networks spread over several countries and territories. So, a person enlisting in the network and getting involved in its creation by inscribing in his/her turn other people can finally have partners in other countries, so that, by the circulation of goods that they bring, these people create revenue both for the company and for the people in the upper line, according to each person's degree of involvement. There is a significant connection between network marketing and globalization, the latter being an increasingly debated topic nowadays.

In network marketing, an international network means much more than recruiting people from another country, because this thing in itself does not bring significant revenue or may not bring any earnings at all. In order to obtain financial advantages, an independent network needs to be built, able to develop without the leader's permanent help.

The construction and development of international network marketing has to do with an adequate strategy, a well designed system, investments and measurable actions. The main trump of network marketing is that in a network the distributors work individually, although they are part of a team. When the company launches itself in a new country, it announces, together with the team leaders, the marketing strategy to be used. Depending on this strategy – being a checked

system leading to success – each distributor will work, yet for his own business.

### 3. Conclusions

Network marketing can mean the accentuation of the tendency to bring the products closer to the final consumer, not just in terms of shortening the time the product takes to get to the client but also in terms of the products' personalization to the client's profile and, in this way, in terms of building consumers' loyalty.

Small businesses can be viable during the periods of significant transformations and crisis through their capacity to adapt and the relatively small risks, all the more as they are supported by large corporations. In this sense, a distributor's individual business in network marketing can be considered a small business.

Team activities, the mentoring and the support provided in network marketing are determining educational factors supporting the passage from the employee mentality to the self-employed mindset.

In the context of the growing concern for the environment and for health, the quality products provided by the direct sales companies as well as the quality satisfaction guarantee represent strengths for such companies.

The easy access to this type of activity might represent a solution to increase one's revenues, all the more during crisis situations. The crisis has triggered lots of dismissals, and the revenues of many people have decreased. During these circumstances, more and more people are looking for new opportunities to earn supplementary revenues. At the same time, to adapt to the present financial situation, the network marketing companies have increased their bonuses, in order to provide a supplementary stimulation for their distributors. So, relying on consumption goods and loyal consumers, the effects of the crisis have been diminished.

As the direct sales companies that use multi level marketing have developed in countries with a strong economy and democracy, their marketing techniques, their communication, their market development, their focus on image and the ethic and legal aspects of the activities promoted by these firms in Romania might constitute a valuable

school for many people who, in other circumstances, would not have access to such information.

On the other hand, the easy access of anyone in such organizations might hijack the network from its initial purpose, if its regulations and policies are not very clear. The existence of fraudulent pyramidal schemes and the erroneous association of the MLM (Multi Level Marketing) type of activity with such businesses have generated a lack of trust in the legal MLM activities. In general, marketing plans have been experimented based on them, many distributors recording successes. However, nobody guarantees successes for all the network members.

The existence of this type of activity supposing high-quality services and products has had no major impact on the Romanian economy so far, considering the volume of merchandises sold by these systems compared to the general volume of goods sold in Romania. Yet, the development of the network marketing systems can be beneficial through its concurrential aspects and through the education of both the consumer and the distributor.

The training of efficient distributors supposes the development of certain essential general skills (communication, leadership, financial education, motivation). And this can only be beneficial for the Romanian society.

Considering all these elements, and the relatively scarce bibliography analyzing into detail the domain of network marketing, we consider it important to give more attention to all the aspects related to network marketing, in the present context of globalization.

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# An Empirical Approach of Corporate Environmental Responsibility in Romania

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## Abstract

*The aim of the present research paper is to investigate the corporate environmental responsibility (CER) in Romania, by taking into account a series of 24 relevant best practices examples in the field. First part of the paper analyses the concept of CER in close relationship with corporate social responsibility (CSR), by emphasizing the role of governments and companies in environmental protection. The main components, evaluation stages and common challenges associated with CER are briefly presented in the second part of the paper. Third part of the paper appoints the environmental responsibility in the European Union from the national public policies point of view, meanwhile fourth part of the paper presents an empirical evaluation of CER in Romania, with a special focus on supported issues and allocated budgets during 2006-2010 period. The paper ends with a set of conclusions and recommendations for strengthening CER in Romania.*

**Key words:** corporate environmental responsibility (CER), corporate social responsibility (CSR), sustainability, environmental protection, environmental audit

**J.E.L. Classification:** M14, Q56, Q57.

## 1. Introduction

Broadly considering corporate social responsibility (CSR) as “a concept whereby companies integrate social and environmental

concerns in their business operations and in their interactions with their stakeholders on a voluntary basis” [1] or “the responsibility of enterprises for their impacts on society” [2], the freely assumed inclusion of social, environmental and ethical criteria in the corporate economic conduct remains the central idea of the CSR definition. Corporate environmental responsibility (CER) is a part of the vast concept of corporate social responsibility (CSR), and like CSR, CER is driven by a set of different reasons: pragmatic or rational reasons (the company assumes CER because of the competitive advantages induced by a responsible behaviour); deontological reasons (the company assumes CER because of an intrinsic corporate moral duty with respect to the community it is operating in); and social pressure reasons (the company assumes CER because of the consumer activism and constant demands from the shareholders and the investors).

Environmental protection was traditionally considered to be an issue of public interest imposed by governments to the private sector through regulations, sanctions and incentives [3], but the changes occurred in the last decades with respect to the societal perceptions on corporate roles and responsibilities are directing CER from “nice to have” to “must have”. On the other hand, the private sector is stimulated in freely adopting environmental responsibilities also because of the clear economic and financial benefits induced by CER [4].

In the specialized literature pertaining to highly developed countries [5], a complete definition of CER takes into account at least

the harmonization of the following three main themes: environmental commitment in which the company fully embraces sustainability and has a net positive impact on the environment and society; material and energy management in which the company operates within the finite ecological limits of the environment; and effective stakeholder engagement in which the company is fully transparent and accountable, with a demonstrated process in place to engage and empower stakeholders. In more specific terms, CER represents “the duty to cover the environmental implications of the company’s operations, products and facilities; eliminate waste and emissions; maximize the efficiency and productivity of its resources; and minimize practices that might adversely affect the enjoyment of the country’s resources by future generations” [6].

## **2. Characteristics of corporate environmental responsibility (CER)**

The most relevant aspects regarding CER refer to its main components, evaluation stages and common challenges.

The following components of CER are offering a detailed vision with respect to the analysed concept:

- Corporate environmental commitment and awareness;
- Stakeholder engagement;
- Measuring, reporting and auditing;
- Transparency;
- Commitment to continuous improvement;
- Going beyond compliance [7].

In order to evaluate their impact on the environment, usually the companies use a set of instruments (or “steps”) that broadly represent their environmental accountability or their CER:

- Corporate environmental policy;
- Environmental audit;
- Employees involvement;
- Green procurement;
- Green products [8].

The most frequently identified challenges regarding CER are the following:

- Role of CER in supporting sustainable development and critique of classical and neoclassical models of market economy [9];
- Role of multinational companies (MNC)

in pollution control [10];

- Relationship between environmental and economic performance [11];
- Difficulty of discerning between real environmental commitment and public relations (PR) based on green washing [12];
- Need for effective participation of all the stakeholders in the corporate environmental decision-making process;
- Need for transparency and/or external third-party auditing in corporate environmental reporting and funds allocation [13];
- Need for standardized indicators and reporting procedures (like, for example, the ones of Global Reporting Initiative) [14];
- Need for adoption of environmental management standards (e.g.: ISO 14001, EMAS etc.).

These challenges mainly address the triple-bottom line analysis and the split of social and ecological responsibilities between governments – companies – society as a whole, and they are expressed in a more stringent way at the level of European Union.

## **3. Corporate environmental responsibility (CER) in the European Union**

Comparing the development of corporate environmental responsibility in the European Union and the US, the corporate activity in the area at the European level has been much more pronounced. In this sense, more than half of the firms that have achieved ISO 14001 standardization requiring rigorous environmental management systems to be installed at a corporation are located in the European Union, meanwhile many NGOs that promote the idea of CER can be found in Europe as well [15]. In its Europe 2020 Strategy, the EU Commission sets out the priority of sustainable growth based upon a more resource-efficient, greener and more competitive economy [16].

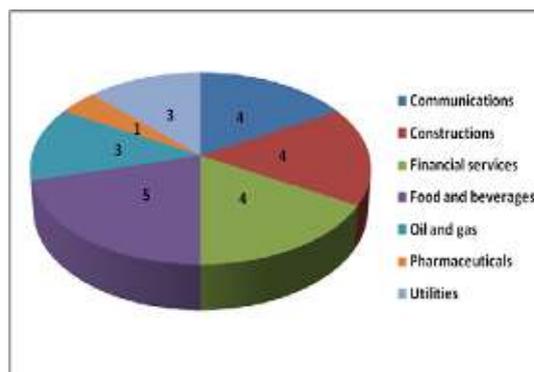
Considering the environmental responsibility from the national public policies point of view, the European Commission analyses the CER concept mainly from two points of view: i. the potential of CSR in tackling climate change, and ii. green, social and sustainable public procurement [17]. The

corporate contribution in tackling climate change in sectors such as power generation, industry and manufacturing, transport, retail or building focuses on innovation and investment in clean technologies, products, services, or production processes such as those related to energy efficiency, renewable energy or sustainable mobility [18]. Referring to the role of governments in sustainable public procurement, green public procurement (GPP) is the process in which public authorities take environmental concerns into account in tendering for goods, works and services [19].

#### 4. Corporate environmental responsibility (CER) in Romania

For conducting an empirical analysis of CER in Romania, a set of 24 case studies (corporate responsible initiatives) in the environmental area were taken into account (for the 2006-2010 period), representing a number of 13 responsible companies (Orange Romania, Vodafone Romania, Carpatcement Holding, Provident Financial Romania, Raiffeisen Bank, UniCredit Tiriac Bank, Coca-Cola HBC Romania, Tuborg Romania (URBB), MOL Romania, Petrom, Terapia Ranbaxy, Apa Nova and Transgaz) grouped into 7 fields of activity (Communications, Constructions, Financial services, Food and beverages, Oil and gas, Pharmaceuticals and Utilities). For a distinctive distribution of the 24 corporate environmental responsible initiatives on the 7 main fields of activity, see *Figure 1*. The information was retrieved from the [www.responsabilitatesociala.ro](http://www.responsabilitatesociala.ro), a site presenting examples of best practices in different six areas of CSR in Romania: education, art and culture, environment, social issues, human rights, and sports.

*Figure 1. Sector segmentation of analysed case studies (24) in the area of CER*



Source: Authors' representation using the information presented on <http://www.responsabilitatesociala.ro> site.

*Table 1* presents a detailed situation of the 24 analysed case studies distributed by companies and main fields of activity, with a special emphasis on their corresponding budgets (if they were made public on the [www.responsabilitatesociala.ro](http://www.responsabilitatesociala.ro) site).

*Table 1. Synthesis of CER analysed case studies (24)*

FIELD OF ACTIVITY (TOTAL NUMBER OF CER PROJECTS)	
Companies (Number of CER projects)	CER projects (CER budgets in Euros)
<b>COMMUNICATIONS (4)</b>	
Orange Romania (2)	Orange – Adept work camp, 2008 (N/A)
	Orange – Adept, 2005-2007 (€ 170,000)
Vodafone Romania (2)	National program of recycling of mobile phones, 2007 (N/A)
	Clean seaside, 2005-2006 (€ 50,000)
<b>CONSTRUCTIONS (4)</b>	
Carpatcement Holding (4)	Together for the nature, 2007 (N/A)
	Bucharest is breathing, 2007 (€ 55,000)
	Bucharest is breathing, 2006 (N/A)
	Together for the nature, 2004-2006 (N/A)
<b>FINANCIAL SERVICES (4)</b>	
Provident Financial Romania (1)	Every park has its own story, 2010 (N/A)
Raiffeisen Bank (1)	I Love Velo, 2010 (N/A)
UniCredit Tiriac Bank (2)	Cicloteque, 2010 (€ 150,000)
	Our forest, 2008 (€ 29,000)
<b>FOOD AND BEVERAGES (5)</b>	
Coca-Cola HBC Romania (2)	Program of ecologically and responsible driving, 2009 (N/A)

	"Green003", 2007-2008 (N/A)
Tuborg Romania (URBB) (3)	Green umbrella 2010 – The green capital of Romania, 2010 (N/A)
	Green umbrella 2009 – From now on, the city is even greener!, 2009 (N/A)
	You and the green umbrella – Always close, 2007 (N/A)
<b>OIL AND GAS (3)</b>	
MOL Romania (2)	Green spaces, 2009 (€ 150,000)
	Green spaces, 2009 (€ 41,000)
Petrom (1)	The parks of the future, 2007 (€ 1,500,000)
<b>PHARMACEUTICALS (1)</b>	
Terapia Ranbaxy (1)	The green garden kindergarten, 2006-2008 (€ 12,000)
<b>UTILITIES (3)</b>	
Apa Nova (2)	Save the snowmen, 2007 (N/A)
	Apa Nova came out with full, 2007 (N/A)
Transgaz (1)	Green Olympics, 2010 (N/A)

Source: Authors' representation using the information presented on <http://www.responsabilitatesociala.ro> site.

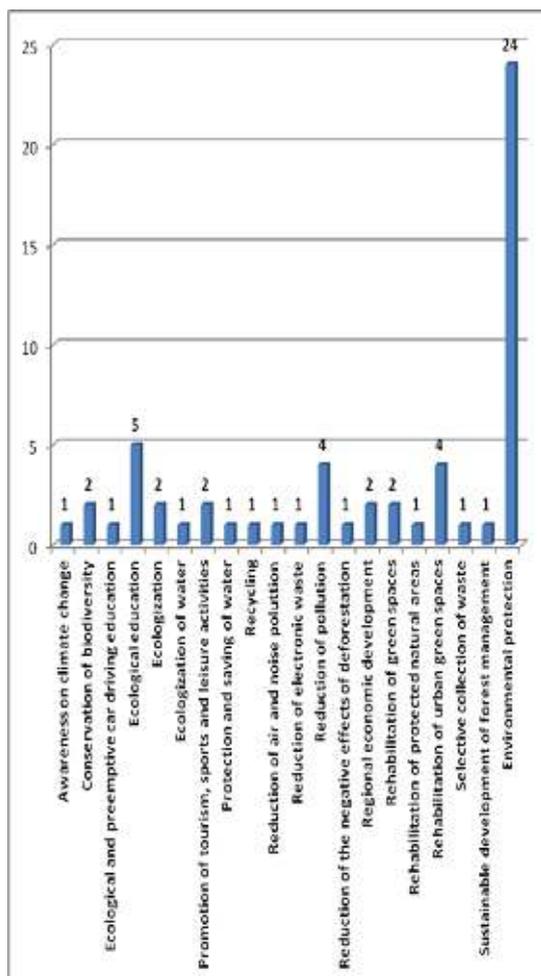
The industrial sectors where the corporate involvement in environmental issues is stronger are the following: Food and beverages, Communications, Constructions, Financial services, Oil and gas, and Utilities. The development of CER in these specific sectors could be explained by using two types of arguments, both of them proving the increasing CSR commitment in Romania in the last years: on one hand, a strategic approach of CSR, CER being specifically developed in those business sectors where the corporate impact on the human and natural environment is considered to be very high (Food and beverages, Communications, and Constructions); on the other hand, an intensive approach of CSR, CER being also highly developed in the Financial services sector, a field of activity that proved to be one of the most corporate responsible ones in Romania. In this sense, a correlation could be established between the main corporate object of activity and their involvement in CSR issues.

Regarding the budgets for the 24 analysed case studies, only 9 of them were made public by their corresponding companies (Orange Romania – € 170,000; Vodafone Romania – € 50,000; Carpatcement Holding

– € 55,000; UniCredit Tiriac Bank – € 179,000; MOL Romania – € 191,000; Petrom – € 1,500,000; Terapia Ranbaxy – € 12,000), with Petrom and its “Parks of the future” project (2007) leading the top of corporate financial involvements in supporting environmental issues (€ 1,500,000), followed at great distance by UniCredit Tiriac Bank (“Cicloteque” project, 2010, € 150,000) and MOL Romania (“Green spaces” project, 2009, € 150,000). The Oil and gas sector could be highlighted because of its consistent financial involvement in the environmental issues.

Using a methodology that could be presented on request, our analysis envisaged further on the main types of CER issues supported by the analysed companies in Romania. The results, presented in *Figure 2*, emphasize that excepting Environmental protection, which is a common element for all the respective case studies, a special focus was put on: Ecological education; Reduction of pollution; and Rehabilitation of urban green spaces.

*Figure 2. Supported CER issues by responsible companies in the analysed case studies (24)*



Source: Authors' representation using the information presented on <http://www.responsabilitatesociala.ro> site.

The implementation of ISO 14000 series environmental management standards is strongly assumed by the most responsible companies in Romania (most of them listed on the [www.responsabilitatesociala.ro](http://www.responsabilitatesociala.ro) site).

## 5. Recommendations and conclusions

For a comprehensive image of the CER in Romania, the information presented above in the empirical analysis conducted at corporate level could be complemented with a set of broader guidelines for strengthening the environmental protection emphasized in *The National Strategy for Promoting CSR in Romania 2011-2016*:

- Increasing awareness regarding the risks of the productive activities over the preservation of the environment;
- Promoting an approach based on environmental reduction impact at the corporate level;
- Promoting environmental impact analysis

at the corporate level;

- Organizing scientific / specialized events on environmental protection issues;
- Promoting an active involvement of the corporate environmental officials in order to improve the CSR activities;
- Promoting the application of sustainable solutions for linking environmental effectiveness with cost efficiency;
- Promoting the application of CSR in public procurement in correspondence with the provisions in the National Strategy for Sustainable Development;
- Protecting the water;
- Protecting the historical monuments and the ecosystems;
- Sustainable managing of forests;
- Issuing of norms and instructions for preventing the occurrence of corporate damages on the environment;
- Supporting corporate investments in areas underdeveloped in economic, social or environmental terms;
- Elaborating guidelines and specific methodological instruments for environmental protection [20].

Concluding about the empirical analysis of CER in Romania, a consistent strategic approach could be observed in the last years, the environmental issues supported by the Romanian companies reflecting their main objects of activity and being correlated with the main priorities emphasized at the European level. Although after the economic and financial crisis the social issues are leading the nowadays top of corporate involvement because of the community pressure, the ecological issues still remain a basic component of the CSR policies of the Romanian companies.

## 6. Acknowledgement

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## Simulating the Evolution of Romanian's Pupils and Students Considering the Country's Economic Activity

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### Abstract

*The authors present the result of a research that uses already trained and validated artificial neural networks (ANN) in order to simulate the influence of Romanian's economic situation over the number of country's pupils and students (PAS). The objective is to determine which of the four economic indicators (GDP per capita in PPS, Share of government budget appropriations or outlays on research and development, Real GDP per capita and Employment rate) have the more influence and is that influence over the evolution of Romanian pupils and students. The present paper continues to reveal the result of a research from which the early results were shown in a different international conference. In conclusion, the use of the ANN is considered a success and the authors determine the possibility that ANN research application be extended to other countries or even to the European zone.*

**Key words:** Artificial intelligence, Artificial Neural Network (ANN), Pupils and Students, GDP per capita.

**J.E.L. Classification.:** C53

### 1. Introduction

The importance of the government implication in the education is more emphasised with the spectre of financial crisis effects. But the government's investment in education, research and jobs is

determined by its economic result, such as Gross domestic product (GDP). Even if it is hard to find a linear or direct link and determination between the GDP and the number of the Romanian's pupils and student (PAS) a country has, it is obvious the existence of a direct relation between them. The present paper offer a method that uses nonlinear mathematics to determine the influence between indices for economic activity and PAS in order to assure the base for future research and to forecast the PAS accordingly to country's GDP.

### 2. Theoretical elements

*Artificial neural network (ANN)*

Today, Artificial Neural Network (ANN) can be found in the majority of the human life activity, their potential being considered immense. Starting with the human brain and continuing with the actual common application of the ANN, their use effectiveness is demonstrated as can be seen in Akira Hirose's book "Complex-valued neural networks: theories and applications" (Akira, 2003).

*Input and Output data*

The input and output data can be found on European Commission website (<http://epp.eurostat.ec.europa.eu>) and they are defined as follows:

GDP per capita in PPS (GDP), as - Gross domestic product (GDP) is a measure for the economic activity. It is defined as the value of all goods and services produced less the value of any goods or services used in their creation. The volume index of GDP per capita in Purchasing Power Standards (PPS)

is expressed in relation to the European Union (EU-27) average set to equal 100. If the index of a country is higher than 100, this country's level of GDP per head is higher than the EU average and vice versa. Basic figures are expressed in PPS, i.e. a common currency that eliminates the differences in price levels between countries allowing meaningful volume comparisons of GDP between countries.

Share of government budget appropriations or outlays on research and development (GOVB), as % of total general government expenditure - Data on Government Budget Appropriations or Outlays on Research and Development (GBAORD) refer to budget provisions, not to actual expenditure, i.e. GBAORD measures government support for R&D using data collected from budgets. The GBAORD indicator should be seen as a complement to indicators based on surveys of R&D performers, which are considered to be a more accurate but less timely way of measuring R&D activities. In this table, total GBAORD is expressed as a percentage of total general government expenditure.

Real GDP per capita (RGDP), growth rate and totals as percentage change on previous year - Euro per inhabitant - GDP includes goods and services that have markets (or which could have markets) and products which are produced by general government and non-profit institutions. For measuring the growth rate of real GDP, the GDP at current prices are valued in prices of the previous year and the thus computed volume changes are imposed on the level of a reference year; this is called a chain-linked series. Accordingly, price movements will not inflate the growth rate. Real GDP per capita is calculated as the ratio of real GDP to the average population of a specific year. It is often used as an indicator of how well off a country is, since it is a measure of average real income in that country. However, it is not a complete measure of economic welfare. For example, GDP does not include most unpaid household work. Neither does GDP take account of negative effects of economic activity, like environmental degradation.

Employment rate by sex (EMPR), as % - This employment rate is calculated by dividing the number of persons aged 15 to 64 in employment by the total population of the

same age group. This is not the Europe 2020 employment rate indicator which refers to persons aged 20 to 64. The indicator is based on the EU Labour Force Survey. The survey covers the entire population living in private households and excludes those in collective households such as boarding houses, halls of residence and hospitals. Employed population consists of those persons who during the reference week did any work for pay or profit for at least one hour, or were not working but had jobs from which they were temporarily absent.

Pupils and students (PAS), in Thousands - This table includes the total number of persons who are enrolled in the regular education system in each country. It covers all levels of education from primary education to postgraduate studies (excluding pre-primary education). It corresponds to the target population for education policy

### 3. Simulating the PAS using ANN

After the training, the ANN evaluated the importance that every input data has over the output data. The result of the evaluation is presented in table 1.

*Table 1: Input Data over Output Data Importance*

Input column name	Importance, %
GDP	38.48
GOVB	31.66
EMPR	13.41
RGDP	16.43

As can be seen the most influence over the PAS evolution is showed by the GDP, followed by closely by the GOVB. Also, the EMPR and the RGDP have much smaller influence over the evolution of PAS.

### *Validation and Testing*

The second set of data testing is formed from data that was never fed to the ANN in order to train it. So this set was new to the trained ANN. The results of the comparison between the real data and the simulated data are presented in table 2.

Table 2: Testing results - Actual vs. Output

PAS_ real	PAS_ simulated	Difference PAS_real vs PAS_simulated [%]
3903.50	3879.15	0.623799
3879.20	4019.27	-3.6108

The ANN is able to simulate trends of the PAS relatively to the input data very close to the real ones. As expected, the more accurate ones are the trends of the GDP and RGDP, as the trends of the GOVB and EMRP contain a bigger amount of error. This can be explained by the importance the ANN allocated for each of the input data.

Figure 1. Simulated PAS versus the simulated GDP values.

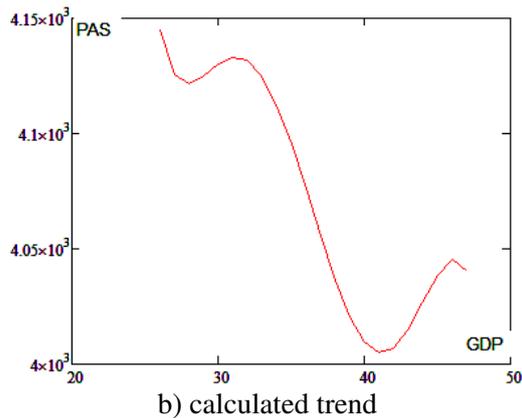
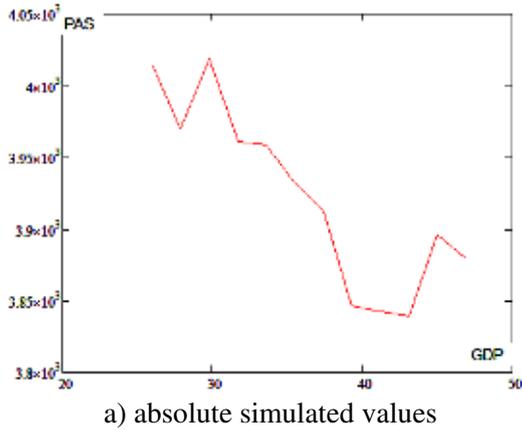


Figure 2. Simulated PAS versus the simulated GOVB values.

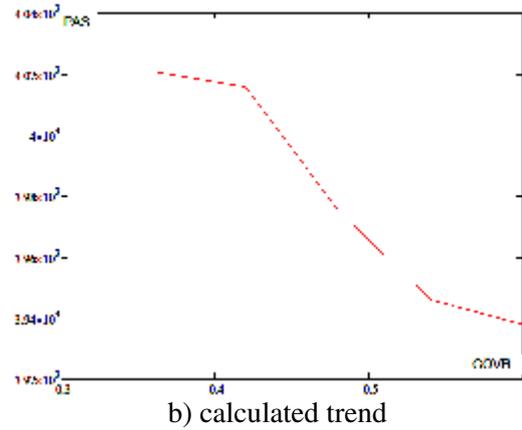
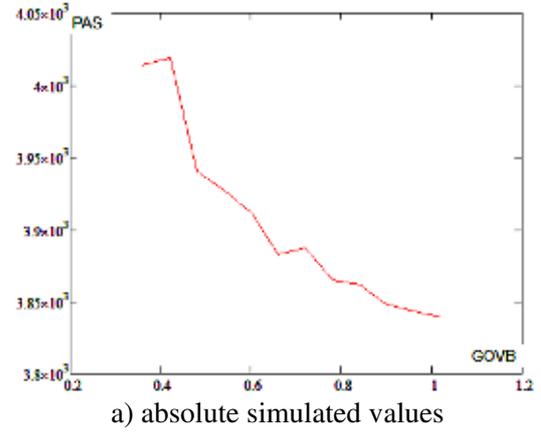


Figure 3. Simulated PAS versus the simulated EMRP values.

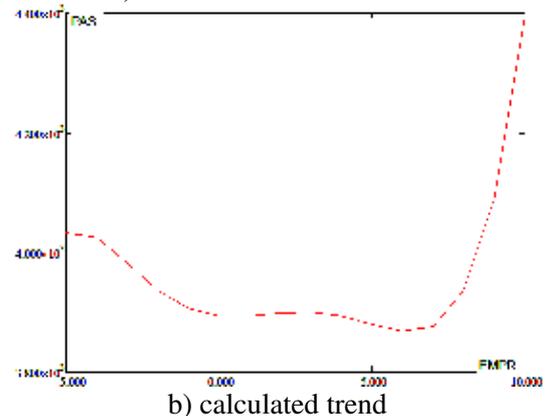
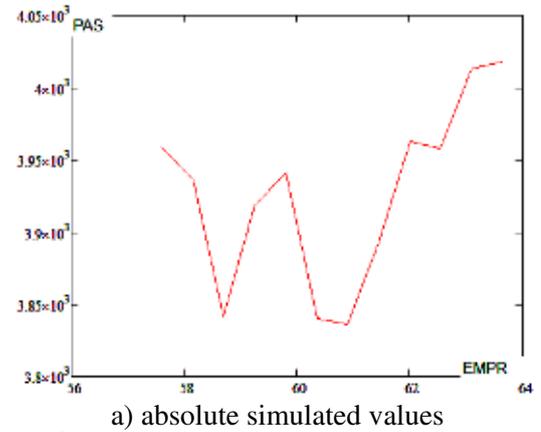
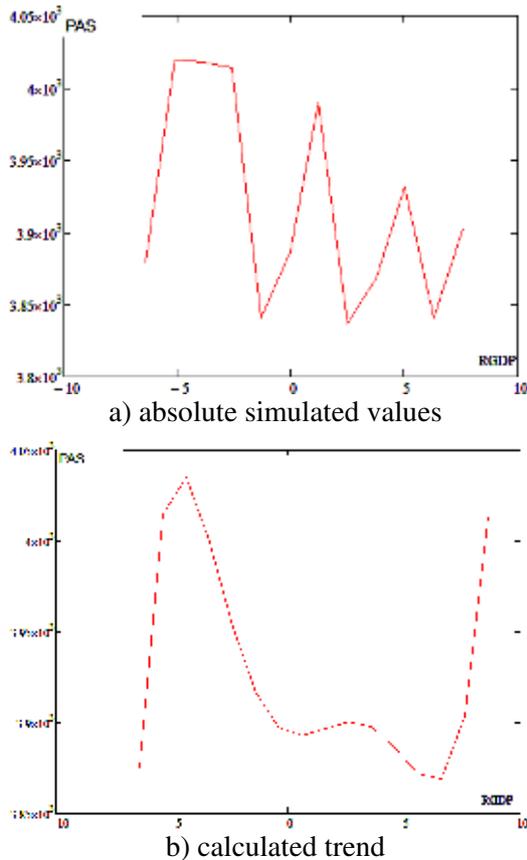
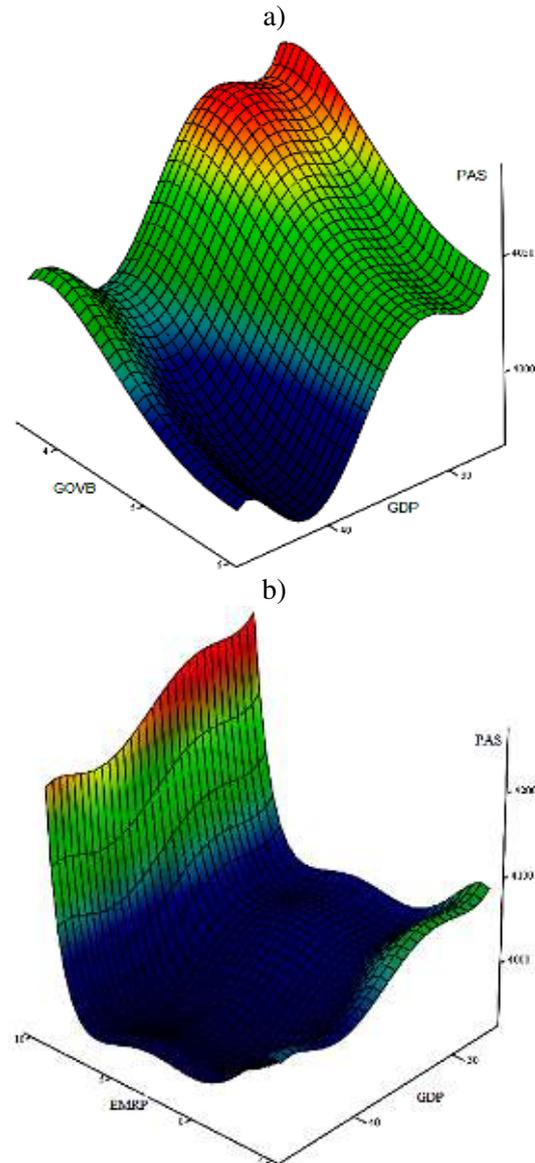


Figure 4. Simulated PAS versus the simulated EMRP values.



students (PAS) is the GDP per capita (GDP) followed by the Real GDP per capita (RGDP), Employment rate (EMPR) and Share of government budget appropriations or outlays on research and development (GOVB).

Figure 5. 3D Simulated PAS variation versus: a) GDP and GOVB; b) GDP and EMRP; c) GDP and RGDP; d) EMRP and GOVB; e) EMRP and RGDP; f) GOVB and RGDP.

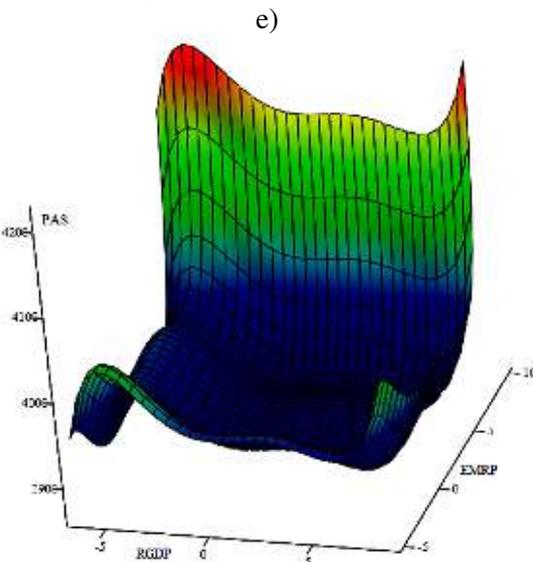
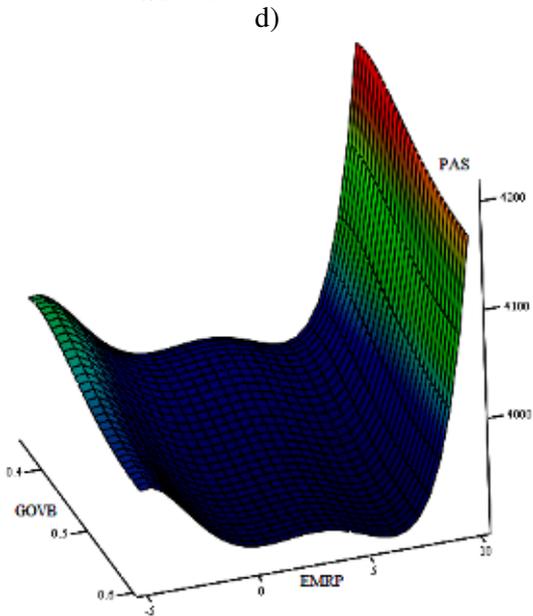
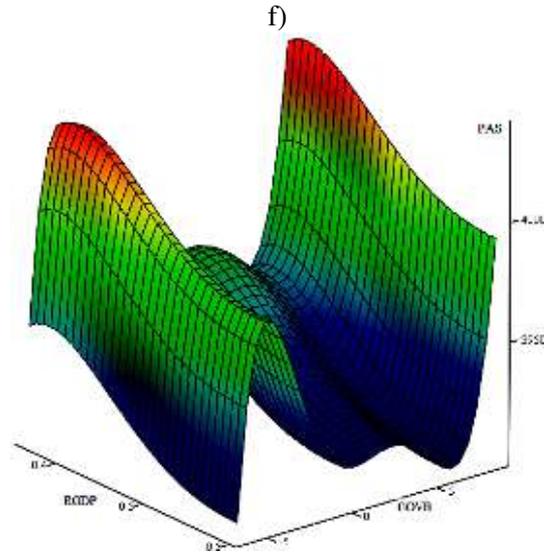
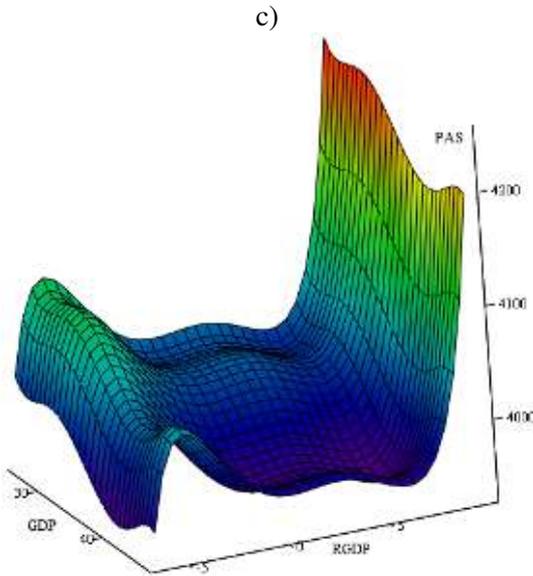


In figure 2, the 3D variation of the CONS simulated values is presented considering the determined trends of the each input data, based on the simulated data as consecutive values in arithmetic progression, for each and every input.

Analyzing the 5th figure, the following conclusion can be extracted:

- The GDP has almost the same influence over the PAS than the GOVB and the EMRP, but with a slight overcome, as it can be seen in figures 5.a and 5.b;
- The EMRP has a stronger influence over the PAS than the GDP, the GOVB and the RGDP as it can be seen in figures 5.d;
- The RGDP has almost the same influence over the PAS than the GDP and the EMRP, but with a slight overcome, as it can be seen in figures 5.c and 5.e;
- The GOVB has a stronger influence over the PAS than the RGDP as it can be seen in figures 5.b, 5.d and 5.f.

Analyzing the above statements from the simulated data, it becomes obvious that the most influential data for the Pupils and



#### 4. Acknowledgment and Conclusions

The research established the necessary theoretical characteristics for the pre-processing, training, validating and testing the ANN for the simulation of the numbers of Romanian’s Pupils and Students considering the country’s indices for economic activity. The ANN training is considered a success and all the initial conditions are respected.

The ANN offers information about the importance that the input data has over the PAS. The most influential inputs are the GDP (38.48%) and the GOVB (31.66%). This confirms the real situation that the countries with the biggest GDP and GOVB have the most numerous pupils and students.

The researchers consider that the studies must be extended over a larger period of time and also over a bigger database. This can create a more prepared ANN, and thus a more accurate result. Also, the 3D representation of the influences must be analyzed in order to determine the significance of the inflection point determined in every PAS representation.

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## Multi-Dimensional Approaches to Organizational Performance

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### Abstract

*Nowadays, addressing the different dimensions of organizational performance is a topic of major interest, as researchers, managers and stakeholders, alike, tend to increase its importance. This attitude towards organizational performance is motivated by the fact that many companies want to improve their performance evaluation system, aiming to capture the many factors behind its performance. Moreover, multidisciplinary perspectives on performance measurement, such as the balanced scorecard, the performance prism or the performance measurement matrix, point out the importance of non-financial measures in reflecting the overall activity of an organization.*

*Considering the diverse facets of organizational performance, this paper aims to detail existing performance frameworks designed as multi-dimensional models that can be used in performance evaluation. The main objective of this paper is to highlight the importance of a multi-dimensional view on organizational performance, as all factors influencing it must be taken into consideration.*

**Key words:** performance prism, balanced scorecard.

**J.E.L. Classification:** M21.

### 1. Introduction

No doubt, performance has been and still is a continuous concern for the management of any organization. Unfortunately, identifying all factors that have influence on organizational performance is a difficult task. Consequently, it is of great interest to analyze the perception of the „performance” term in the economic theory.

Researchers and practitioners in the economic field have diverse opinions when defining business performance, hence there is no generally accepted definition of this term. Therefore, some economists address performance in terms of business objectives, referring to the extent at which objectives are achieved, others regard it as a measure of the value created by an organization, while a latter category considers performance in terms of productivity and efficiency of the business.

Considering an organization as a group of people which conduct activities aimed at achieving a common objective, performance refers to the degree at which an organization, as a social system, with certain resources and means, achieves its goals [11]. In this context, performance is analyzed in relation to the objectives pursued, as an internal reference. This first assessment of performance emphasizes a subjective point of view, as performance is entirely dependent on business objectives. Thus, companies that have set modest goals can consider a certain level of performance as high relative to its high level of achieving pursued objectives, while other companies can appreciate the same level of performance to be reduced relative to a lower degree of fulfilling some ambitious objectives. Therefore, the same level of performance can be assessed differently.

In this context, performance is considered to reflect all that contributes to achieving the strategic objectives of an enterprise, but also all that contributes to improving the value-cost couple[3]. Consequently, performance is defined by referring to the value created by an enterprise relative to its costs.

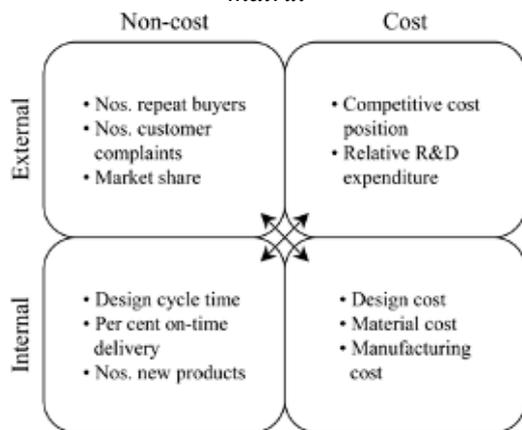
From another point of view, performance is defined in terms of effectiveness and efficiency, as a state of competitiveness of a company, reached through a certain level of effectiveness and efficiency which ensures a

sustainable presence on the market of the respective company [9].

## 2. Performance frameworks

Among the first proposed performance frameworks, the performance measurement matrix provides a wide range of performance measurements. Designed by Keegan, Eiler and Jones in 1989, the performance measurement matrix anticipated the different dimensions of an organization’s performance, putting in light that factors that drive performance of an organization are both internal and external, some of them generating costs, some generating non-costs - Figure no. 1. Thus, by using this framework, it is possible to identify all business performance indicators, and consequently, reduce eventual omissions in the performance measurement process. However, the performance measurement matrix provides little evidence on the various dimensions of performance that should be measured.

Figure no.1 – The performance measurement matrix



Source: Keegan, Eiler and Jones (1989) [5]

In order to overcome shortcomings in the performance measurement matrix, the results and determinants matrix was developed in 1991 (shown in Figure no.2). The model, designed by Fitzgerald et al. (1991) [1], was the result of their study conducted on performance measurements in the services sector.

The results and determinants matrix assumes that there are two basic types of performance measurements in any organization, namely those relating to results (competitiveness, financial performance), and those focused on the determinants of the

results (quality, flexibility, resource utilization and innovation).

Figure no.2 – the results and determinants matrix

Results	Financial performance
	Competitiveness
Determinants of the results	Quality
	Flexibility
	Resource utilisation
	Innovation

Source: Fitzgerald et al. (1991) [1]

However, this approach highlights the fact that results are based on past performance of the company relative to specific determinants. In other words, criticism of the model shows that the results are indicators of the past, while determinants are indicators that influence future developments.

Still, one of the most used and well-known performance frameworks is the balanced scorecard, a model designed by Kaplan and Norton in 1992. The model is a simple one, aiming to assess four logical questions (as seen in Figure no.3) [6]:

- How do we look at our shareholders?
- How do our shareholders see us?
- What must we excel at?
- Can we continue to improve and create value?

By answering these questions, an organisation can properly evaluate its overall performance, given that several perspectives are considered – financial perspective, customer perspective, internal business perspective and innovation and learning perspective.

Figure no.3 – The Balanced Scorecard



Source: Neely et al. (2005), adapted from Kaplan And Norton (1992)[8]

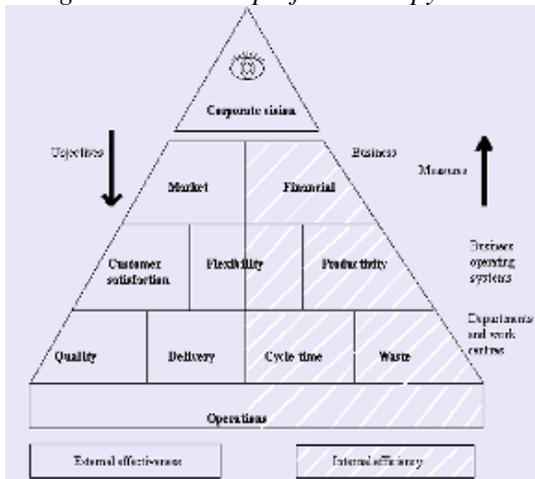
Kaplan and Norton’s balanced scorecard has some characteristics which make it preferable when structuring a system of performance indicators. Firstly, this four dimensional approach helps an organization establish explicit links between the strategy adopted and those performance indicators that it uses for strategy implementation and monitorization. However, there is no universal set of indicators that are suitable to all firms in all situations (as assumed in most approaches, for example, when determining financial performance), but business-specific indicators should be designed for specific situations.

Secondly, the four areas of interest within performance indicators will be projected - financial, customer-focused, process-oriented and innovation and learning - meet the needs of the key stakeholders of the company. It would be therefore possible to extend this model to one desired by organizations’ stakeholders.

According to Kaplan and Norton, by analyzing the four aspects mentioned above, an organization should be able obtain a balanced view on its activity, given that all major aspects of its activity have been considered.

Performance models above are based on models of hierarchical organization within companies. There are also models that focus on promoting horizontal flows in the company, for example, the orientation process, without excluding the hierarchical view. The most relevant model of this type is the proposed Lynch and Cross (1991), called performance pyramid (Figure no.4).

Figure no.4 – The performance pyramid



Source: Lynch and Cross (1991) [4]

Performance pyramid is built based on the idea that a company operates at different levels, each of which has a center of interest. However, it is imperative that between these levels is a constant connection, hence the pyramid links corporate strategy to daily operations of an organization. Lynch and Cross suggest measuring performance through eight dimensions (as seen in Figure no.4): cycle time, waste, productivity, financial, flexibility, quality, delivery customer satisfaction and market, the first four reflecting performance in terms of internal efficiency of the organization and the last four considered as performance indicators in terms of external effectiveness.

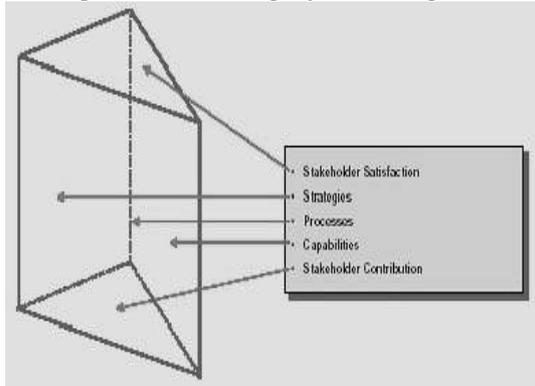
At the bottom, the objective is to improve the quality and delivery period and reduce cycles and losses. At this level a number of non-financial indicators will be used to measure operations. The four levels of the pyramid are designed in order to support each other in achieving goals. For example, reducing the duration of a cycle and/or losses will increase productivity and therefore increase profitability and cash-flows.

### 3. Recent approaches to organizational performance

One recent approach uses the performance model performance prism (Neely et al., 2002). The performance prism is a model developed by Cranfield University and highlights the importance of all stakeholders in an organization, without focusing on a particular group. Thus, the company takes into account the needs of all stakeholders and what are their expectations, and therefore identifies what the company needs and what it wants from its stakeholders.

There are five aspects of the performance prism (Figure no.5), namely, stakeholder satisfaction, stakeholder contribution, strategies, processes and capabilities.

Figure no.5 – The performance prism



Source: Neely, Adams and Kennerley(2002)[7]

In building the prism, the five above mentioned aspects require a series of specific questions (and answers), namely:

- Stakeholder satisfaction - Who are the key stakeholders, what do they want and need?
- Strategies - What kind of strategies do we need to meet the desires and needs of our stakeholders?
- Processes - What critical processes do we need to execute our strategies?
- Skills - What skills do we need to maintain and improve our processes?
- Stakeholder contribution - What contributions do we need from our stakeholders, if we want to maintain and develop these capabilities?

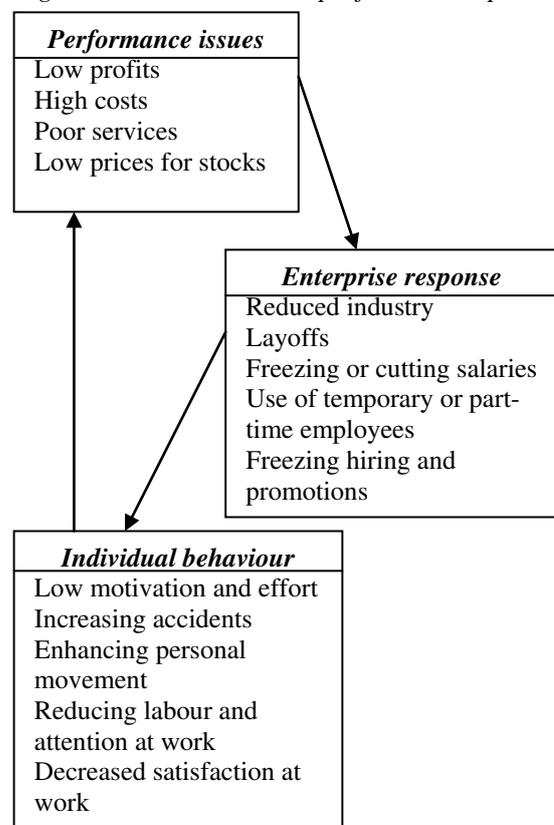
The performance prism is different from other models that address performance as it focuses attention to business stakeholders, and not to its strategy. The „stakeholder” term, by referring to a group of people that have a common interest in a business or industry, implies the fact that both customers and employees, investors and suppliers, regulators and pressure groups have an important influence on organizational performance, along shareholders and managers. Company’s success is seen in this context as based on successful partnerships and relationships between the organization and its stakeholders.

In accordance to Neely, Pfeffer J. (2010), considers that human resources are the ones responsible for the performance of an organization, showing how the first influence the latter. Thus, in building the downward performance spiral (shown in Figure no.7), Pfeffer identifies those factors that determine chain reductions in organizational

performance.[2]

According to Pfeffer, human capital is of major importance in any organization [2], hence it should consider its people first. Pfeffer argues that many companies have sought solutions in places that were not productive at all, treating their businesses as portfolios of assets that can be bought and sold. Consequently, by reducing the activity of an organization and contracting parts of it to third parties, in the attempt to find the shortest and simplest way to profit and performing countless other actions, will weaken or destroy organizational culture [10].

Figure no.6 – Downward performance spiral



Source: Pfeffer (2010) [10]

#### 4. Conclusions

Although it seems simple to define and measure, organizational performance is a complex universe within different ideas and theories mingle. The present study offers a detailed review on existing performance frameworks, pointing out their strengths and weaknesses and revealing that:

- There are many factors that have an important influence on the success of an organization;

- Different frameworks can be designed in order to meet the needs of a specific organization;
- Performance needs to be assessed from multiple points of view;
- Not only shareholders, customers and employees count, but also investors, suppliers, regulars and other pressure groups.

Some of the frameworks discussed in this paper, such as the balanced scorecard, the performance prism or the downward performance spiral, emphasize the importance of analyzing performance in the light of some new topics, like customer satisfaction, employee attitudes, how the company is perceived by its competitors, etc. It is therefore necessary to study all aspects of a business and its relationship with the internal and external environment in order to design a proper and adequate performance framework.

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# Quality Management Spas

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## Abstract

*Applying quality management in coastal tourist facilities became a necessity under current economic development. Increased quality of tourism services must be established as a priority for owners and management of tourism companies under increasing competition Powerful seaside tourist market.*

**Keywords:** quality, tourist services, management, spas, eurespa

**Jel Classification :** L83

## 1.Introduction

Applying quality management in tourism Spas, as in other forms of tourism is essential and decisive influence on the quality of tourism services. Introduction of quality management in tourist services units increase the quality of services, whether we speak of accommodation, catering, transport, leisure and spa. These services make up a whole contributing to the optimum and higher satisfaction of needs and requirements of tourists.

## 2. Quality Management Spas

Quality is more important, if we refer to Spas, because those who benefit from these services are often people with special needs, elderly people, people who enjoy a good health or people who simply relax by appealing to certain therapies offered by this form of tourism.

*Accommodation services* require the existence of appropriate accommodation (hotels, motels, villas, etc.) and suitable equipment to ensure hygiene tourists.

Quality of accommodation depends essentially of:

- existence of technical and material accommodation and related facilities at a higher quality (sufficient and functional furniture, functional sanitation, cleanliness and hygiene of the accommodation, equipment rooms corresponding to the number of stars that is classified accommodation, there additional services and their provision in appropriate circumstances, etc.)
- staffing accommodation capacity, number, level of training and qualifications, work organization in hotel units.

Providing leisure tourists accommodation is fundamental to Spas and is subject to: [1]

- Location of accommodation (they must be accessible, quiet area, with numerous green spaces, equipped with special facilities)
- Soundproofing rooms in relation to high traffic areas (not to be located near railway stations, bus stations, amusement parks, etc.);
- Quality of its personnel (staff must be courteous, friendly, provide useful information).

Hygienic conditions are dependent on:

- quality medical equipment;
- proper functioning and maintenance of medical equipment;
- the existence of inventory items for personal hygiene;
- frequency of replacement inventory items for personal hygiene.

Insufficient accommodation, equipment are inadequate, the disparity between comfort level and demands of tourists and the small number of workers or their poor preparation adversely affect quality benefit tourism tourist flow dimensions and possibilities of recovery of the tourism potential of natural and anthropogenic .[3]

Catering services is an important side of serving tourism fits into the category of basic services. As economic activity, catering is not exclusively designed to meet the needs of consumers-tourists, but it is often associated

tourism activities and its dynamics is influenced by the evolution of tourist traffic. Between the tourism and catering are interrelated, the latter determines the quality of services and influence the content and activity tourism offer.

Primordial component in the structure of modern tourist offer, catering is the main means of raising the quality of tourism services in conditions of maximum efficiency.

Nutrition services aimed at meeting the food needs of the tourists, but also recreation and entertainment needs, developing in relation to housing services or independent of them.

Quality catering services depends greatly on the quality of production activities, marketing and service. They imply the existence of specialized areas for each activity, functional and equipped with modern equipment, qualified staff and specialized and consumer conditions culinary (sanitary rules, ambience, comfort, etc.).

Network catering units, restaurants occupy an important place of various specializations, offering consumers a wide range of dishes, and usually they are located within hotels (for Spas their existence inside or near the hotel has a role the choice of the unit).

Specific features of catering services in relation to tourism activity are: .[1]

- Presence in all key moments of tourism consumption: boarding places, places of destination and accommodation, places of entertainment, spa places;
- Necessity of a wide typology of food units that meet the needs of food and entertainment, etc.
- Special requirements to ensure rigorous diet, for medical spa tourism special diet regimens are necessary to contribute to successful treatment;
- To meet the requirements both local and foreign tourists (international cuisine, regional or local);
- The holiday treatment, diet should not affect the results of medical treatment, which is different in each particular seat is the tourist-patient and condition being treated.

Ensuring a constant high quality of catering services, is not only in using intrinsic quality material consumption

(tangible side benefit), but also in the art of hospitality (the intangible side benefit).

Learning the art of restaurant staff aims to structure customer in such a way that tourists really feel that is treated as a guest.

A characteristic feature of catering, to distinguish it from other units and to be competitive in the competitors, is the introduction, cultivation and maintenance of professional hospitality to their clients.

The spa tourism, introduction and maintenance of professional hospitality plays an important role due to the fact that here we work with a special category of tourists (tourists, patients) who have special characteristics and needs.

Transport services are essential in any form of tourism, they provide tourists travel from place of residence to place of destination or stay.

The vehicles used to move tourists in any form of transport used (road, air, rail, water) must meet the technical and functional. Comfort, convenience, speed, security, regularity, making travel time, the tariffs, additional services when traveling, are some factors to consider in assessing the quality of tourist transport.

Leisure services contributes to physical and psychological needs of tourists, thus creating the necessary spending leisure time enjoyable and instructive.

Equipment and recreational facilities and spas are outdoor thermal pools, indoor swimming pools, saunas, sports, bowling, ski, lift, games, libraries, museums, theaters, parks, athletics tracks, casinos, alleys designed for cleaning the land, beaches and furnished endowments, solariums, gyms, fitness centers, etc..

Approval is an indicator quantity and quality of the tourism phenomenon, while the quality factor for tourism development. The main trends that manifest in their leisure offer is ongoing development, quantitative and qualitative, and diversity of leisure and means available to tourists to ensure your shopping experience of spending free time.[3]

Cleaning services or medical spa treatment are additional travel and tourist occur in situations where complete their stay at a resort (motivated by rest, relaxation, sun-sea cure, etc.) to carry out simple treatments

(exercise, aerosols, mineral water cures, thermal water baths, etc.), taking preventive

Smooth running of these services requires the existence of natural therapeutic factors and addition of modern facilities such as cleaning hotels and sanatoria complex, the services of accommodation, diagnosis and treatment are offered framed the same building.

Quality spa services is valued both in terms of existing facilities in the basics of treatment (medical equipment to meet safety standards, to be functional and in sufficient numbers, the the capture of the natural factors of course well maintained and functioning to normal etc.) and personnel involved in providing these services. Contact staff must meet certain requirements related to training (specialists in certain types of diseases), moral conduct, willingness to serve promptly and efficiently, kindness, understanding the needs of tourists to their satisfaction as better.

The main spas in Romania have the necessary facilities for these services, but greater efforts should be made for tourists provide quality services to meet their every need at the highest levels, because current conditions are putting a growing emphasis on health care policy, physical and mental health is one of the basic levels of civilization

### **Signs of quality in tourism and spa tourism**

Marks of quality in tourism are: [4]

- the stars are typical in all units of tourist accommodation: hotels, villas, hostels, rooms for rent and camping. They are marked with the number of stars, according to the classification criteria established by certificates issued by the Office of Tourism Authorization and Control. The maximum number of star accommodation is 5, but not all areas receive the maximum;
- the daisies, show quality rural tourist guesthouses and stars are equivalent;
- the dolphins symbolize quality categories of beaches on the following criteria: quality of sand, sand thickness, there showers, clothing exchange booths, toilets facilities, existence of groups of first

aid facilities and recreational facilities.;

- the quality categories are signs for restaurants, bars, fast foods, confectioneries, bakeries. There may be class "luxury" category I and II.

### **Mark Q**

Q brand is a specific brand hotel units, as a tool for assessing the capability of hotels to operate in an optimal context and coherent, validated at the highest current standards.

Classification of hotels in the number of stars is based only on certain physical attributes (space, equipment and facilities and hotel rooms, etc.) and less on qualitative characteristics and codes of good practice based on quality standards (hospitality, availability, solicitude, basic and additional tourist services quality, etc.).

Q brand to introduce the hotel sector is to improve the quality of services to increase customer satisfaction and guarantee that customers will benefit in any hotel units valued and certified by a high level of quality services, regardless of hotel unit that category [2].

Such a system was introduced in Spain, a country with tradition in tourism, where the number of stars appear with the letter Q, the symbol of a system showing the highest quality of service offered by number of stars.

### **Blue Flag**

Blue Flag - is a symbol of international recognition of certain beaches and marinas. Beach operators enrolled in the program "Blue Flag" enjoy significant advantages in terms of its own image, but also in terms of overall tourism activity.

Benefits of this program are: to ensure appropriate environmental management, ensuring security and promoting clean and beaches, as well as environmental education and information activities on the environment, cleanliness priority for tourists, promoting a whole, local, national and international beach, beaches in the registration requirements of EU regulations, attracting foreign tourists because this distinction has wide international recognition, having an organic symbol recognized internationally visible presence on the world map of towns with beaches "Blue Flag" 7-10% increase in the number of tourists per season, including periods of start of the season.

At European level, some countries have many blue-flag beaches, for example Spain with over 450, 140 Turkey, Bulgaria 10, while in Romania until 2005, there is no distinction beach. Now, after efforts, some beaches of Mamaia resort (beach Vega, 2010), North Eforie, Saturn, Neptune, Venus (2006) were obtained from the Foundation for Environment distinction "Blue Flag".

#### **Mark Eurespa**

Eurespa logo-med is European quality brand spas and health centers. Holding logo certifies Eurespa-med requirements ESPA (European Association resorts) on general infrastructure therapies, hygiene and security of tourists.

European Association of resorts based in Brussels, and brings together representatives of national associations in the field of European countries. This logo was introduced in order that accredited health resorts are distinguished from other competitors, the international recognition of the high quality of tourist services patients. Eurespa for accreditation must fulfill and comply with a number of 400 criteria in the following areas: system management and compliance, procurement and supply of therapeutic factors, implementation procedures and therapeutic spa's, accommodation and catering activities.

Eurespa logo - quite appreciated med health insurance companies and major tour operators in Germany, considering that it is reference to a certain high international quality tourism services and spa. In our country, only International Hotel Felix has Espa certificate for spa complex, several units in the country carrying out such activities on a specific ISO 9001 certifications.

In the near future it is expected that five other hotel units may be certified to the standard Espa. Hotels are located in resorts Ocna Sibiu, Geoagiu Spa, Vatra Dornei, Saturn and Felix..[5]

### **3. Conclusions**

In the current period, quality has become a global strategic management of businesses because it causes the highest degree of competitiveness of products / services domestically and internationally. Quality is the main factor regulating the market through

customer entitled to choose what best suits his needs and his expectations.

Quality products and services to its customers is one of the strategies underlying the development of seaside tourism companies, and more.

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# The Analysis of Human Resources Management Particularities in Tourism

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## Abstract

*The human resources management in the tourism companies is part of the marketing mix and has a series of particularities that distinguish it from the same activities of the goods production sectors.*

*The article proposes to emphasize, theoretically, the human resources management particularities in tourism, and from the practical point of view, the results of a research are presented, achieved during the March-April 2012 period, in seven representative tourism companies from Iași municipality. The questionnaire used in this research aims at emphasizing the manner in which the managers take into account these specificities in recruiting and selecting the employees, motivating and training them for obtaining performance and coagulating the work teams, around the values promoted through the organizational culture of the analysed companies.*

**Key words:** human resources management, tourism, organizational culture.

**J.E.L. classification:** M12

## 1. Introduction

In order to be effective, competitive, the tourism companies give a special importance to the human resources management and especially to the personnel management that has direct contacts with the clients. In the service processes, most of the times, the customer satisfaction is indissolubly related to the provider personnel, the appreciation of their quality being confounded with the executants themselves. The means of creating and delivering the service must combine the efficiency and competence with the charm, interpersonal skills, so that the client and company's interests are simultaneously served.

## 2. Theoretical considerations

In the tourist services, the personnel is considered the essence of the offer, because of the complex role and the responsibilities it has. The contact personnel of the service company has a crucial role, representing the interface. The contouring of the company image depends to a great extent on the time in which they answer the requests, the precision and politeness they show.

### 2.1. The contact personnel

The contact personnel has a complex role within the tourist services, being considered the most important aspect of the attending processes. These employees are at the crossroads of the client and company's interests, often conflicting, having the role of satisfying, to the highest extent possible, both parties.

From the point of view of the service company we can emphasize several roles of the contact personnel [14]:

- They represent the company in the relationship with the clients;
- They represent the trademark image, and the confirmation of qualitative standards and the trademark name before the clients depends on their behaviour;
- They represent an important factor of differentiation and competitive advantage;
- It represents an essential part of the service offer, the visible one, that takes place before the clients or with their participation, determining the objective quality of the service, and the most abstract and profound aspects of the consumers' satisfaction as well.

From the point of view of clients, the contact personnel represents, in very many cases the motivation for using the company services, representing a strong factor of gaining customers' loyalty politics. The differentiation, in the case of companies that display similar qualitative standards, is insignificant from the technological point of view, because of standardization, the human resources representing the determining factor. That is why, the main objective of the human resources management in the tourism companies is maintaining the competent, productive, motivated contact personnel, loyal to the employer and reducing the number of temporary employees.

## **2.2. Particular aspects of the contact personnel activity**

The contact personnel of the tourism companies are given a special attention within the human resources management, because of the fact that they represent the interface between the company and the consumer.

Its role is multiple, of simultaneous representative of the client and the company, and the work is very complex. The operative tasks must be executed quickly and well, with politeness and readiness, so that the company achieves the quality, productivity and incomes desired, and the client leaves satisfied. Their role is crucial in achieving the qualitative standards and maintaining the customers' loyalty.

The presence at the attending place of other consumers or potential consumers requires a particular attention, all the clients having the right to an equal, nice, and competent treatment.

These aspects of the contact personnel activity are strongly generating stress and role conflicts. The main causes are: the psychological conflict of the service provider with his own role, the conflict between the norms and the rules of the company they represent and the customers' wishes, the mediation of conflicts that appear between the company clients [7, 8,12,15].

a. **The psychological conflict of the service provider with his own role** – derives from the fact that some clients are very difficult, they request things of which they are not sufficiently informed, and then project their discontent on the contact personnel,

others are arrogant, always dissatisfied with something or they always want more or to be served immediately, generating conflicts with the other clients.

Starting from the marketing principle “the client is a king” and “the client is always right”, the employees must prove a lot of tact, patience and competence, comply with the politeness and respect conventions, so that all clients are satisfied. This conflict of roles affects the self-respect, the situations when there are huge gaps between what the provider thinks and what he/she must do are frequent, in order to correctly accomplish his work tasks. The employees' advice in solving the conflicts and the recognition from the managers and colleagues can compensate a part of these negative aspects of the employees' work.

Despite the fact that the obligations generated by the nature of this type of jobs are complex and stressful, in the service companies, especially in the commerce and tourism ones, there are the smallest salaries and the biggest number of employees, and the studies requested at employment are under the average level. The professionalization of the contact personnel and its transforming into a competent personnel, indispensable to the company, requires the employers' special attention on the human resources management.

### **b. The company-client conflict**

The role of company-client conflict mediator derives from the tasks of the contact personnel, to arbitrate between the attending regulations and procedures imposed by the company and the clients' requests.

The conciliating attitude in treating the exceptions is very convenient for the client, it induces satisfaction and loyalty, but it is a perturbing factor of productivity, it increases the attending time and the waiting periods for the other clients. Certainly, the exception must not become a rule.

The employees' flexibility is redeeming for the company before the client, and in the cases when the resources are insufficient and the priorities are not clearly established, only the employees' inventiveness, creativity and competence can attenuate these deficiencies. The capacity of dealing with the unforeseen situations, to satisfy the clients' requirements even in limit situations, being proud that they belong to the organization, the company

prestige being emphasized, induces satisfaction to the provider as well, reducing the stress. These positive attitudes, especially encountered in the great hotel chains and in the small pensions, do not mean that there are no sabotages where the personnel reduced number and the small salaries make more and more room to crowds, queues, employees' tiredness, who become more and more predisposed to making mistakes and exceed the normal attending time.

**c. The conflicts between the clients**

Although the tourism companies have the right to select their clients, and the organizations differentiated according to categories has the role of limiting the access through the high price, the presence of several consumers or potential consumers at the attending place can generate conflicts between them. The differences of education, culture, hierarchies of values are manifested in the case of clients' interactions among themselves. The majority of conflicting situations start from non-complying with the order of waiting lines, of reservations, of places registered on the tickets or travel certificates or restrictions regarding smoking, the consume of alcoholic drinks, of social cohabiting norms etc.

The mediator role of the contact personnel is very stressful, difficult and unpleasant. Both parties cannot be right at the same time and everybody cannot be satisfied, of what the employee decides that the company position represents. Taking measures and formulating an official position requires a special attention, all the clients having the right to an equal, condescend and competent treatment.

**2.3. Particular aspects of human resources management in tourism**

The human resources management in tourism is an integrant part of the marketing mix, being indissolubly related to the customers' satisfaction and the company image. Recruiting, selecting and integrating the employees are difficult activities, because in this field, a good professional training must be doubled by talent, charm, style and a personality suitable to the job. The intrinsic quality of the future employee and vocation cannot be acquired, training only refining talents.

These valuable employees represent the essence of service companies. The test periods or the apprenticeship are specific to the field of tourism and services. The employees

will be directly and indirectly observed, through behavioural simulations, then guided, in order to have a realistic vision on what they must do, how, when, integrating in the atmosphere and acquiring the organizational culture of the service company. During the trial period, they must acquire several categories of knowledge and skills, and namely [12]:

- Theoretical knowledge
- Procedural knowledge;
- Knowledge related to the company environment;
- Social and relational skills;
- Cognitive skills;
- Emotional skills.

The knowledge development starts with the training process, the integration within the organization, of the manner of collaborating but it must be accomplished through continuous learning. The employees must complete and permanently develop their professional knowledge and develop their skills. A particular aspect of the employees' recognition, in the tourism companies is considered the feed-back. In the specialty literature five basic aspects are emphasized, regarding the employees' reward and recognition [17]:

- Achieving the company objectives is the most important reward;
- Achieving the objectives is the foundation of rewards (salary, feed-back, recognition);
- The specific and difficult objectives of the attending personnel must be made public in order to offer recognition, even if they are intangible, such as the evaluation on a scale of courtesy improvement;
- The objectives' accomplishment (the feed-back) must be popularized within the company (recognition) in order to stimulate the employees;
- The specifications on the manner in which the objectives must be reached are not absolutely necessary – the feed-back speaks for itself about results, it is a corrective function, that helps the employees progress, even in the absence of other rewards.

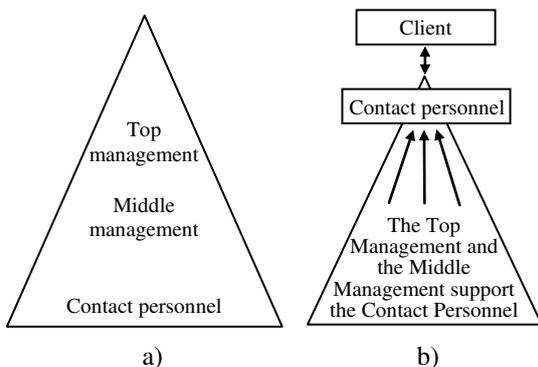
**2.4. The organizational culture in the tourism companies**

The organizational culture in the tourism companies is formed because of the repeated interactions between the members of the organization, of a common idea regarding the beliefs and values of the individuals composing it, although there are strong modelling factors that particularize it, such as: the management style and implicitly the manner of taking decisions, the formalist level, the organization structure, the different competences, the politics, the know-how and the systems that offer value and support to the work and the attending behaviour.

The organizational culture is what “binds” the organization in a chain of tacit significations, that offer human specific meanings to all the organizational activities and processes. At the same time, it is the most important factor of resistance in any change demarche, no matter its scope. [1, 2, 12]. One of the most important factors in building the organizational culture is due to the particularities of interactions between the employees, the leadership and the quality of organizational communication. The particular aspects derive from the contacts with the clients, and their understanding represents the essence of life for the tourism companies.

The efficiency, efficacy and the company survival in itself depend on the attending interaction. In the tourist companies with a strong attending culture, the management proves, through involvement, the client’s crucial role. The managers are not only preoccupied with the global service, but they focus also on the details that count, giving the company the notoriety that distinguishes it from the competition [6, 13, 14, 15].

Fig. 1. The traditional pyramidal organization versus the client focus [12]



Communication is an essential aspect of the organizational culture, beyond the informative role, it creates the teams, the familiar, warm, friendly atmosphere, which makes the clients feel good. An efficient internal communication ensures the efficient distribution in the attending points, strengthens the work relations, making them productive and harmonious, institutes trust, respect and loyalty of employees among themselves and towards the management and the company in itself. The managers’ role is crucial in formal communication, and the compliance of information, communication and decisions entail integrity, trust in the capacity of formal leaders to develop strong, competitive teams.

### 3. Research regarding the human resources management in the tourism companies of Iași

The research was achieved during the period March 2012-April 2012 in seven tourism companies, representative for Iași municipality, using a questionnaire with closed questions. The questions’ variables were assessed with different Likert type scales. The questionnaire was applied to the general managers from the analysed companies. The ideal situation was marked with a distinctive colour.

According to the assessment scale presented in table 1, the representative tourism companies of Iași Municipality registered very good results and they obtained the grade VERY GOOD, regarding the manner in which the managers take into account the particularities of the tourism sector, in the human resources management, having within the answers in the questionnaire 11 situations that overlap the ideal situation, of 13 possible ones, in the following manner:

Recruiting, selecting, training, motivating and coagulating the work teams in the tourism companies of Iași:

$$Qualification = \frac{11}{13} \cdot 100 = 84,61\% =$$

VERY GOOD

Table 1. Questionnaire regarding the particular aspects of human resources management in the tourism companies

<b>HUMAN RESOURCES RECRUITMENT AND SELECTION</b>	
1. Rigorous recruitment and selection : the suitable person at the suitable place (does not exist/to a small extent/occasionally/in general lines/to a great extent)	A B C D <b>E</b>
2. Image on the working force market (does not exist/unfavourable/medium level/favourable/excellent)	A B C D <b>E</b>
<b>MOTIVATING AND DRIVE OF HUMAN RESOURCES IN OBTAINING PERFORMANCE</b>	
3. The use of a motivating salary and bonuses for the employees' motivation (very little/little/average level/high/to a high extent)	A B C D <b>E</b>
4. The existence of feed-back and the public recognition of meritocracy (does not exist/ little/average level/high/to a high extent)	A B C D <b>E</b>
5. The achievement of company's objectives – means of employees' drive (does not exist/to a small extent/occasionally/in general lines/to a high extent)	A B C D <b>E</b>
6. Enriching the tasks and responsibilities – means of employees' drive (does not exist/to a small extent/occasionally/in general lines/to a high extent)	A B C D <b>E</b>
<b>DRIVING AND COAGULATING THE TEAM FOR OBTAINING PERFORMANCE</b>	
7. The intensive training of professional, procedural and interpersonal competences (very low/low/average level/high/to a very high extent)	A B C D <b>E</b>
8. Coagulation around the values and norms of the organizational culture within the company (very low/low/average level/high/to a very high extent)	A B C D <b>E</b>
9. Encouraging the contact personnel (very low/low/average level/high/to a very high extent)	A B C D <b>E</b>
10. The interest given for constituting a performing and compatible team for delivering the tourist services (little and occasionally, little, but continuously/average level/much/very much)	A B C D <b>E</b>
11. Work autonomy (very little/little/average level/high/to a very high extent)	A B C D <b>E</b>
12. Monitoring the employees' satisfaction, of the existence of a positive attending attitude (does not exist/to a small extent/occasionally/in general lines/to a great extent)	A B C D <b>E</b>
13. Client focus (little and occasionally/little, but continuously, average level/much/very much)	A B C D <b>E</b>

#### 4. Conclusions

For achieving a performance management in the tourism companies, the strategies regarding human resources aim at attracting the most suitable candidates, their intensive training, their integration within the organization, the involvement of the new employees, and the responsibility to provide a competitive service. The adequate reward stipulates

a large range of modalities : salaries, bonuses, performance incentives, recognition and feed-back. The performance management means continuous learning and the continuous enrichment of the service company values and culture, emphasizing the excellence and productivity. The employees must support the achievement of the company objectives, create value, and the leaders must support performance and inspire trust and passion for exceeding the difficulties of attending activities. The performance will be re-

flected in the financial results and the position held on the tourist market, in the company image, in the work market attractiveness, in the public relations.

Although the companies analysed got the VERY GOOD qualification, as regards the manner in which the managers take into account the particularities of the tourism sector, in the human resources management, in order for this activity to be even more efficient, the following requirements are also added: developing the initiative and autonomy, giving the possibility to the higher professional training employees and managers of all the hierarchy level to think in an anticipative manner. In this regard the company managers also have to exceed certain mental barriers, that emphasize the correct execution of tasks and procedure compliance, but diminish initiative in approaching the exceptions. Or, if the “client is the king”, the service personalization and the empathy are basic elements in tourism. That is why the systematic theoretical and practical training, the capitalization of the accumulated professional experience, must lead to the diversification, enrichment and increase of tasks and responsibilities, stimulating at the same time the motivation and responsibility.

- Solving the problems related to ensuring some decent incomes, giving a stimulating salary, including bonuses, remains a problem of great actuality in the Romanian tourism. The salaries of this field have remained among the smallest ones in Romanian economy, being comparable only with those from the agricultural sector, which leads to the massive migration of the working force from this field towards similar jobs in other European countries.

- Correlating the evolution of human resources, according to structures and functions, in accordance with the information and communication technology in all the structures of accommodation, food departments and the maximum reduction of the waiting times and bureaucracy in attending clients.

- Client focus, encouraging and stimulating the contact personnel, creating a climate of simultaneous satisfaction of employees and clients.

The improvement of human resources management from the tourism companies must take into account the particularities of this sector of activity, and the experience of

countries which achieve considerable incomes from tourism, thus achieving a competitive export activity.

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## Exploring Romania in Search of Social Economy: the Concept of Social Economy Studied in the Light of Protected Units

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### Abstract

*Social economy is a new concept used to define that part of economy in which the activities of organizations are aimed at improving social welfare and secondarily at increasing the profit and benefits. The European and Romanian legislative framework authorize the establishment of certain organization as participants of social economy. The research is focusing on protected units, as organization of social economy taking in consideration the economic and social criteria proposed by researchers. The main purpose is to show the importance of protected units. The specific objectives of this paper are to set the boundaries of the social economy concept based on the review of the important theories and to describe a sector of Romanian social economy from protected units approach. The results will show the evolution of the sector in a period of four years which coincide with the implementation of The Sectoral Operational Programme Human Resources Development.*

**Key words:** Social Economy, Protected Units, Disadvantaged Group, Work Force  
**J.E.L. classification:** H75, J14

### 1. Introduction

Modern economic environment is surrounded by new circumstances that require new activities. These new activities taking place at the boundary between public and private sector are aimed at “helping in solving social issues and protecting the right

of various stakeholders” [1]. These activities require a legislative framework, the support from the State and the voluntary involvement of civil society.

### 2. Perspectives on concept of social economy

The synergy between market capitalism and state economy led to emergence of a new concept social economy. Setting the boundaries to this concept is even difficult taking in consideration the main two opinions. The American approach defines the social economy as an alternative sector, separate from and “balancing the state and the market” [2]. It includes legal organizations which through voluntary participation are involved in manufacturing activity or providing services but the status does not allow them to be a source of income, to generate profit or other financial gains. The legal entities are formal organized, they are independent, with their own rules and mechanisms of decisions making. From European perspective definition of the concept is more analytic with a strong emphasis on the mixed and pluralistic nature. Social economy is embedded in a system where the Market, the State and the Private households are the main source of influence. This triangular system describes the plural nature of resources that contribute to the social welfare [3]. Social enterprises are managed by different stakeholders (e.g. employees, volunteers, public authorities, donors). The organizations are structured to exclude profit as main goal and the provided goods and services are used to increase the benefit of community. The main forms of

organization recognized by European law are: voluntary organization, charities or associations, cooperatives, mutual aid societies, foundation and trusts. The typically for-profit organization can be considered as social enterprises when they acquire certain characteristics, including a constraint on the distribution of profits. The EMES European Research Network, a group of scholars coming from all European Union member states, carried out a research analyzing the concept of social enterprise. According to the results of the research there are four criteria which reflect the economic and entrepreneurial dimension of social enterprises: a continuous activity of producing or/ and selling goods or services; high degree of autonomy; a significant level of economic risk; a minimum amount of paid work. The social dimension of the enterprises is reflected by other five indicators: explicit aim to benefit the community; the initiative is launched by a group of citizens; the decision-making power is not based on the capital ownership; various parties are affected by the activity; and there is a limit on profit distribution [4].

### 3. Funding projects support for social economy

In practice there is no official definition of the term social economy recognized by European Union despite the interest given in this area of activity. At the European Union level social economy is represented starting from January 2008 by Social Economy Europe former CEP-CMAF (the European Standing Conference of Cooperatives, Mutual societies, Associations and Foundations). According to Social Economy Charter [5] the social economy accounts for 10% of all European companies and 10% of total employment. They recognize and accept the specificity of each state regarding the legal form of organization in social economy, and they mention “the capacity to grow and to adapt to new social and economic challenges” [5]. This capacity is supported by different projects and form of financing by European Union due to priorities and strategic objectives such as: social cohesion, full employment and the fight against poverty, sustainable development and better governance. The link between social

economy and employment is evident, taking in consideration the high number of workers of this sector. One of the instruments that promote employment mainly by funding initiatives to help people improve their skills and job prospects is European Social Found.

The founded operation are aimed at stimulating job creation and skills development; enhancing community capacity for social support; supporting economic growth; protecting the environment and mobilizing disadvantaged groups. In order to generate high quality jobs and a better quality of life, the European Social Found is supporting the sustainable integration of the disadvantaged and people with disabilities into the work force. In the human resources field in Romania, Sectoral Operational Programme Human Resources Development sets the priority axes and the major intervention areas.

One of the priority axes is number 6.1 Developing Social Economy. In Table number 1 are gathered data about the value and the total number of eligible projects on developing social economy in Romania.

*Table 1. Total number and value of Romanian eligible projects on developing social economy. (Euro)*

Private organization	4	50.986.241,21
Non-profit organization	36	394.750.921,74
<b>Total</b>	<b>40</b>	<b>445.737.162,95</b>

Source: Sectoral Operational Programme Human Resources Development (<http://www.fseromania.ro>)

Most of the amount 394.750.921,74 Euros was allocated to projects implemented by non-profit organization, only 4 projects where initiated by private organizations.

Concerning the form of organization according to Lepoutre *et al.* in the social entrepreneurship spectrum are included three types of organizations. First type is non-governmental “organizations are not-for-profit organizations that have an explicit social mission, but depend on market based income for less than 5% of their revenues” [6]. Second type is hybrid social enterprises. They are addressing to social needs through a private organization. “Receive at least 5% of their revenues from the sales of services or products, or identify themselves as a regular

business as well” [6]. The third type is socially committed regular enterprises. Because this type of the organization is under the area of social responsibility concept we will not take it in consideration, focusing our research on the first two types of organizations as entities of social economy. Other classification of social economy actors divides the organization in traditional ones including cooperatives, mutual organizations, foundations and associations and recent emerged entities: social enterprises.

Cooperatives are organization created due to the necessity of a self help method of individuals with similar jobs. Association and foundation unite people with similar social aspirations and mutual societies are created by individuals with similar needs. An increasing number of organizations established in social economy is observed during past years, from a total of 54684 in 2008 [7] to a total of 74104 in April 2012 [8]. The number of associations is greater than the number of foundations because the legal frame work is more accessible as opposed to other form of registration. (E.g. minimum level of initial assets). The growing number of organizations from third sector of economy indicates the existence of important social problems, the increased interest in solving this problems and more involvement of civil society. One of the most important obstacles in terms of social economy is legislative regulation. Currently, in Romania, there are six laws defining legal framework of some of the activity carried out by social entrepreneurs. In terms of economic and social criteria that must be achieved by social enterprises there is only one type of organization that meets the standards of social economy: protected units. Concerning labour market and the integration of people from vulnerable groups Law no 44/2006 establishes the protection, promotion and the rights of persons with disabilities. Article number 80, 81, 82 and 83 refers to protected units, the rights they have and state benefits, such as a grant from the state, exemption from income tax if at least 75% of income is reinvested for acquisition of technological equipment or improving protected places of work. The concept of protected units is referring to economic operators regardless of the ownership and organization, with at least 30% of the total number of employed persons

with disabilities employed with individual work contract and others structures of the economic operators or non-governmental organizations, which have their own management and at least 30% of the total number of employees employed are people with disabilities.

#### 4. Insight into social economy in the county of Iasi

During 2007 - 2010 in Iasi were authorized and operated 15 protected units. Two thirds of them have acquired that status in 2008 and 2009 (Table. 3), and three quarters are profit-oriented, being organized as companies (Table. 2).

A significant proportion of protected units were established shortly prior to obtaining approval, which indicates an entrepreneurial premeditation, while the services are the predominant activity.

*Table 2. Characteristics of protected units (Work Integration Social Enterprises WISE) operating in Iași county (Romania), from 2007 to 2010.*

Number of protected units	15
Organization form	73% companies 20% NGOs 7% self employed
Background at time of authorization	40% up to one year 33% from 2 to 9 years 27% 10 years or more
Field	53% services 33% production 14% commerce

Source: Romanian Ministry of Labour, Family and Social Protection (www.mmuncii.ro)

Economic activity of protected units is not fully generated by employment of workers with disabilities, but this component can be considered dominant and decisive. To explore the size and dynamics of the economic results of this category of operators, we realized a sum of annual turnover, profit and number of employees, based on data from the balance sheets (Table. 3).

This analysis shows a relatively linear trend of economic indicators, which ignores the upward trend in the number of units protected from year to year.

*Table 3. Indicators of economic activity for 15 protected units (Work Integration Social Enterprises WISE) operating in Iasi county (Romania), from 2007 to 2010. Turnover and profit are denominated in thousands of euro.*

Year/ Indicators	2007	2008	2009	2010
New units	3	5	5	2
Cumulative units	3	8	13	15
Total turnover	5.326	7.434	7.422	7.237
Total income	836	752	677	706
Total employees	130	197	199	185

Source: Romanian Ministry of Finance (www.mfinante.ro), based on declared balance sheets

Legal mechanism designed to increase employment of people with disabilities, including an obligation of employers with at least 50 employees to purchase goods or services from protected units. The measure is addressed to employers who did not employ people with disabilities and shall apply optionally in tandem with the payment of contributions to the state budget. Territorial Labour Inspectorate Iasi carried out a series of controls, between July 2010 and December 2011, during a national campaign focused on checking how employers comply with the obligations established by Law no. 448/2006. Inspections covered a period of activity for employers of up to 3 years prior to the check.

*Table 4. Employers options (at least 50 employees), compared to the obligations established by Law no. 448/2006. Multiple options possible during the period checked.*

Employers controlled	57
Have at least one disabled employee	28%
Purchased products or services from protected units (Work Integration Social Enterprises WISE)	53%
Contribution paid to the state budget	53%
Not complied with any obligation	23%

Source: Territorial Labour Inspectorate Iași (www.itmiasi.ro)

The results of these inspections show that the opportunity to access the offer of protected units is used symmetric with pay an administrative charge (Table. 4). The final result showed a total or partial non-compliance level of 23%, as time duration or value of purchases / payments.

Compared to the global situation in the county, protected units and their employees is a small drop in a large glass of water. Nor at national level proportion does not change.

Social entrepreneurs engaged in organization line of protected units, oscillates between the idea of profit and opportunity. For the moment, low local amplitude of the phenomenon shows that the information and institutional guide does not provide solid benchmarks to develop protected units.

Coming years will confirm or refute the tangible results of the projects during the period analyzed by this article. Optimal balance between material profit sought by social entrepreneur and social profit, wanted by the institutional state, is the magic formula, to which converge daring initiatives of the moment. Social economic future depends directly on the accuracy and convergence of institutional setting made by the state, forced to accept a win-win relationship with respect to private entrepreneur.

## 5. Conclusions

Social enterprises operate in uncertain condition of Romanian business environment. It is a difficult situation because they must meet both the social and economic criteria, mentioned in theoretic literature, and the principles promoted by European Union. Protected units were chosen as a specific form of social enterprise organization in Romania. As indicated by Romanian law and the results of our research most of protected units are private companies that generate profit from manufacturing activity or service providing. The attention on this particular form of organization is a starting point in studying the impact of promoting social economy by national and supranational authorities. Financing and implementation of various programs for development of this sector supports the idea of synergy between public and private sector in order to solve social problems than a

separate sector. Through protected unit's activity, social and economy inclusion, good employment practices, cooperation and solidarity are promoted. With three characteristics: social aims, enterprises focus and local ownership, social economy enterprises, are helping to develop an inclusive society and active citizenship.

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## Improving Managerial Cognitive Skills through Mind Lab Method

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### Abstract

*Today, more than ever, managers are called to solve the problems facing the economy at the beginning of the third millennium, and on this basis, to solve many social problems of humanity.*

*Also, the business world moves today in a very rapid pace and less ordered. This has a direct implication: in any business, managers need to become extremely efficient. In such an environment, very aggressive in terms of competitiveness and totally unpredictable, managers encounter many difficulties when they implement successful strategies or when they adopt methods and techniques to enhance efficacy.*

*In terms of managerial efficiency, these circumstances compel managers to become as effective as possible. The manager profession requires the systematic training of skills in many developmental areas.*

*Based on these considerations, the paper presents The Mind Lab Method, as a unique and innovative approach for development and training the cognitive skills of managers through strategy games.*

**Keywords:** *Mind Lab Method, strategy games, managerial skills, cognitive skills, leadership work.*

**J.E.L. Classification:** M54; J24; O15

### 1. Introduction

The business world moves today in a very rapid pace and less ordered. This has a direct implication: in any business, managers need to become extremely efficient. Even in Romania, gone the days when businesses grow with the market, without a very clear intervention of management, in terms of business performance and market exploitation. It seems that these days will not

return anytime soon.

In terms of managerial efficiency, the circumstances compel managers to become as effective as possible. A truly efficient and effective management, professional managers exercised, is the main "supplier" of performance in areas managed. Efficiency implies the existence of effects in relation to efforts to obtain it. Effectiveness is to achieve objectives and also to exercise of managerial tasks, in the temporal and qualitative pre-conditions. Effectiveness is focused on achieving performance management.

In such an environment, very aggressive in terms of competitiveness and totally unpredictable, managers encounter many difficulties when they implement successful strategies or when they adopt methods and techniques to enhance efficacy.

The manager profession is a very complex profession, requiring for a person to be effective in many activities. Today, more than ever, managers are called to solve the problems facing the economy at the beginning of the third millennium, and on this basis, to solve many social problems of humanity.

The set of skills that managers need to succeed in their work depends on the management level they are located: *lower levels of management* or *top level management*. Skills or competencies are observable behaviours and routine nature of skills.

The question is: What type of skills does a manager need?

Seeing managerial skills as a mixture of technical, human (interpersonal) and conceptual skills, the American specialist, Robert L. Katz (1974), has developed **the mix of managerial skills** [6].

**Technical skills** include knowledge of and proficiency in a certain specialized field, such as engineering, computers, financial and managerial accounting, or manufacturing.

These skills are more important *at lower levels of management* since these managers are dealing directly with employees doing the organization's work.

Katz believed that technical skills give lower-level managers the ability, knowledge and proficiency in a particular area, not just to carry out tasks, but also to plan and coordinate the tasks of workers in that area.

**Human skills** involve the ability to work well with other people both individually and in a group. Because managers deal directly with people, this skill is crucial. Managers with good human skills are able to get the best out of their people. They know how to communicate, motivate, lead and inspire enthusiasm and trust. These skills are equally important *at all levels of management*.

Finally, **conceptual (cognitive) skills** are the skills that managers must have to think and conceptualize about abstract and complex situations. Using these skills managers must be able to see the organization as a whole, understand the relationship among various subunits, and visualize how the organization fits into its broader environment. These skills are most important *at top level management*.

The three basic types of skills are needed by all managers. Each level of management has its own skill mix. Skill, as used by Katz, means an ability related to performance that is not necessarily inborn, but can be developed.

We believe that while talent and natural inclinations play undoubtedly an important role, becoming manager is the result of a professional and personal transformation process.

Based on these considerations we identified in the Mind Lab method an excellent tool to educate and develop the thinking of adults with major professional responsibilities.

## 2. What the Mind Lab is?

The International program Mind Lab is an educational program that was originally designed for the personal development of children between 4 and 14 years. It supports the systematic training of skills in three developmental areas: cognitive skills, social skills, and skills in the field of emotional intelligence.

**The Mind Lab Method** is a unique and innovative approach for the development and training of thinking abilities and life skills through *strategy games*.

Mind Lab's unique concept is based upon the notion that strategy games serve as a high-powered educational tool. Strategy games contribute to the improvement of cognitive skills and to creating an awareness of thinking processes. They also help the learner to better cope with emotional and social situations. The game-playing experience is at once enjoyable, captivating, and exciting – thus kindling great motivation and enthusiasm among students and serving as the foundation for a deep learning process.

This educational program was originally developed in Israel in 1994, by Ehud Shachar and Dan Gendelman, both experts in educational sciences. Today, Mind Lab's research team includes experts in science education, strategic games, psychologists, and engineering and computing experts [7].

The Mind Lab educational program is built on a strong theoretical basis in science education and psychology, making continual reference to the theories of renowned scientists and researchers such as Dewey, Gardner, Perkins and Feuerstein and applying them in educational practice.

The philosopher John Dewey already, at the start of the 20th century, recognized the urgent need to transform education into a more democratic practice. [2] In his Constructivist Theory, Dewey claimed that the child must be placed at the center of the learning process, and be allowed to learn from experience and not just from theoretical and academic resources. He viewed games as an excellent educational tool for achieving this goal.

Professor Reuven Feuerstein, pioneered the successful educational method Instrumental Enrichment and the crucial concept of Mediated Learning. [1], [3]. Feuerstein stresses the central role of teaching thinking processes (as opposed to the teaching of content) with the aid of a mediating, enabling environment, a concept that has been espoused and applied by the Mind Lab Group.

Professor Howard Gardner developed the Multiple Intelligences theory. This theory depicts the great variance existing between different individuals' personal talents and

learning styles - and consequently, the flexible teaching approaches that should be applied in order to effectively reach each and every pupil.

Professor David Perkins, in his work, stressed the need for teaching thinking processes and who particularly emphasized processes connected to understanding and transfer – two concepts which are also central in the Mind Lab philosophy and methodology. [5]

Professor Robert Sternberg has examined in his studies the idea of Successful Intelligences – those actual expressions and applications of intelligence in real life situations (as opposed to standardized intelligence tests).

We are identified the potential and usability of this program for managers to develop essential skills in leadership work.

### 3. How the Mind Lab Method works?

At the heart of the Mind Lab Method is the notion that the most effective way to learn is through an immediate and authentic experience that leaves one wanting more. Game-playing is the perfect example of such an experience – it is entertaining, engaging, and exciting, and therefore stimulates eager involvement. Game-playing also provides fertile ground for the training and application of thinking abilities and life skills.

In other words – the Mind Lab Method both *stimulates* learning and *simulates* real-life.

The goals of the method:

- **Developing awareness** – awareness of thinking processes is essential for personal enhancement in every walk of life. The Mind Lab Method enhances students’ capacity for reflective thinking and enables managers to be more aware of internal and external processes.

- **Imparting Thinking Skills** – in our information-rich age, an ever-increasing emphasis is being placed on the importance of basic thinking skills. The Mind Lab Method provides a broad range of these skills: problem-solving strategies, decision-making models, logical and mathematical thinking, verbal and communication skills, and more.

- **Strengthening Life Skills** – the game-playing experience is an extraordinary

simulator of emotional and social processes. It obliges us to deal with situations involving cooperation and competition, winning and losing, success and failure, and it reinforces our ability to effectively manage and control our emotions, to defer gratification, and to enhance our determination, perseverance and self-discipline.

- **Interdisciplinary Transfer** – the application of content and skills learned in one setting to another is considered by many researchers to be one of the most important learning abilities. The Mind Lab Method establishes an organizing base for many aspects of our lives. Through this method, it is developed the ability to identify links between different fields of human thinking and activity, and this consequently enables the managers to transfer knowledge and apply it to other fields.

Mind Lab’s learning process is simple, yet extremely powerful. The process begins with managers engaging in game-playing, which ultimately empowers them with skills and knowledge relevant to real-life situations. The Mind Lab Method is the bridge that connects the World of Games with the Real World.

The educational process consists of 3 powerful and research-proven stages [7]:

- **Stage 1:** involve the managers in the study group in a thinking game (selected from those included in the program);

In this first stage, the selected managers learn one of the many strategy games present in the program, and then go on to play in small groups. The facilitator provides them with a game kit and explains the game strategies underlying the thinking concepts. There are many examples of cognitive, emotional and social skills strengthened by the Mind Lab Method and very essential for managers: problem solving, decision making, forward planning, logical thinking; managing emotions, patience, perseverance, learning from failures, self discipline; teamwork and cooperation, dealing with competition, communicating efficiently.

- **Stage 2:** using one or more Mind Lab thinking methods to improve cognitive skills, emotional and social skills;

In this second stage, the facilitator and the managers summarize the game-playing session with the help of a thinking model,

such as:

- **The Detective Method** – orients managers toward the right questions, thus helping them to solve problems;

- **The Mirrors Method** – help managers learn from errors and failures and thus improve their continually;

- **The Stoplight Method** – help managers to make better decision.

This models relate to cognitive processes triggered by game-playing (for example, identifying and dealing with a problem, or having to make a difficult decision), or to emotional or social processes (for example, recognizing having made a mistake or the need to cooperate as part of a group).

- **Stage 3:** transfer learned methods to applications in daily management activities.

To consolidate, every day of the course ended with a reflective summary on the activity throughout the day. The facilitator and managers examine the game patterns and then initiate a discussion relating to relevant real-life situations. This helped the managers to reflect on ideas learned by comparing them with their previous thinking. In so doing, the managers succeed in applying the knowledge derived from the game experience to other aspects of their professional lives.

After testing the Mind Lab program for selected managers in the study group, companies can assess the impact of using this program within each company.

To analyze the impact of Mind Lab program use on managerial performance, it can compare two sets of results: the professional results of managers, found after the first performance appraisal process of the post program period and professional results of latest performance appraisal process before participation of the managers at the Mind Lab program. [4]

#### 4. Conclusions

We believe that the Mind Lab Method can be very efficient for Romanian managers training and can help them to develop strategic thinking skills so necessary in daily managerial activities.

The application of content and skills learned in one setting to another is considered by many researchers to be one of the most important learning abilities. The Mind Lab Method establishes an organizing

base for many aspects of life. Through this method, the ability to identify links between different fields of human thinking and activity is developed, and this consequently enables the transfer of knowledge to other fields.

The efficacy of the Mind Lab Method has been put to the test in a number of comparative research projects carried out in conjunction with senior researchers, most notably with Professor Donald Green of Yale University. The research verifies that the Mind Lab Method significantly improves thinking abilities and life skills.

#### 5. Acknowledgements

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## Information and Knowledge - Catalysts of Organizational Environments Case Study - Team Work Association

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### Abstract

*This paper aims to demonstrate the way in which knowledge and information become essential elements of building up a system (Students' Professional Association of the University of Bucharest - Team Work), contributing to strengthening its position and providing solutions for other systems that Team Work enters into partnership with through synergistic effect. Knowledge-based society requires each socio-economic entity to find solutions to adapt them to the situations they find themselves in, which are often outside the regulations. Knowledge offers us the chance to anticipate, thus avoiding crises situations. Therefore, Team Work becomes a system that creates people and contexts.*

**Keywords:** informational system; information system; informational circuit; informational flow; knowledge.

**J.E.L. classification:** D83

### 1. Introduction

Nowadays globalized society unveils the importance of information and technology era. Thus, it is required to bring a new approach to the ways we perceive organizational development and build an architecture based on facilitating informational flows. Information has to be processed correctly and coherently.

From this point of view, an organization such as Team Work transposes a new state of mind related to professionalism and is a

catalyst for cohesion.

### 2. The informational system

The informational system represents all data, information, informational circuits, informational flows and means of dealing with the existent information within a company that aim to provide the necessary informational support to achieve the company's objectives.

The information which is used effectively within the decision-making process must meet the following conditions: to be accurate and trustworthy, to be complete, to arrive in real time, to allow information processing by means of modern facilities and procedures. Information depends on the quality of informational circuit which represents the route covered from the transmitter to the beneficiary.

### 3. The informational flow

The informational flow represents the amount of information exchanged between transmitter and information beneficiary and it is characterized by: content, volume, frequency, quality, direction, form and support.

### 4. The information system

The information system represents a unit in which information passes through a digital format - in other words, it transforms, it is processed or expressed in a digital form.

The management of information systems represents the mode in which the information

resources and the strategies related to the use of information technology at different levels are managed: end-user, organisation and global.

People who manage or use the information system should know the conceptual framework in at least five areas, namely: the fundamental concepts of the information system, technology, applications, the development and management of the information systems.

The information systems play a vital role in the success of an organization. Thus, they can provide internal, external or inter-organisational informational infrastructure for the business' needs. They play a significant role in providing management and operational activities within the business. The design of information systems will be carried out by taking into account the particularities of the informational circuits as well.

The length of an informational circuit is determined by several factors and of utmost importance are the following ones: the utility of the transmitted information, the position within the organizational structure of the transmitters and receivers, data processing speed, the performance of the communication channels, etc.

The informational flow represents all the information transmitted during a certain period of time, from the source of information to the receiver through a system of information channels. An informational system comprises several informational flows, as well as many connections that are established between various components of such flows. At the level of the economic unit, the informational flows are grouped based on the economic unit's functions.

The informational procedure represents a sequence of operators having a certain generalization degree and a routine nature whose performance ensures the solving of a given problem by means of specific methods.

The quality level of procedures is determined by the managers' and performers' satisfaction degree in relation with the necessary information, at the same time ensuring the performance of the decision-making process in optimal conditions and providing for each decision-maker the proper conditions for conducting activities in the best way.

## **5. Elements of knowledge-based management and the knowledge-based society**

Knowledge management concerns especially the relationship between people and the results of their work directed to creating, disseminating and assessing the necessary knowledge in order to carry out development strategies.

A significant aspect of knowledge management is related to the process of creating an environment and culture that are favourable to positive practices and exchange of ideas. Knowledge management supports the increase of efficiency and effectiveness of knowledge units with the purpose of social and economic development up to the level where this factor becomes the key element in producing added value. Intelligence and creativeness, innovative ideas and rapid flow of information represent a competitive advantage that should not be neglected.

It is true that every society has always been a “knowledge society” in its own way, because either formally or informally, the progress of civilization was due to competition between technological knowledge, culture endowed with various forms and degrees of knowledge, which have massively contributed to the placement of these societies on a certain stage of social and economic development, but a distinctive feature of societies based on knowledge and information is based on the importance we assign to change management as well.

Knowledge management seems to be a special discipline and therefore organizations try to apply formal techniques and information systems in order to make their resources available and used as efficiently as possible (i. e. insurance systems with resources) and to use expertise techniques (the development of human resources, cooperation and group abilities development systems). Within the organizational environment, knowledge originates from information turned into effective action proficiency by those who own them, through assimilation and integrative comprehension, followed by commissioning in given contexts.

Knowledge management has emerged based on a continuously increasing interest to change the conventional/traditional format of

managing the owned expertise. At the beginning of the decade, numerous organizations have learnt that they are no longer able to keep pace with the level of increase of the complexity of the issues present on their business agenda, the dissemination of knowledge through consecutive “transfers” being essential for the concept of “technological society” in which we currently live in.

## 6. Team Work organizational context

The case study aims to demonstrate that an organization is the result of processing information in a context where a group of people realise that they can solve problems that emerge at the level of several processes. Thus, information can compete to the design and the strengthening of a system, but it can also facilitate the system in finding solution to problems that arise in the socio-economic environment.

From this perspective, Team Work emerged ten years ago as a necessity and it has constantly adapted to the dynamics of the global society. Dividing the Association on departments provided the occasion for setting up a project team to solve specific problems, but also problems from interdisciplinary border areas.

The biggest advantage of the Association was the fact that it used the potential of diversity: age, religion, sex, education and professional experience.

Team Work has thus become the source and processor of information. Information processing in various projects has created new spaces for analysis and has defined “virtual realities”. In order to receive and transmit information, Team Work has emphasized and used information systems through: partnerships, internships and employment opportunities, opportunities to participate in volunteer activities, training opportunities or various organized events.

Informational flows and procedures have become essential components in the communication process, thus, the aforementioned stages have created contexts in which students were able to develop abilities and skills for the future; at the same time, the benefits mentioned above have represented and still are the action vectors of the Team Work Association that were created

by people through interdepartmental and within departments collaboration.

Team Work Association has defined an information system which represents a set of data, information, informational circuits, informational flows and means of dealing with information existing within departments of the Association, but also in its relations with education, NGOs, business environment, family, state institutions and universities.

This Association has designed an information system in which information goes through a digital format being processed for future use and providing the necessary impulses in making decision on an organisational level. Computer network, website, newsletter represents only some of the components of the information system.

Managing the information resources and implementing the strategies regarding the implication and use of information technology on different levels: end-user, organisation and global represent Team Work’s objectives which are of utmost importance.

From the Association’s perspective the relationship between people and the results of their work meant to create, disseminate and assess the necessary knowledge in order to achieve the implementation of development strategies are related to the building up an environment and culture that are favourable to positive practices and exchange of ideas within projects and internships. The knowledge domain which is so vast provides the chance of systematizing contexts based on the informational disorder that surrounds us. Knowledge supports the growth of efficiency and effectiveness of the Action Centres with the sole purpose of social and economic development, but also to educate youth in order for them to meet the challenges of a market that is becoming more fluid.

Should we carry out an analysis of the Team Work’s organizational environment we would learn that informational flows play a significant role within the business and intra-departmental relations. During these informational flows we are also considering the documents flows that represent means of exchanging information.

All the projects made by Team Work (*Grandma’s Garden, The “Smile”*)

humanitarian campaign, DAAD Research Grant and Scholarship in Germany, The Spring Cleaning, etc.) are examples of the use of informational flows, informational systems, information systems, procedures, knowledge and knowledge management.

In conclusion, through its informational component and flow, Team Work successfully manages to be: creator of information (through contexts provided for people); processor of information (through partnerships and internships provided); user and receiver of information (both through partnerships and internships provided, but also through organizing volunteer activities, trainings and events).

Therefore, Team Work creates performance by using knowledge management systems to manage the business know - how - the, but also the principles of synergistic economy, based on responsibility, innovation, efficiency, effectiveness, efficient use of capital.

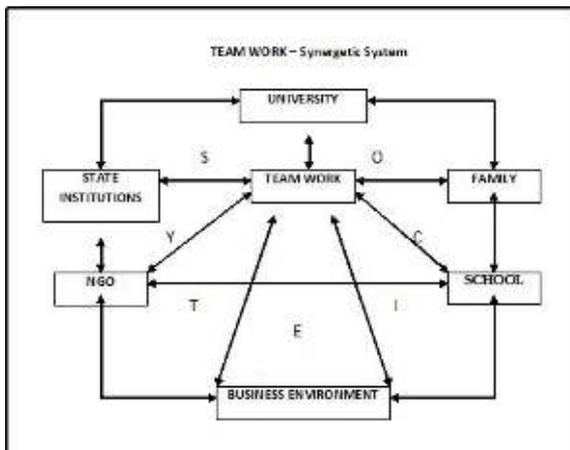


Illustration no. 1 - Team Work – Synergistic

## 7. Conclusions

We have proved that in an organization, information and knowledge are key elements which contribute to organizational

development. Team Work's activities have managed to successfully implement a system based on creating competences for its stakeholders: both internally and externally. Organizations adapt easier when they have access to information; used properly, it may become knowledge.

Another remark is that the quality of processes in an organization is also dependent on consistent procedures.

In essence, we are talking about three important aspects: to know, to do and to be. The first one is related to information, the second refers to action and the third is about mentality. Knowledge guides us towards the latter.

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## Organisational Culture – Formation, Adaptability and Integration

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### Abstract

*This paper aims to identify the elements that contribute to forming organisational culture and its universe, explaining the processes of external adaptation and internal integration, in order to enhance the organisation's functionality, its capacity to perform in an external, ever changing and competitive environment.*

**Keywords:** organisational culture, adaptation, integration, external environment, performance

**J.E.L. Classification:** M1, M14

### 1. Introduction

Organisational culture is a phenomenon defined and treated in different ways by different researchers. There is not an unequivocal position on how an organisation can form culture.

### 2. Formation of organisational culture

Culture is formed when the organisation's members accept situations that provide the right conditions for solving certain problems. The solutions are developed from the interaction of employees, arising from their previous experience or they are provided by the formal or informal leaders. If these solutions can successfully solve certain organisational problems, they will be adopted in practice along with the associated values. Over time, the company staff accepts the values as organisational formal rules that they will respect in their activity and that will be assimilated by the new employees. In this case, the foundations of culture shaping are being laid, having a working atmosphere, “the way we do things here” type. [1]

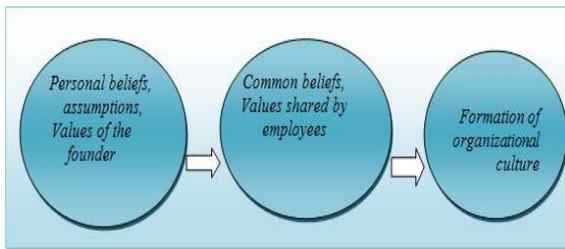
As members of a family, organisations within certain branches or sub-branches – although similar in size, equipment, and technology – are very different. The personality and image of each organisation is created, first, by the people who are part of it. Once in the organisation with their own ideas about themselves, about the others, about welfare and happiness, about bosses and subordinates, they spread their beliefs while assimilating at the same time the habits, rules and restrictions existing within it. From this combination of beliefs, precepts, ideals, behaviours and languages, heroes and anti-heroes the culture of each organisation arises. [2]

An important cultural feature of young organisations, at an early stage of development, is due to the founders or their families. Personal beliefs, assumptions, the entrepreneur's or founder's values are imposed on the employees and, if the organisation is successful, they are shared by all the members of the group, becoming a benchmark for their jobs. The common beliefs, assumptions, values shared by the employees become the main organisational source that creates a sense of identity and the main way to form different skills. [3] The founders have a special role in the culture of a company, usually leaving an important mark of their personality on the firms set up. Even if the future generations sometimes bring important changes in the firm, the founder's role remains relevant. [4]

The organisation's founder, but also other leaders who have appeared during its functioning can have major contributions to the emergence or development of a certain cultural type. Many major cultural values of successful organisations have been shaped by their own founders: Walt Disney at Walt Disney Productions, Thomas J. Watson at IBM, William C. Durant at General Motors, David Packard and Bill Hewlett at

Hewlett&Packard, also known as HP. As David Packard stated: “*It is necessary that people work together to achieve common objectives and to avoid working in different directions, if it is desired to achieve the highest level of efficiency and success.*” (The HP objectives have guided the company in running the business even since 1957, when they were written for the first time by the co-founders Bill Hewlett and Dave Packard).

Chart 1. Formation of organisational culture



Source: created by the author

The American author Edgar Schein (1992) argues that leadership is an essential element in the process of creating, managing, and sometimes destroying and reconstructing the culture. In fact, he says “*the only important thing that leaders do is to create and manage culture*” and that “*their only talent is to understand and work within the culture*” [5]. Leaders must be able to assess how organisational culture evolves, as well as the moment when changes are needed. Assessing and improving organisational culture, as well as determining the need for major cultural changes is critical for achieving the long term organisational success. [6]

The specificity of each organisation is reflected in its beliefs, values and habits of its members. Organisational culture is derived from its past and present, from the people who currently work in the company, from technology and physical resources, as well as from the objectives and purposes of those operating within the company. Organisational culture is sometimes called corporate culture because this concept is used to describe the internal corporate environment. Organisational culture is important because the individuals act based on the values shared by them, their behaviour having a great impact on the activities within the organisation. [7]

Organisational culture is considered to be the invisible “force” behind the readily observable and tangible things within an organisation, the social energy that causes people to act. [8]

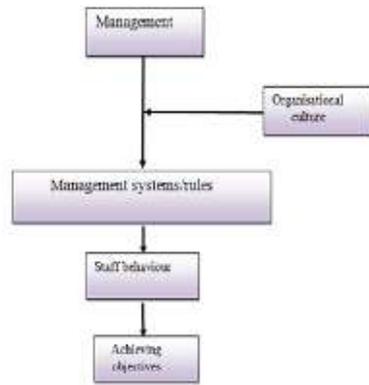
The question arises whether an organisational culture can be created to influence behaviour the way management desires. Managers usually try to establish the core values of the company. Management and culture are interdependent. There is a strong link between organisational culture, management, leadership and future performance of an organisation. As soon as a new company is set up, its culture is formed as well and it reflects its members’ way of thinking and imagination. Senior management, through the authority available to it, is able to take decisions that effectively affect any member of the organisation and to significantly influence the company’s organisational culture. Senior management develops next to a series of work processes also a culture of work, reflecting its image, its belief about what should happen in the organisation in order for it to survive and succeed.

The manager who is aware of the cultural dimension is an example, determining which rules are to be acquired and which are to be rejected. Culture is of interest to the management if and only if it allows increasing the chances of being effective through interventions at several levels:

- increasing the knowledge related to the organisation’s reality: understanding the social climate, analysis of trades, the auditing of the work assessment systems and management control are not the only ones passing through the filter of culture;
- stimulating strategic reflections by improving the diagnosis and its application; in this regard, it allows testing the adequacy of the decisions on the selection of what is likely to succeed;
- expanding the analysis field of the situations for the manager and stimulating the explanation of the organisation’s functioning before changing it; culture reunites the principles of intelligence and rationality in the organisation: this does not mean avoiding the change, but better knowing its effects;
- bringing a stimulating framework for managers in terms of ethics. In this way the manager, as a person, will develop his/her

own analysis of the facts, culture being a collective counter-weight, consisting of all the values that the group had formed and that it must take into account. [9]

Chart 2. The relationship between management and organisational culture



Source: Gavrilă T., Lefter V., Management of organisations, Economic Publishing House, Bucharest, 2004, p. 59

The quality of being a manager aware of the cultural dimension cannot be acquired within the training process unless the personality remains malleable. We identify three roles of managers: of the cultural spokesperson, of the cultural assessor and of the facilitator of the cultural change.

➤ The role of managers as cultural spokespeople is primarily one of recommendation, support and education. The spokespeople help the other members to identify and assess the symbolic “import” and the impact of events, things and actions on culture;

➤ The main role of the cultural evaluator refers to assisting the company in knowing its own culture. This can take many forms. For example, the managers in some organisations could assist their colleagues in determining what is appropriate for the culture and what does not have to encourage the feedback internal mechanisms, which helps to confirm the bad functioning of the organisation. The cultural evaluator is a person employed by the company whose sole responsibility is to “spread” culture within the company and beyond.

➤ Another role of managers is that of cultural facilitator. Cultures change and adapt to the organisation’s objectives and

circumstances and are therefore not truly static. The manager’s role as cultural facilitator also involves the active state of the change of culture and the members’ adaptation to these cultures. Their role is to identify what consequences there will be as a result of the changes taken related to the “cultural centre”, to the set of values, beliefs and assumptions that exist conceptually within organisational culture.

Managers should take into consideration the vital role of culture in affecting cooperation behaviour. Culture produces unity in work activities, in teamwork and loyalty, giving people a sense of who and what they are. [10]

The creation and development process of organisational culture is a psychological process that is associated with the members’ survival needs (survival and safety), creating human relationships and with the development process (self-development and self-realisation). The main factor of organisational culture formation can be considered the staff’s urgent need for: membership to a particular group, sharing certain beliefs, self-development and self-realisation, creating a sense of cohesion and unity leading to the achievement of the organisational objectives. [11]

As stated by Dutch Professor Geert Hofstede, organisational culture is “*the psychological assets of an organisation that can be used to predict what happens with the financial assets over the next five years*”. [12]

### 3. Organisational culture universe

#### 1. External adaptation

To understand the formation of organisational culture it is necessary to provide answers to two major issues the organisation has to face:

➤ External adaptation and survival related problems;

➤ Internal integration related problems;

An organisation sets its own values and norms as a result of the environmental influences and of the various past and present circumstances. External adaptation and internal integration represent an ongoing and interrelated process. Organisational culture must continually adapt itself to the external

environment, to the market and to the various fluctuations. At the same time, it needs to integrate itself internally, to create common norms and beliefs, which will be shared by everyone in the organisation. These common assumptions and beliefs are the basis of organisational culture, creating cohesion and unity.

At least two additional influences that underlie organisational culture should be mentioned here:

➤ Firstly, in the initial stage of organisation development, the founders can deeply influence organisational culture. In the next stages of organisation development, its culture will reflect a comprehensive set of values, aspirations, and ideas of the founder next to those of the others’ members of the organisation;

➤ Secondly, the national culture, social customers and norms of the environment in which the company operates also influence organisational culture. In other words, the culture of a larger society influences the culture of the organisations within it.

The external adaptation and survival related problems refer to how the organisation finds a niche and faces the ever changing external environment. The dominant values of a national culture can be reflected in the constraints imposed on the organisation by the environment in which it has to function. For example, the form of government can have a dramatic impact on how a company does business in a country. In addition, the organisation’s members were raised in a certain society and they bring with them the prevailing values of that company. For example, individuals learn within the company values such as freedom of speech or respect for individual privacy, and the presence or absence of these values and of others within the company has implications on how the organisation will act. [13] The external adaptation and survival process is seen by the American author Edgar Schein as cyclical, each step can be addressed sequentially, but it is also possible to have a simultaneous approach, if it is required to have a rapid adaptation to the environmental changes.

*Table 1. The steps of external adaptation and survival process*

Stages	Interpretation
<b>Step 1: Mission and strategy</b>	The organisation’s members should share the same perceptions about the mission, the core objectives and the latent functions of the organisation.
<b>Step 2: Specific objectives</b>	To develop a common perception of the organisation’s members on the company’s objectives derived from its mission. In order to be able to see these objectives similarly and to work towards achieving them, the group should be based on a common language, on the existence of underlying convictions and assumptions.
<b>Step 3: Determining the means necessary to achieve the set objectives</b>	The group will not be able to achieve the goals set until there is consensus on the means and methods used to achieve the set goals. This step involves the adoption of certain decisions on organisational structure, division of labour, reward/sanction systems, communication system and authority system.
<b>Step 4: Assessing the results</b>	Defining a common perception on the criteria needed to assess the degree to which the group achieves the goals. This step also involves determining the information sources and how they are used to become effective in achieving

	the objectives.
<b>Step 5: Establishing the corrective means</b>	Identifying the necessary actions when there are situations in which the group fails to meet its objectives.

Source: adapted from Schein E., 2004, p. 87-91

External adaptation shows how an organisation, seen as a single group, faces changes, risks and uncertainties, exploring new possibilities and engaging in different competitive situations. [14] The external adaptation and survival process strongly influences the group’s internal integration. Within organisations, the external adaptation process and finding solutions for the internal integration related problems are interdependent and interrelated.

## 2. Internal integration

The internal integration process concerns the need to develop and maintain effective relationships among the group members.

The stages of an internal integration process refer to:

**A. Creation of a language and of certain common conceptual categories.** In order to function as a single group, individuals have to build a communication system and a common language, enabling them to interpret in the same way the different situations.

**B. Defining the group boundaries and the inclusion and exclusion criteria.** It is an important part of the internal integration process and it involves establishing a consensus of the group members on the inclusion and exclusion criteria from the group.

**C. Distribution of power and of the status.** The group members must build their own system of norms and rules governing the way in which power and authority are distributed and maintained and the existence of a consensus is crucial at this point to avoid uncertainty and anxiety related to achieving the set objectives.

**D. Development of privacy, friendship and love rules.** These rules are designed to create cohesion among group members, to lead to achieving the set objectives.

**E. Defining a reward and sanction system.** Consensus, at this point, is essential for each member to know the way of rewarding, motivating or sanctioning applied according to the activity they carry out.

**F. Explaining the unexplainable.** Each group, organisation, society has to face during its existence a series of unexplained events. It is important to find explanations and solutions capable of solving these uncontrollable and even inexplicable problems that will reflect through myths, stories and rituals exposing how the organisation dealt with these situations. They will deeply mark the organisation’s history, its value system, contributing to forming organisational culture.

## 4. Conclusions

Internal integration contributes to forming the feeling of belonging to a particular group, to developing team spirit and cohesion, to the birth of the belief that only by acting together can the organisation’s members exploit the existing opportunities, minimise the threats and cope successfully with any situation.

The ideas that arise from the stages of the internal integration process, along with the beliefs related to the necessary steps for external adaptation, form a set of dimensions which can be the basis of analysing and describing culture. [15] The cultural factors have a strong impact on management functions and on the actions of employees and managers.

Organisational culture is a factor of success or failure for the organization.

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## Emotional Marketing as a Strategy of Relational Marketing

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### Abstract

*Nowadays, emotional factors are important as classic functional aspects of customer purchasing behaviour. A new concept of marketing has emerged in the marketing domain: emotional marketing. Emotional marketing is the ability to communicate powerfully through the use of different techniques that evoke emotion. There have been psychological studies on the importance of emotions in every stage of decision-making in purchasing processes. Emotions play a key role in any kind of social or business decision. The emotions are manifested in verbal, facial and textual expressions. In the paper emotional factors are outlined. They are very important for business goals.*

**Keywords:** emotions, emotional marketing, emotional factors.

**J.E.L. Classification:** Z00

### 1. Introduction

If we take into consideration the definition according to which emotions are a mental physiological state associated with a great variety of feelings, thoughts and internal behaviours (physical) and external (social), we realize that they represent a universal language spoken and understood. Emotions give an instant result as they stimulate decision taking three times quicker than rational thinking does. On a saturated market, wishes are more important than needs. Besides quality and price, modern consumer wishes trust, love, and dreams – intangible factors. The modern principle of satisfying the consumer leads to the rise of the importance of emotions which are to be

considered as distinctive elements that rise the value of products/ services. The consumer doesn't look for a product that should satisfy his rational needs and processes, but after produces and services with symbolic, psychological and cultural meanings, produces that become sources of feelings, relations and emotions that suit the consumer's personality.

### 2. Emotional Marketing Traits

Traditionally, consumers' buying decisions are taken according to two types of needs: functional – satisfied by the product functions and emotional needs.

At present, the products of diverse companies are approximately equal, being necessary to diversify them through other factors that imply ambiance, context, multisensorial stimulation (music, colours, symbols), forms and images with certain meanings, in one word – the intangible aspects of the product.

Emotional marketing, as part of relational marketing, deals with people's emotion stimulation to determine them to buy a certain product/ service, as emotions influence each stage of decision taking in the process of buying.

In our days, organizations have to build their marketing strategies on emotional basis, following two new directions: “capture the heart, not the mind”, “follow heart quota, not pocket quota” [1].

The use of emotional marketing as marketing strategy ensures profound personal relationships with the clients conquered by emotional aspect but also a competitive position on the market. The stress falls on the product no longer, but on the relationship of the client with the product and the emotions communicated by the product.” The modern

consumer looks for experiences rather than produces and sensations rather than values.” [2]

Emotional marketing answers questions like: “Which are the attitudes, behaviours, preferences and emotions of those who buy?”, “How does consumer’s mind react when being stimulated by advertising and promotions while he is in the supermarket or navigates on a commercial site?” “Can we measure their emotions before, during and after the moment of buying?” [3]

In order to answer this last question, the organizations must get accustomed first of all with all types of manifestation of emotions and their methods/ instruments of measure.

### 3. Textual Expression of Emotions

Emotions are expressed in more ways: facial, vocal and textual. For each of these ways special measuring techniques have been developed.

As far as it concerns the textual expression of emotions, we will make the following specifications:

-According to the last researches, the text offers an important modality of detecting emotional aspects. Textual information is a medium of communication, rich in emotions and can be obtained from more sources like: books, newspapers, web pages, e-mail messages etc.

- At present, textual channels are used intensely for virtual communication, being real drivers for social emotions.

-For emotional measuring of a text, there are taken into consideration words which express feelings and emotions directly or indirectly.

-Text analysis can be made in two ways: the separate analysis of the words or the analysis of the concept. For this analysis there have been developed new techniques and computerized instruments. (e.g.,EMV Headline Analyzer”)[4]

Textual expressions can and must be used by companies to their advantage, the emotional marketing helping them to write convincing ads.

The words that generate an emotional answer when they are read or heard determine specific positive thoughts or touch sensible domains for the target groups. They are words that generate sympathy for the product they describe and the necessary

safety for the trust in the company that promotes the product.

The introduction of these words in an advertising text generate the emotions necessary for the transformation of a potential client into a real one. The suggestion of time constraint is also important as it may lead to an immediate action of the client.

The words with an emotional impact have been identified and introduced in a data base (eg. For the English language there is a list of about 200 words), being known and used by big advertising agencies to create advertisements and slogans and also for the creation of specific marketing instruments.

### 4. Emotional Marketing Techniques

Emotional marketing depends on experience. You cannot really use emotional marketing unless someone has already experienced your product or service. You cannot use poster printing pieces and brochures that talk about how your product has saved a life unless your company has already experienced that.[5]

A few marketing techniques work well in emotional marketing:

**a. Word of mouth** - people trust other people that tell them your product works or if it is the best.

**b. Forums** - this is basically electronic word of mouth.

**c. Trials** - if you have concrete results, and the people who participated in the trials are satisfied, you have proof that your product works, which appeals to people's skeptical side.

**d. Testimonials** - again, people trust other people. If people are willing to take the time to give a testimonial, others will know you have a great product.

#### **e. Emotional Marketing Copy**

When you write your brochure copy or flyer copy, use emotional words, such as "pride," "happy" and "confidence." Use feelings you know that your customers want to feel (this should come from your target market research).

#### **f. Emotional Marketing Colors**

Everything about your marketing materials, including your choice of colors, affects your customer. Green makes people think of money and greed;

turquoise can make people feel tranquil and peaceful; dark blue is generally connected to feeling depressed. You can search for "colors" and "meaning" on the Internet to find lists that will tell you what colors are associated with what feelings.

**g. Emotions Do Not Have to Be Sad**

When people think of emotional marketing, they most likely think of sappy, cry-worthy long-distance type of commercials. But, that is not the only emotion you can appeal to. Why not make people smile and even laugh? When people laugh they release endorphins, which are compounds that make them feel good. If people feel good while viewing your marketing materials, they'll in turn feel good about you and your product.

Emotions can be powerful motivators to do, or not do, something.

So it is not surprising that using emotions in marketing can yield equally powerful results.

## 5. Five Emotional Factors of Marketing

The primary emotional factors in marketing are fear, guilt, pride, greed and love. Here is a look at how each emotion can play into marketing.

### **Fear**

This is a big one in emotional marketing, and can be based on a fear of the bad that can happen if you don't act in a certain way. An example is a hosting company that may try to sell you a dedicated server account over the less expensive shared server account by listing all of the potential problems that can result if your site is hosted on a server with other sites.

### **Guilt**

While marketing can be effective when based on creating feelings of guilt for not doing something, another effective route is showing how to remove guilt. An example is a working parent who has little time to prepare home-cooked meals, but sees an ad that states purchasing ABC Frozen Food that is packed with wholesome and nutritious ingredients is just like cooking yourself.

### **Pride**

Marketing that uses pride as an action-enticing emotion is focused on making the

consumer want to use or purchase something because of the sense of power, accomplishment, envy or respect they feel it will generate. An example is a private, exclusive membership that is costly, but will give the purchaser notoriety and can be used as a powerful marketing element on its own, once purchased.

### **Greed**

We have all seen marketing that focuses on appealing to a greedy emotion, and it's very effective. An example is a "package" price for a group of products, or a list of over-the-top bonuses with your purchase. The claim of a specific product or service helping you make more money and become more successful is another example.

### **Love**

Love in marketing is sometimes underplayed, but a good example is products and services that are presented as the top of the line, the best options for providing the very best for the loved ones in your life or even yourself.

## 6. Examples of Ways to Use Emotions in Marketing

Here are seven creative ways to use emotional factors in marketing. Use these as a jumping point to think about different ways you can introduce more emotions in your marketing activities.[2]

- Share or create a story about how your product or service saved or can save the day for a client
- Use a current event to stoke fear (i.e. DoS attacks on MasterCard, "If this can happen to the big guys, it can happen to you...")
- Make your service seem essential and the payoff huge so your potential clients have a guilt-free reaction to saying "yes"
- Show some emotion yourself by speaking from the heart and letting your passion and enthusiasm come through in your marketing copy, prospect calls, customer service, etc.
- Go dramatic by making a video that shares a story that is touching, eye-opening or fear-inducing
- Be inspirational and talk to your prospects one-on-one, walking them

through the process of working with you and outlining all they have to gain

- Create a character that mirrors your prospects and use it/him/her as your business mascot, providing a familiar touch point, answering questions, and solidifying your brand.

## 7. Conclusions

In recent years, many authors have intensified their studies on emotional intelligence and emotional marketing. The emotions, like the functionality of the product/service, influence the decision-making processes of customer purchasing. Nowadays the customer is very fond of the company brand with which he/she lives unique emotional experiences.

After examining emotions that affect customer purchases and the emotional marketing techniques, the paper outlines technical measurements of emotions either from textual or from facial expressions. These measurements are very important for the enterprise to understand the buying motivations of customers.

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## Communication through Events and Sales Forces Adopted by Competitors in the European Space

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### Abstract

*Marketing communication is for competitors from Europe a strategy for highly competitive markets where they operate.*

*The use of different marketing tactics of the communication involves choosing those communication techniques aimed at positive results consistent with objectives. In this respect, events marketing and sales forces form the communications tactics beneficial for the companies that pursue marketing objectives in the reference markets.*

*Knowing the advantages and the specific techniques of sales events and forces constitute an advantage given to those competitors who adopt these communication techniques.*

**Keywords:** marketing communications, events marketing, sales forces.

**J.E.L. classification:** M31

### 1. Introduction

A highly competitive environment of the European space raises big adjustment problems and finding solutions to maintain or gain a competitive position on the relevant market. So often companies are moving towards adopting and implementing promotional communication techniques to rapidly achieve their objectives. Combining more effectively the communication techniques through a communication

program can positively meet the objectives of the communication requirements, firstly, and the sales goals, secondly. Choosing the events marketing and the use of the sales forces are justified by the attributes and characteristics of the two techniques of communication, mentioned above but also by the positive results that can be obtained after the implementation of specific tactics both to the events and the sales forces.

The difficulty using the two techniques of communication comes from the failure of the managers to take them into account as a real potential for communication and to develop and implement a program based on coherent and consistent communication. Also, the human resources involved, especially for sales forces, require appropriate training to assume the role of communication, on one hand, and the competitive strategy on the other. In other words, the aim to use sales forces and marketing events by companies, should be linked, mainly, to obtain a competitive advantage in the relevant market, but also to gain, retain their customers and develop strong long-term relationships with them. This vision involves responsibility to make decisions on choosing and implementing the most appropriate communication techniques to achieve the proposed goal and an adequate correlation between the activities and tactics that can be achieved through events and through sales forces.

### 2. Attributes and characteristics of marketing events and sales forces

Events marketing is an effective way of communicating with internal and external target public, in order to achieve communication on corporate image, its reputation or its business objectives.

Due to their attractiveness to the public, managers often resort to this communicational technique based on specific attributes [1]. These events attributes have in view the following:

- involvement, which means both organizers and audience to resonate emotionally with the brand, event or the experience;

- interaction both with the audience and the brand or products advertised;

- immersion, all senses are oriented towards the communication message sent by the company and isolated from other messages of the competitors;

- intensity, when the event is unique and memorable;

- individuality, the event is customized to communicate with each participant;

- innovation in everything that means, content, location, audience, event;

- integrity, the event is based on authenticity and reliability, giving real benefits to consumers.

All these attributes can be considered components of communication strategy viewed and respected when implementing. In terms of target audience, the event must be able to provide major rewards, real benefits, so as to contribute to changing the consumer's buying behavior and consumption behavior in the desired direction.

If we consider the internal public of the company, in particular those employees working in sales department, then we can discuss about the role of sales forces in the marketing of the company. Through its sales forces, the company is trying to promote its products by applying the techniques and specific marketing tactics, such as prospecting, identifying target groups of consumers, their profile description, conducting merchandising activities, providing consulting, contracting and negotiation etc. All these objectives can be achieved only if the management of the company provides its sales forces, the specific tasks through specialized training, the role of communication mix component.

Thus, sales force will be selected and trained for this purpose, to meet the demands of strategic communication and consistent with business objectives. Assuming all the aforementioned objectives, then the sales forces will gain as dominant features, flexibility and selectivity. Selectivity refers to the fact that in their work, they can apply market segmentation techniques, targeting only those groups of consumers who may be treated as potential or prospects. Flexibility supposes a greater adaptability to the requirements of each type of identified consumer and in addition, a rapid adaptation to the conditions of their sales process steps.

Furthermore, the communication sales forces can develop strong relationships, with their long-term customers, contributing to the implementation of relationship marketing in the company's activities.

### **3. Categories of events and marketing techniques and the sales forces**

Specific techniques and organized public events are internal trainings and teambuilding sites, annual conventions, conferences, symposia, webinars, Happy Hours.

Regarding the external public, the marketing events are designed to attract consumers to the products promoted through various interactive spectacular and attractive techniques, offering to solve the identified problems among the target audience in a unique way. Thus there are used techniques such as sponsorship, fairs and exhibitions, product launches, conferences, seminars, symposia, workshops, touring shows, Open Day.

Choosing specific communication techniques involves setting clear objectives and almost perfect correlation of these events with the target customer profiles.

The sales forces carry out the prospecting of the market identify potential customers and describe their profile by a series of predetermined criteria. Customers can be divided into distinct categories: actual customers, customers who once bought the company's products, customers who repeatedly purchase, loyal customers who buy a wide range of the company's products.

Depending on the stage of life cycle in which the client is in relation to the company can be organized the following events can be

organized [2]:

- to the prospectors, fairs and exhibitions are recommended because they can achieve marketing objectives such as informing the public of the advent of the new product or on product characteristics, first attempts to stimulate the trial of the promoted product.

- for customers who have purchased for the first time, traveling shows are particularly effective because they are subordinated to marketing objectives that have to satisfy customers and persuade them to repeat the purchase.

- for customers who repeatedly purchase, organizing meetings of consumer groups is a technique commonly used because it can be thus achieved the goal of satisfying customers and those objectives that have in view the customers to purchase other products from the same range.

- Actual customers represent a distinct and very important because they attract other clients to the company's products by recommending the products promoted. Those customers are loyal, which is the major consumer group that praised the company for being able to develop strategies they preferred.

In their activity, the sale forces use selling strategies based on different models. The classic stages of the sale based on a model relatively easy to handle and to implement any type of products advertised. This model is based on knowledge and proceeding sequentially through stages in which both the seller and the customer will go in order to complete the sale in a positive way for both partners. From this perspective can be identified as distinct phases, phase of exploration, the actual sales stage and closing stage of the sale.

In the exploration phase, when the sales force is aimed at identifying potential customers and their distribution in the different categories as sociodemographic and behavioral characteristics, there can be used events like fairs and exhibitions, traveling shows, techniques that are effective in achieving the sale. A simultaneous approach of these two types of communication techniques, events and sales force, requires a plan of different activities and objectives of common communication. It is considered that the sales forces have as support, in the exploration stage, other tools such as

catalogues, brochures, promotional offers, all of which are presented at trade fairs, exhibitions and traveling shows. These communication tools help to attract potential customers and convince them to try the products promoted for the first time.

The actual sales phase, the sales forces have to resort to selling techniques based on strong arguments, able to convince customers to buy advertised products. Now they have to take advantage of demonstrations on these products, which can be achieved through workshops, seminars. To demonstrate competence, persuasion and communication skills, sales forces need at this stage, appropriate training programs on teambuilding or specific training. Organized in the form of publicly available internal events, such programs are to enhance the level of professional performance of the sales force, but also to accomplish the objectives of marketing, communication and sales adopted by the company.

In the closing stage of the sale, events for clients are useful to be organized in order to prolong the positive effects of the sale, to develop an appropriate follow-up and create databases with major customers of the company.

Meetings of the customers with the sales representatives can be held in a special circumstance designed to create a favorable atmosphere, open communication between partners, vendor and client and can generate sufficient information to determine the client to return to the company's products. Long-term customer loyalty remains a prime approach pursued by competitors through various techniques, actions or sales marketing and communication tactics.

#### **4. Recommendations on the use of event marketing and sales forces by companies**

In a fierce competition existing in Europe, to gain markets and customer groups, more and more companies use the advantages of using communication techniques based on consistent communication program that consists of combining the most effective techniques. In events marketing and sales forces, companies that have addressed these practical techniques have proved highly effective if combined properly, planned and implemented. Thus, the first issue to be

considered deals with the clear activities to be carried out by sales representatives and their objectives to be attained. Then we will choose appropriate techniques consistent with the events for the objectives initially set. It should be stressed that considering we have to consider both the specific sales objectives such as attracting new customers, increase sales volume for the advertised product, etc. and communication objectives such as enhancing brand image, increase company awareness.

These objectives can be achieved if the advantages of the events and sales forces are clear. In marketing events, the advantages refer to the relevant benefits (relevant) and participation (involving) the customer must experience strong personal character and implicitly for sale too. These advantages are related to specific attribute of the sales forces: interactivity (personal interaction), relationship cultivation (cultivation) and obtain the answer (response), thus developing a strong relationship with customers [3].

Knowing the competitive context is also an important element in decision making about the nature of the events to be adopted and sales techniques that will be addressed by the sales forces. Capitalizing on existing opportunities in the competitive environment must be an objective pursued by the company's marketing team, as well as a communication plan to avoid threats from other competitors should be considered.

Identifying potential customers and choosing proper events geared to the profile and sales approach appropriate methods are key elements in achieving positive results in marketing communications. Customers should not only be attracted to the company's products, but they have to be helped to have a positive experience vis-à-vis the relationship with the company's sales representatives, in order to develop a long-term relationship based on trust and satisfaction of both parties. Sales forces can significantly contribute to these objectives through training and the role being undertaken at the same time, supported by the sales specific techniques marketing events. The creativity, involvement and adaptability to the particular customer, sales forces will monitor each client, putting into practice the concept of relationship marketing. Through marketing events, the spectacular, dynamic customization and

development will contribute decisively to strengthen the customer's relationships and corporate's image. Thus, competition will determine the orientation of the companies towards a planned simultaneous approach of the two promotional communication techniques, events marketing and sales forces.

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# Marketing Tourism Services in Romania. The Opportunities and Challenges of the Current Context

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## Abstract

*The Romanian tourism activity does not measure up to the tourism potential of the country and the efficient marketing of tourism services is often mentioned as a means to improve and develop tourism. In our opinion the current international context generates both opportunities and challenges for tourism services marketing. This paper aims at identifying and at presenting the key aspects that tourism services marketing faces in Romania, considering the main characteristics shaping the current context.*

**Keywords:** tourism services marketing, tourism competitiveness, quality, human resources, tourism organizations

**J.E.L. Classification:** M31

## 1. Introduction

The instability and dynamism of the present tourism market and the changes in consumer behavior bring to attention the tourism services as competitiveness factor and tourism services marketing as a direct consequence.

Marketing tourism services in Romania faces numerous challenges, especially in the current context shaped by the global crisis. In our opinion the marketing of tourism services in Romania should focus on three key issues in order to face the fierce competition in the tourism sector – the quality of tourism services, the aspects concerning human resources, and the difficulties encountered by the organizations producing and delivering tourism services.

The paper aims therefore at briefly presenting the current context and the recent evolutions of international tourism and at presenting the three identified key factors that must be paid particular attention to for an

efficient tourism services marketing in Romania.

## 2. International Tourism -The Current Context

In the context of a difficult international environment, influenced by the economic crisis, international arrivals reached a peak level of 913 million in 2008, but starting with its second half international tourism entered a period of uncertainty. The situation continued to deteriorate in 2009 when international arrivals dropped by 4%.

But tourism has proved its resilience once again, with international arrivals situating on a growing path in the last quarter of 2009 after 14 months of negative results. And in 2010 tourism recovered spectacularly with international arrivals going up by approximately 7%, to 939 million, according to the data released by UNWTO. Although 2011 was characterized by a rather slow economic recovery, major political changes in the Middle East and North Africa, and the natural disaster in Japan, international tourist arrivals reached 980 million. Moreover, according to the first results disclosed by UNWTO, in 2012 international tourism will continue its growth despite the difficult economic conditions and the forecast at the beginning of the year projects an increase of international arrivals by 3-4%.

In Romania, the number of tourist arrivals in accommodation structures dropped by 14% in 2009, and continued to drop by another 2% in 2010, due to the effects of the economic crisis. In 2011 a growth of 16% was recorded, allowing an optimistic forecast for 2012. However, tourism figures remain at an unsatisfactory level in Romania, where the tourism potential allows for a superior valorization.

### 3. Key Factors in Approaching Tourism Services Marketing in Romania

Quality represents one of the key elements in the buying decision, and the increasing competition in the tourism services market has determined an augmentation of consumers' exigency. Consumers have become increasingly aware, demand high quality services and the organizations producing and delivering them must acknowledge the importance of quality as a competitiveness factor.

The conceptualization of service quality and especially of tourism services is rather difficult and complex due to their intangibility. In the case of services quality cannot be measured until the consumption actual takes place, and the buying decision is subject to a higher degree of risk than in the case of tangible goods.

Another issue in defining service quality is the tendency consumers have to evaluate not only the quality of services but also the organization that delivers them, the two being impossible to separate. [1]

A peculiarity of the concept of service quality is related to the contribution of each employee, more or less visible, to the positive or negative perception of quality, to the extent up to which the entire personnel forms a “quality chain”. [2]

In tourism, the notion of quality has new valences due to the peculiarities of tourism services, implying its definition based both on the process of service delivery and results quantified by consumer satisfaction. In other words, consumers' assessments are the results of comparison between clients' expectations and real services performance. [3]

Moreover, given that services unlike goods, are felt, rather than consumed satisfaction or dissatisfaction following consumption is determined by the consumers' perception on performance. It is necessary therefore for organizations to identify the elements that are most important to consumers when they evaluate service quality and to act to improve those particular elements.

The quality of tourism services in Romania is one of the most debated subjects when tourism comes up and unfortunately many times in a negative tone.

Although raising the quality of tourism services in Romania is signaled as priority strategic objective since the early 90's, the problems in this area are not by far solved, the strategy for improving tourism services being still in the elaboration stage, according to the Multiannual Program for marketing and tourism promotion of 2012.

The most important accomplishments in the direction of tourism services quality improvement are represented by the implementation of the two programs “Marca Q” in 2004 and “Blue Flag” in 2006.

The human factor has become an extremely important aspect in all activity sectors and especially in tourism which is characterized by increased involvement of human resources in developing and delivering tourism services. Due to the increasing competition in international tourism it has become apparent that the decisive element in creating and delivering high quality tourism services is represented by the human resources. High profile organizations in tourism lay at the top of their priority list the continuous education and specialization of the personnel who becomes more and more a differentiating element.

Regardless of the delivery method the role of human intervention (individually or as a group) is almost universal.

Using efficiently the human factor under the current circumstances dominated by emphasis on quality becomes both an opportunity and strategic element. The role of human resources played in the field of quality has been recognized as one of the most important factors in increasing organization competitiveness. [4]

Tourism was and is still considered an intensive work force consuming activity, but also an important jobs generator. Studies elaborated so far show that as far as the capacity to create new jobs is concerned tourism is superior to other industries.

At the same time an opposite tendency is manifesting, that of substitution of the human factor by technology, part of the tourism industry generating an e-service environment where human intervention is reduced or even eliminated. [4]

Tourism and human capital are intertwined and braided in a complex relationship, each of the two playing the part of both cause and effect. Therefore, the

stimulation of tourism growth is an important means of reviving the labor force and on the other hand the development or the retrenchment of tourism activity is directly tied to human resources availability or lack of it.

As a consequence the analysis of the relationship between tourism and human capital must take into account a series of key issues related to the peculiarities of tourism and its implications on human resources management: the skills and knowledge necessary for tourism employees as well as the lack of needed qualifications, aspects regarding education and professional training of tourism employees, the recruitment policy, remuneration and permanentisation of tourism employees, the information technology and communications impact. Other elements in approaching human resources management in tourism include the cultural, economical and social peculiarities of the reference zone.

The percentage of tourism employees differs from one country to another being subject to a series of factors: the tourism potential of the country, the tourist policy and the level of economic development, the level and dynamics of the labor productivity in the tourist sector, and the tourism development perspectives.

But more important that the number of tourism employees are other aspects such as the characteristics of tourism industry professions, the professional training, the cost of the training, the permanentisation and the attenuation of the seasonal character.[5]

National and international experience has demonstrated that under the circumstances of increasing competition among tourism services providers the commercial success of a tourism product cannot be ensured solely by the attractiveness of its components and price but depends on the professionalism of the human resources involved, on their hospitality, attitude and promptness in reacting to tourists' demands.

World Travel and Tourism Council estimated that in 2011 travel and tourism in Romania directly supported 184 500 jobs, 2.2% of total employment and the figures are expected to rise by 7.5% in 2012. [6]

Nearly 60% of the tourism labor force is represented by women and most of the tourism employees (75.1%) are 15 to 44

years of age, according to the data available in 2008.

In the case of Romania, the dynamics of the tourism personnel is a reflection of the tourism activity at national level. Since only around 2% of the working population is active in the tourism sector, one may assert that the labor force structure in the economy is atypical, but the development of the service sector will determine in our opinion a future increase in the tourism labor force.

Related to the development perspectives of the human resources in tourism the need for further investments in training is obvious.

It is also important to improve the image of the industry as employer at present tourism being appreciated less than other sectors in this regard. The general perception is that tourism industry is exceeded by other industries as far as remuneration level, advancement and career opportunities, work schedule and job security are concerned. [7]

The smallest average gross salary in Romania remains the one in the hotels and restaurants sector.

There are also other considerations that contribute to the reduced attractiveness of tourism as employment provider such as socio-psychological factors related to the servitude assumed by the jobs in the tourism industry. [8]

Due to the complexity of tourism in the framework of tourism services creation and delivery a multitude of participants are involved, and their activities are intertwined. Under these circumstances it is essential that the central coordination of the national tourism activity be seconded by the coordination of tourism organizations acting at local level.

Moreover, in tourism beside public sector organizations there are also numerous private organizations, tourism being positioned at the confluence of the two sectors. The activity of all these organizations has a profound and direct impact on tourism, its development directions and operations, flexible and efficient management practices being called for. Most organizations creating and delivering tourism services have as main objective the maximization of their economic results. To this end the management operations focus on the valorization of organization resources, mainly its human

resources in order to create and deliver the services.

In our opinion, in Romania tourism organizations are confronted with two main difficulties – change and change management and building a reputation as tourism services providers.

Change is a key element for tourism organizations, the permanent research of a vast series of influences being called for – social, cultural, economic, demographic, legal, political, technological, and competition factors. The resilience of an organization and its response to the changing environmental conditions and market uncertainties are fundamental for its survival.

The delivery of services to the consumers may be conceptualized as a system in which separate elements are created, put together and delivered and within this system the delivery is the visible side for tourists, that which determines the level of satisfaction thus contributing to the construction of organization reputation.

The uncertainty characterizing the present global environment adds to the already known arduous conditions for tourism organizations: fierce competition, constant necessity for quality improvement, and preoccupation for adequate price setting.

#### 4. Conclusions

The current international context is molded by the global economic crisis and its obvious effects. Although international tourism has proved its remarkable resilience in the face of the crisis, its presence generated a series of effects that emphasized the already recognized challenges of the tourism market – fierce competition, dynamism, and changes in consumer behavior.

In this framework it is even more difficult for Romanian tourism to prosper, one of the most important issues for its development being tourism services and tourism services marketing. Considering this setting we identified and presented in this paper the consequential aspects of three factors that in our opinion are of vital importance for tourism services marketing in Romania - the quality of tourism services, the issues concerning human resources, and the

difficulties encountered by the organizations producing and delivering tourism services.

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## Strategic Marketing in Tourism

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### Abstract

*Tourism is a very dynamic economic sector because is very depended of environmental changes, especially now, when the global economy pass through successive crises. For the competitive organizations, the success means to transform their specific activity in a more market oriented business. The objectives of any organization must be fixed going from a better understanding of the markets. Strategic marketing means to know and analyze the consumers' needs and the market which organization refers and suppose to realize some important activities, such as market segmentation, differentiation and positioning. A very important step in strategic marketing is to identify the sources of comparative and competitive advantage and to design the strategy framework.*

**Key words:** marketing, strategy, segmentation, differentiation, positioning.

**J.E.L. Classification:** M31

### 1. Introduction

Considered a very important sector for today economy, the tourism activity is very complex, includes various resources, many participants and involves a diversity of decisions. These decisions are specifying to several factors situated on different levels of responsibility, and must be integrated and harmonized corresponding to all tourism actors: local communities, firms, local and central authorities.

To get the best results for anyone of these actors, it's indicating to realize a strategic marketing approach.

### 2. Conceptual Element of Strategic Marketing

There are many opinions concerning the

concept of strategic marketing. Among the time, the specialists considered that strategic marketing approach can has different dimensions.

In a management approach, relevant is the strategic planning, market analyze and segmentation, differentiation and positioning, design strategy [1].

For other authors, strategic marketing means marketing studies, segmentation and positioning [2].

As an evolution process of marketing, strategic marketing means a phase of permanent and systematic analysis of market needs, in which are developed those concepts of performing products and services that ensure the qualitative development to customers and target different categories of consumers, in terms of increased welfare for them and for society [3].

Many authors consider that strategic marketing means strategic and operational processes in the marketing planning process [4].

The key instrument of this process is the strategic marketing plan.

### 3. The Process of Marketing Strategic Planning and the Marketing Plan

The strategic marketing planning process means to create and maintain a good relationship between objectives, goals and resources of an enterprise and its marketing-mix, going from the market situation.

The strategic planning is realize on several organizational and decisional levels, such as: the superior level (named the strategic plan of the enterprise), the level of strategic business unit (named unit strategic plan), and the functional marketing level (named marketing strategic plan or product strategic plan) [5].

For tourism, this work is more complex, because there are many decision factors which are involved: tourism services

suppliers, tour-operators, local or central authorities etc.

Generally, the central authorities (usually tourism ministry, office etc.) conceive a strategic plan (going from tourism organizations' needs and opinion), and every tourism enterprise has its own plan, conform to general plan.

The essential goal of strategic planning is to elaborate the marketing strategy.

Developing marketing strategy to create customers is a very complex process. Based on an understanding of the markets (customers and competitors), organizations establish objectives. The traditional view is that marketing is essentially about responding to buyer needs, and doing so will create competitive advantage. Successful competitive strategy helps to define and redefine the competitive game [6].

The strategic planning is a complex process which includes successively operational phases, values and hypothesis, in which, based on enterprise situation analysis, are identified and established its marketing objectives and strategies, is assessed and controlled the degree of achievement of proposed objectives [7].

The strategic planning means the process of creating and maintaining the strategic balance between the objectives and possibilities of the organization, on the one hand, and the opportunities arising from a dynamic market, on the other hand [8]

The results of strategic planning process are materialized in marketing strategically and operational plans.

Generally, the strategic plan covers a period of 3-5 years, and tactical plan concern a period no more than one year.

The strategic plan in tourism is the tool that allows materializing the strategic planning process. This process involves several steps or phases, such as:

- settling marketing objectives (the mission and the generally objectives);
- analyzing the current situation (marketing audit, SWOT analyze and the important assumptions);
- settling the marketing objectives and strategies (designing marketing strategy , identifying marketing plans and marketing mix);
- allotting the marketing budget;

- settling the marketing program, and marketing control [9].

In the same opinion, there are some important aspects that must be followed: a clear definition and description of activities and resources of the organization, a clear formulation of objectives, a good identification of future opportunities, a good description of marketing environment, a clear description of the means that allow to fulfill the objectives, good recommendation for short and long terms.

#### **4. Segmentation, targeting and positioning**

After the analyze of business portfolio (using several methods such as Boston Consulting Group, General Electric-Mc Kinsey, Arthur D. Little Methods etc.), the tourism organization must realize a good description of its market.

Segmentation process means to divide the market of potential customers into homogeneous groups and subgroups. For tourism organizations (hotel chains, tour-operators etc.) is important to identify those subgroups whose needs the firms have the capacity and capability of addressing and designing offerings according to there's needs. The criteria that can be used in segmentation operation are: geographic areas, demographic characteristics, psychographic profile, behavioral [10].

For example, for a hotel chain, the segmentation criteria that can be used are: tourism motivation, age, marital status, family dimension, geographic location, dimension of personal income, education, occupation, frequency of travelling etc.

The segments that are identified require distinct marketing strategies.

With the support of marketing research, marketers can understand consumers and markets create appropriate products and services, get a distinct and solid position on target-market.

Positioning means placing the organization's offer in a multidimensional market model, assuring a distinct place in consumers' psychology [11].

The positioning concept is often difficult to be explained.

Al Ries and Jack Trout think that positioning starts with a product or even a piece of merchandise, a service, a company,

an institution, or even a person, but positioning is not what can be done to a product. Positioning is what it can be done to the mind of the prospect [12].

Positioning is very important for the case when a new brand is introduced to the market and tourists try to connect it to familiar brands or products.

For example, a new hotel in a resort, that has the same classification with many other hotels from a tourism resort.

For realize a good positioning, the marketers can used several methods, such as: maps of perceptions, multiple regression etc. [13].

But positioning is not enough; the marketers must find the points which make the difference between brands, products, services etc.

For example, when tourists must choose between spending a holyday in similar tourism mountain resorts, they can make differences going from level price, services quality, accessibility etc.

In choosing a point of difference, marketers prefer to find benefits that reflect an existing consumers' belief.

For brands positioning, marketers try to find these products' attribute which is important to consumers and distinguish the brand from alternative offers.

For brain-marketing there are seven categories of goals that represent the ingredients for needs cocktail: product category, time of use, place of use, application, attributes, emotional benefit, and experiential benefit. Together, all of these elements activate the brands that compete for choice [14].

Many new products are failing because advertising campaigns do not register anything distinctive in the customer's mind. Creating distinctive brands requires more, an entirely new - and sensory – vision, one that appeals to emotions [15].

Positioning brand it's an operation that refers to the specific and distinctive meaning of the brand in the mind of customers.

After segmentation, targeting and positioning, marketers must analyze the competitive strategies, going from target-market and the elements of marketing-mix.

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## Sales Management - Essential Factor for Contemporary Companies Competitiveness

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### Abstract

*The idea of making a study about sales management was inspired by the existing reality of many companies from Romania. In this context, the increasingly deepening crisis, sales activity and its management becomes an essential role in the activity of a competitive firm. The idea that sales represent a vital problem for many companies must be solved by an adequate approach to the growing globalization relations. Amid the market transformation from "seller market" in "buyer's market", the sales problems started to become more acute. Today, when the buyers' market poles were moved from one continent to another (e.g.: market development in China) sales means more than to close a deal, selling pursue to achieve customer satisfaction and loyalty. Thus, we propose in this article systemic research, combined with some pragmatic guidelines concerning contemporary sales management company.*

**Keywords:** sales management, seller's market, buyer's market, contemporary business

**JEL Classification:** M51

### 1. Introduction

The deepening economic crisis caused the contemporary company to develop increasingly commercial function by setting the strategic function with other functions, sales activity occupies its essential place in

the company's business, bringing a decisive contribution to business competitiveness.

Competitiveness of a company is its ability to increase revenues due to increased sales and/or profit margins in competing markets in order to gain better position or defend the held positions (Bradley, 1995, p 299). It is so obvious that sales activity is a factor in business competitiveness, something that requires the responsible attention to this activity. Therefore, the selling can not and should not be left to chance, it is a very important activity within the firm, which depends directly on its success or failure.

Selling through specific techniques and procedures, aims fruition of production results, its final passage as soon as possible, thus contributing to the full technical - productive potential of company that has constantly attempt to offer merchandise to the buyer to the terms and conditions required and not least provide a real gain at least the extent of efforts.

Equally, sales department, by policy and strategies must respond continuously to the requirements of financial effort in support of all company activities, because it is engaged in an ongoing effort to recover the value of goods sold (especially since the sale takes place while the buyer does not pay for the goods when their purchase). From this point of view, Sales Department is an important lever in helping the firm's financial system.

Thus, the paradigm sale - production - customers, is functional if used as a tool for production the mechanism production-market to its advantage, which maintain, develop and diversify relations of production

results in company environment. In such circumstances, the sale, as a whole economical- organizational system, is properly to commercial function of contemporary company. In this sense, each element of the marketing mix has its importance: a product or service with lower quality indicates more than any advertisement, the price is used by buyers as an indicator of quality, the place matters: a thing bought in Madrid has a different value than one bought in Târgoviște.

During his visit to Romania, in 2005, Ph. Kotler was asked "which he believes that is the most important element in marketing's mix". Kotler said that "each of the 4P is important as long as the organization aims to satisfy consumer needs and their loyalty. Kotler added that the market changes, so marketing changes, but customer care should never change. "

We believe that in any business, whether selling products or services which should take priority is customer care, satisfying its maximum! This simple philosophy is essential that ensure competitive success of firms during this time.

Summarizing, we can say that sales management is critical both in material flow and in the information. Initially the role sales target the circuit of material in particular, but with market development and continued growth of competition, selling (via the sales force) becomes a real source of gathering information on market (consumer customers).

Sales management must develop simultaneously relations with market, know and perceive market needs to provide timely information needed for production. It is essential that this information is qualitative and fair in order to cost-effectively meet market requirements. Selling as organization - functional business company, through its systemic components, provides permanent database and information from buyers-consumers market, stating the requirements and conditions for specialization and progress of the company (depending on specific elements or variables conditioning markets geographical areas, types of consumers, restrictions and freedoms in terms of consumption structure and legal regulations, the terms and conditions of implementation of acts and deeds of trade

and service organization for marketing network and after sales service and / or demonstration conditions use and operation of products, goods and / or services performed).

Sales management is part of the overall management of the company as an essential component, a component that has greatly expanded in recent years came to be an area that adapts itself to the specific sales general management principles.

If initial sales management is achieved through the overall management of the company, the current economic reality push things in a direction that sales management is an independently field. This field uses general concepts of the company management that develops at specific sales activity.

Consequently, between company management and sales management differences are not essential but rather are differences of scale.

## 2. Creating a model for the evolution of sales

To emphasize more strongly the importance of sales management will form a model of evolution of past sales and determine, by extrapolation of the future path of this development. The method, in its simplest form is to determine the moving average (average sales in the previous months for which the forecast), as:

$$M_t = 1/6 (dt + dt-1 + dt-2 + \dots + dt-5),$$

where:

- $M_t$  - forecast for a period;

- $d$ - request for prior periods.

Next we will use, to overcome the non-registration disadvantage of the significant increase in some months, a variant of the moving average formula, where the variables are weighted to the most recent months. This variant of the method is called weighted moving average or exponential attenuation.

$$M_t = a_1 dt + a_2 dt-1 + a_3 dt-2 + \dots + a_6 dt-5, \text{ where:}$$

-  $a_1 > a_2 > \dots > a_n$  and

-  $a_1 + a_2 + \dots + a_n = 1$

The values suggested here could be 0.2 for  $a_1$ , 0.16 for  $a_2$  and 0.128 for  $a_3$ . This means that 20% of the change is real, and 80% due to other factors.

The conclusion is that progress is essential, both for those who made products or services and for distributors, staff and departments, such as procurement, finance, marketing and research - development.

Following a research field analyzed on a sample of companies from Dâmbovița was a lot of the sales management failures, failures that require real improvement, not merely cosmetic. Starting from the reality extensively researched, the last step of this article was aimed precisely to identify real opportunities to improve Dâmbovița sales management industry.

A simple solution that we recommend refers to diagnosis sales management resources in enterprise in two forms: diagnostic functionality in the enterprise sales management and sales management system diagnostics in the industry from the enterprise is.

The scope of first goal of diagnosis is to identify key issues (priority) and certain solutions (tracks) addressed to sale management functionality in this area, and diagnostic steps will be to: identify key points, retaining key issues, identifying causes of failure and establish consequences. The second aspect of the diagnosis must be made in the context of overall system management diagnosis, since any issue arising therein, directly or indirectly affect sales management. This part of the diagnosis include: diagnosis information system (diagnosis conditions for correct operation of information systems and diagnostic information flows), which is designed to detect problems in the system and determining how to resolve them, resolution which will lead to improve sales management within each company. A second step is diagnosis decision system (power) in sales management, which aims to: assess the power system in terms of compatibility with strategic segmentation, evaluate the suitability of power to critical strategic positions, horizontal power relations assessment, evaluation allocation of decision power in elaboration of development strategies of Sales System and evaluation allocation (delegation) of power in top management sales between the various levels of management.

The third step is to diagnose structural organization, diagnostics comprising:

assessing the existence of a formal organization in an organization, evaluation of all functions necessary for each decision unit, properly defined and written, evaluation of control and decision procedures (if they are clearly identified and recorded in documents), assessment of critical functions and positions (if properly defined). The fourth step that diagnosis management style, may include: assessment of the development of sales strategies, given the type of decisions, relations between the centers of decision, type of methods and tools used for analysis and planning, time horizon; the assessment process strategic sales from how to deal with it, evaluating the type of manager.

A second solution that they consider appropriate to the theme analyzed in this article is the Total Performance Scorecard (TPS). Total Performance Scorecard (TPS) is a holistic process of improvement and change management, improvement, development and learning in this concept are treated as cyclical and ethical processes where the development of personal competence, organization and internal involvement is mutually reinforcing. If we improve TPS sales management, this method can be a viable solution. In this case, Balance Scorecard Organizational changes in Balance Scorecard of Sales System, which includes: mission, vision, critical success factors, objectives, performance indicators, targets and actions to improve the sales system. In this sense, the concept would include continuous improvement and functional process control of System Sales, and developing strategies that focus on achieving competitive advantages of sales activity. Or, Personal Balance Scorecard includes the same elements but on sales staff level, TQM (Total Quality Management) will cover the operation of disciplinary Sales System, with continuous improvement as a central pillar.

Obviously the Total Performance Scorecard of Sales System depends on TPS of the organization, influencing each other. The process starts from the whole organization and development on department level, team and employee, so that improvement and change sale management to occur due to the improvement and change of overall management of companies from Dambovita.

This concept can be more successful than traditional methods of improvement, because real change and organizational improvement is obtained if people change and improve in the interior, this involvement is an integral part of the TPS whose purpose aims at maximum involvement and dedication of all involved, and encourage individual learning, team learning and creativity. The main argument we brought to this theory is that if an employee's personal purposes is consistent with the organization, he will think and work towards the shared goal of the organization.

A third solution at this time of globalization is the sale over the Internet that starts to develop more and more in Romania, on sites trading a series of industry specific products. Also, many companies from Dambovită have web pages on the Internet, making it available to customers 24 hours of 24 and 7 days of 7.

Improving sales human resource is also a real solution to improve sales management companies from Dambovită. To increase competitiveness on foreign markets, industrial producers will have to combine improved sales management with a number of key measures for the future.

### **3. Conclusions**

The research is based on classical methodology: descriptive and analytical methods in studying the topic addressed in this article. The study aims to provide in a personal manner all aspects of sales management within the company, and especially those from Dambovită, and to identify those opportunities to highlight the sales management that produce a real improvement in its and their community. In this sense, was elaborated a personal tool research to serve the purpose.

Sales management was analyzed in relation to the management company, noting that the current economic reality pushed things in a direction that sales management has become a field of its own, using concepts of company management, developed the specific sale. So, between company management and sales management are not essential differences, but differences of scale.

The originality of this approach in this article consists in sales management approach of two angles: strategic and operational, and providing relevant solutions enabling increased sales performance management activities.

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# Romanian Consumer Psychology Relating to the Methods of Online Payment

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## Abstract

*With the advent of products and services offered online, buyers have the opportunity to purchase goods of lower prices than the traditional environment. Online market has grown exponentially in recent years, but in Romania, had a weight gain. One of the most important reasons in online shopping stagnation in Romania is distrust of online payment methods.*

**Key words:** internet, online buyers, online payments, online frauds.

**J.E.L. classification:** M21, L81

## 1. Introduction

Speed Internet technology evolves is impressive. If now there are millions of people who use Internet services at any time, the number is growing exponentially every year.

Number of users of Internet services, including Internet shoppers, increased exponentially from year to year. With increasing number of online buyers, are increased also the problems: payments online frauds, hackers stole customer database online paying, in order to use them fraudulently. But over time and improve online payment options, they were obviously secure.

Over time they developed several online payment options, due to two reasons: ease (convenience) and security of payment transactions. The payment methods currently

used, usually, there are: credit card (Visa, Visa Electron, MasterCard, Maestro, JCB, Dinners Club), Internet Banking (with instant confirmation of payment), Mobile, Wire. Each online payment method, in part, underwent changes and adaptations over time, from when it first emerged so far. Depending on ease of use, credibility provider, transaction security, awareness of how to pay, online shoppers have improved, in turn, preferences for one or other online payment methods.

## 2. Frauds on internet and ways to prevent them

A new type of attack on personal computers and especially on corporations is how to "catching" of information in computer and information about the user. Phishing is usually used with spoofing, representing the process which send fake emails that appear to be sent from a legitimate company and the recipient is redirected to different sites where the victim is convinced false by different methods, to disclose personal information such as passwords, credit card number, bank account.

Spoofing, generally, refers to counterfeit an email, which seem to have been sent by another person. The two methods, phishing and spoofing, are somewhat similar, as both refer to counterfeit or falsify electronic documents.

The term "phishing" emerged with the development of online interactions, and especially with the development of online payment options. Users of "phishing" site uses e-mail spam in order to direct victims to

websites created by hackers, web sites, at first glance appear to be reliable. The targeted sites are ecommerce. The hackers sent an urgent message from a "fisher" transvestite in a reliable representative of a recognized ecommerce company site, in an attempt to capture the personal information to taxpayers on the Internet, under some pretext.

"Fishermen" have developed methods and techniques of "catching", using malicious code hidden in the photo files or Web applications, applications that install various applications ghost, which are activated as soon as e-mail that is opened, and accessing pages Web that seem harmless at first glance. Because phishing is a method of identity theft, it is expected that such attacks will be oriented to data centers and, especially, to large companies. But ultimately, are targeted users who make online payments. Information obtained from these sources is successfully used to substantiate other attack schemes to that user. For example, sending an e-mail spam a list of clients, which are known to use the same banking service, is more efficient for "fishermen" than to choose people at random.

This method has proved effective in bank frauds, poorly protected systems are vulnerable to a big "robbery". Attackers use ads and spam to install a trojan virus that captures passwords and other bank details. The method is practiced mainly for transferring illicit funds in various bank networks.

Regular Internet users, who are shopping online, are vulnerable to these attacks, because, first, the lack of information. Any payment made on the Internet, any personal data requested by various entities, can lead to fraud. Therefore, both ecommerce sites and buyers are increasingly vulnerable to these attacks, creating a phenomenon increasingly stronger against attacks.

One of the most important ways to combat phishing is to educate users. This method is closely related to the notion that users have utility unknown e-mails received. Internal users are the weakest link in network security chain. However, many have learned that you should not open e-mails coming from unknown addresses or with strange titles, and those with questionable content. In the long run, ecommerce companies, first, must come to an agreement to use a widely

accepted way to authenticate legitimate e-mail. A trusted sender certificate can work with S / MIME, an application supported by most email applications. The most useful is that each e-mail include a sender's digital signature, and the signature is an authentication standard.

According to a report by Symantec (<http://www.videotutorial.ro/?p=957>), 5% of all phishing sites were detected in Romania, which makes our country to rank third in world, after China and the United States. One way to combat lies is in explaining and education users to react to such attacks. Another effective measure is to check the authenticity of electronic message with the person or business or financial institution concerned. There are technical ways to combat phishing by using specialized software, included in new versions of Internet search engines (Microsoft Internet Explorer, Mozilla Firefox). Also, there are legal methods and legal reach, through which information to deter fraud in Romania.

Another type of fraud recorded in Romania are credit card frauds. This type of fraud has increased exponentially, registering numerous cases of people found at ATM in Romania using credit cards fraudulently. As the main operating modes exist:

- The skimming, which involves the installation of POS terminals and that data is copied onto the magnetic strips of credit cards, which are then used to mark the new credit card;

- Phishing, which is the creation of Web pages and sending false messages to different people, in order to obtain data for Internet identity or credit cards.

Once obtained credit card information, user accounts, e-banking accounts, they can easily be used to pay for services or purchase of goods via the internet, making money transfer or use of the identity whose data were stolen.

Also, for these attacks there are recommendations to customers on the Internet:

- Do not access the link sent in e-mail content;

- Check the site name in browser to see the difference from the original site of the institution, to access the original site directly, not by clicking on the fraudulent link;

- To contact the bank or financial institution to verify if such messages has been sent; in the policy bank not practice such procedures for requesting confidential data;

- Do not ever disclose confidential information about the card account (card number, expiration date, PIN).

Even if there are always new ways to defraud Internet shopping, there are at hand, always, also methods to combat such fraud. Control methods are relatively simple, but have always brought to the attention of buyers and potential buyers on the Internet.

### 3. Internet payment methods

One of the most important and also the surest ways to make payments online is PayPal.

Using PayPal Payment:

- to opening of account, for once, it send their own credit / debit cards data. In this way, the data must be sent whenever a user buy something from the Internet, greatly reducing the likelihood that they are intercepted by a hacker;

- PayPal Buyer Protection Policy exists (buyer protection policy) which allows, within 45 days from buying the product or service, using PayPal to claims that the product / service was not provided on this site under site where it was bought (qualitative or quantitative). For no temptation to abuse this service, PayPal Seller Protection Policy is in operation, through traders are given a similar protection against tampering started from customers.

- if someone wants additional protection, the user can purchase the optional key system safety, which is provided by a device received from PayPal. This function can be used to access accounts and eBay, for example.

- buying online is faster because of ease of payment method.

It is possible to use PayPal even by mobile phone (smart phone)!

Payment via PayPal it can:

- make payments to merchants and service providers like the system;

- send money anywhere in the world, to other users who have a PayPal account;

- can raise money in various activities (charitable event management, including

Personal Information, such as parties or meetings);

- can receive money from customers. The only requirement is that the person from whom money is required must have a PayPal account;

For merchants on the Internet there are many ways to use the system with clients. In Romania, this system is implemented so ecommerce sites, as well as other e-business sites.

In addition to PayPal, there are other online payment products / services, including: credit card, Internet Banking (with instant confirmation of payment), Mobile. One of the most used means of payment in Romania is the bank card. Thus, when performing a purchase on the Internet, the vendor's site offers to buyer a payment section. Buyer completes its data card (debit or credit), complete the payment amount for the product or service purchased and waiting for payment confirmation. In most cases, these operations are performed in conditions of maximum safety.

### 4. Romanian consumers' preferences about online payments

Although there are very aware of the many options that it offers online shopping, personal experience of Romanian buyers to buy, such that way, is quite limited. Studies show that almost all Internet users from Romania have learned about the opportunity to shop online. However, only 54% of them said they shopped online at least once (<http://www.dailybusiness.ro/stiri-new-media/romanii-precauti-in-ctiea-ce-priveste-cumparaturile-de-pe-internet-69018>).

A comparison with similar studies conducted in 2009 shows that, in those two years, there was an increase of only 4% of online buyers.

In 2011, nearly 44% of Romanians who know about the opportunity to buy products online, consider that this method is risky, compared to 2009, when they accounted for half of Internet users in Romania. Moreover, a significant proportion of those surveyed felt this way to buy the one that consumes less time and over 30% of them said that it is cheaper than the traditional.

While buying Internet users from Romania are concentrated on acquiring the best quality

products at the lowest possible price. Another important factor while shopping, it brings pleasant experience. Female respondents found this aspect more important than economic factors.

Although the Romanian Internet users can not boast an impressive experience in the field of online shopping, they often use the Internet as a source of information for planning some acquisitions.

Experienced online buyers prefer to buy from online stores, rather than the auction sites, sites with classifieds or social shopping sites. Over 65% of them had at least one transaction from an online store, listing the main reason for this choice that purchased products are delivered at home. Electronics and appliances are among the most purchased products in this way. The popularity of auction sites is much smaller than online stores, and although for many Internet users auction sites have low prices, many are aware and disadvantages: possible false information about the product and deficiencies of the chosen product site and not delivered.

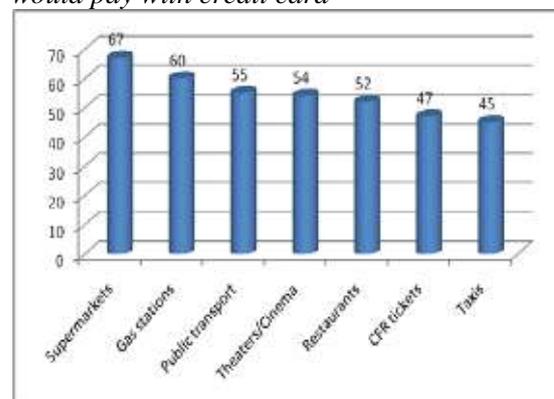
The recent expansion sites of social shopping help, in turn, to increase in online trading activities. Many market players will transfer their offline to online activities in the next two years, developing the market further. New products, that will facilitate and secure online payments, will help overcome the main obstacle to market maturity - lack of confidence - and thus will help develop e-commerce in Romania.

MasterCard and financial portal Conso have developed (<http://www.retail-fmcg.ro/retail>), recently, an online survey to find out the perception of readers about innovative methods of payment. Questions were both, payments with contactless card or device, such as a stick or keychain, and mobile payments, a new field for Romania, but quite visible abroad. Participants responded to questions on where they would like to pay quickly, without giving the card in hand, or if they would be interested to use a pay phone for everyday shopping. According to the survey, 64% of respondents are aware of what is contactless payments, and a percentage of 53% say they would use a contactless card that the bank would offer this possibility. High percentage confirms that contactless programs, which have extended acceptance network especially in

2010-2011, improved transaction process, especially in places where they make daily payments lower, and this led an increase in the number of users.

Even during the economic crisis, innovation in the payments remain stimulating factor - products that add novelty, comfort and safety are Romanian favorites, especially if it simplifies life. In the past two years, contactless technology has spread to areas where, traditionally, payments made with cash - as the means of transport or access to the stadiums where transaction speed is very important. Basically, users can make payments quickly, conveniently, lost no time in queue and without giving the card in hand. Supermarkets (67%), gas stations (60%) and public transport networks (55%) are the places where most Romanians would prefer to pay using a contactless card. Follow theaters / cinemas / concerts (54%), and restaurants / cafes (52%), railway ticket (47%) and taxis (45%), where the Romanians would like to make fast payments.

Figure 1. Places where Romanians buyers would pay with credit card



Source: original

Contactless technology is advantageous not only for users, but also for accepting merchants - efficient cash management process, time for collection and transportation of money and waiting time of customers.

In addition to traditional credit card, contactless payments can be made with a card attached for hanging keys as a sticker stuck to your phone or wallet, or cell phone, was introduced a chip inside it. Thus, the payment instrument can be used more easily at hand and decreases the chances of losing. Also, payments made by mobile phone are a

topic of interest. 44% of online Romanians shoppers would be interested to pay using a mobile phone, while 28% would use this method of payment if they find out more information. Studies estimate that the worldwide number of mobile users, who will pay by these instruments, will reach 2.5 billion until 2015 - which means an increase of 40% since 2011.

### 5. Limitations of frauds made through online payments

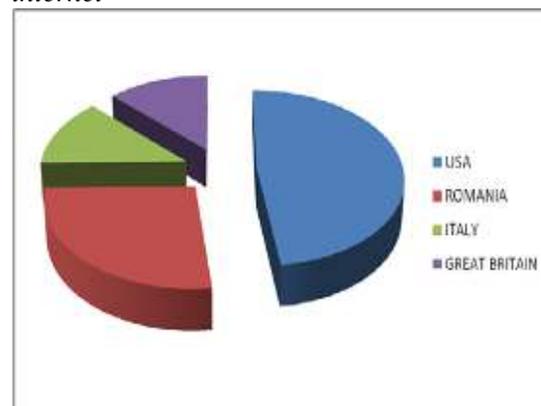
Attempts to online payment fraud, in shops working with ePayment platform, were, in 2011, down 15% from 2010. Anti-fraud system ePayment protected the online stores from losses of about 520,000 euro, each month is identified, on average, 400 fraud attempts. To the number of identified fraud attempts to pay online, is adding a decent amount of pay than 15,000 incidents in 2011. Average response time on Hotline taking such an occurrence is 25 seconds, and the volume of transactions that have been recovered for clients amounted to 520,000 Euro in 2011.

The main types of incidents encountered in 2011 were related to:

- Unauthorized online payments (entering wrong data card, insufficient funds, the bank refused the transaction, the card has a limit amount for online transactions, etc.);
- 3D Secure incidents (how or who determined the password? How it works?);
- Details of online payment (check details of the order, the client wants to ensure that payment is completed, etc.).

The most interesting areas to those who tried to fool security vigilance ePayment system, were telecom (41% of attempts were directed towards this area, favorite sites are here to recharge prepaid cards), travel (22%) and other services (13%). The less prone areas to fraud attempts, were IT&C retail, entertainment and utility payments, each accounting between 1 and 4% of all fraud attempts. Cards used in fraud attempts are issued in 38% U.S., 21% in Romania, 10% in Italy, 10% in Great Britain.

Figure 2. Cards used in fraud attempts on internet



Source: original

The remaining cards used in attempts to overcome the ePayment system security, have been issued in France, Australia, Germany, Brazil and Canada. After locating people who have made attempts of fraud, it emerged from Romania (24%), United States (33%), Italy (8%), United Kingdom (7%) and in other countries like France, Brazil, Spain, Germany, Colombia.

### 6. Conclusions

Following, over time, the evolution behavior of online buyers, it see that one of the main obstacles in its development is method of payment. Whether, it use online payment card, mobile phone or either of e-payment, the Romanian buyers has doubts about online payments. This behavior is greatly influenced by distrust in online payments. This distrust was caused by the large number of frauds that took place online.

Between 2009 and 2011, the number of online buyers increased by only 4% in Romania. This means that, practically, the popularity of online commerce in Romania remained the same. Meanwhile, online commerce has great potential, especially with the decrease in the number of users who have doubts about the safety of online transactions. According to studies performed regularly, there are positive signs about improving online consumer behavior. This behavior, together with confidence for online shopping, getting better every year, is directly proportional to the decrease in crime on the Internet and increasing security of payment options.

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## The Place and Importance of the SMEs Sector within the National Economy

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### Abstract

*The experience accumulated worldwide and also the recent researches funded by the European Commission highlights the important role that small and medium enterprises occupy within the market economy and within providing alternative employment of human resources. This article aims to show the characteristics of SMEs, which are their criterial bounds, as well as what is their place and importance in the Romanian economy.*

**Keywords:** SMEs, knowledge economy, quantum leap, qualitative leap, innovation.

**J.E.L. Clasification:** O10

### 1. Introduction

Although SMEs have been assigned a peripheral role in the 70s, being widespread the idea that large companies are those that provide the economic development, today is widely recognized the reality according to which SMEs have a vital contribution to economic growth of a country. Revealing the economic and social benefits of SMEs have yet changed radically the opinions and perceptions towards them, coming now to consider the SME sector as an area of strategic interest for the economy.

Eleventh century also marked economically the expected time of occurrence of **major** and **irreversible mutations**, with implications in many fields: social, cultural, ideological, religious. Some of these mutations were anticipated for a long time, but became effective only in recent years. Naturally, contemporary economy is the one that takes all these mutations, once

with the causes producing them and turn them into new, useful, interesting, convenient, profitable business opportunities.

The effects of gradual transition from classical to the contemporary economy, where the role and relevance of knowledge are fundamentally different from any other historical moment of human existence and its forms of expression, are still partly unknown. SMEs are a decisive factor in turning the Romanian economy.

They have already won a well-defined position, especially because of the possibilities of adaptation, the large number of jobs provided, the flexibility in technology and management and also the ability to work with industrial giants. Everyone agrees that SMEs are more dynamic and flexible, so can easily withstand to any kind of competitive pressure. A large number of SMEs give together more stability to the Romanian economy than a large international company operating in Romania (Grama, Fotache, 2006).

### 2. SMEs - limitations, features

Ordinance no. 27 of 26/01/2006 to amend and complete Law no. 346/2004 on stimulating the establishment and development of small and medium enterprises sets new criteria for defining the micro and SMEs in accordance with the European regulations in the field. To fit for SME, the annual net turnover of an enterprise should not exceed 50 million Euros or the value of assets held by it must be less than 43 million Euros. Under previous regulations, the ceiling was 8 million Euros. The normative act takes into national legislation the European Commission Recommendations 2003/361/EC concerning the definition of

micro, small and medium enterprises.

Under the new regulations, small and medium enterprises are classified not only according to the average number of employees, but also in terms of annual net turnover or total assets they hold, in the following categories:

a) micro enterprises - have up to 9 employees and obtain an annual net turnover or have total assets of up to 2 million Euros, equivalent in lei;

b) small enterprises - have between 10 to 49 employees and obtain an annual net turnover or have total assets of up to 10 million Euros, equivalent in lei;

c) medium enterprises - have between 50 to 249 employees and obtain an annual net turnover of up to 50 million Euros, equivalent in lei, or have total assets not exceeding the equivalent in lei of 43 million Euros.

Most features of SMEs in Romania are common with SMEs in economically developed countries. The main characteristics of small and medium private enterprises, found in all economically developed countries are the following (Istocescu, 2008, 123):

- SMEs are created by entrepreneurs, alone or in association;
- SMEs are managed, most times, by an entrepreneur, much less by a manager or a specialist/ management consultant;
- SMEs are highly personalized, as they are created to reflect the personality of the entrepreneur;
- SMEs serve to achieve, first, certain personal or group goals;
- SMEs are founded/created in various areas of economic and/or social life;
- SMEs try to exploit existing business opportunities, usually local;
- SMEs are based on the entrepreneur's intuition, flair, skill, experience, vision, education, intelligence, charisma, professionalism (any combination is possible);
- SMEs often assume the role of contractor or subcontractor for big companies, under whose umbrella they operate, most times;
- SMEs are flexible, adaptable to exogenous conditions of the entrepreneurial environment;
- SMEs have specific legislation and in

many countries or in some difficult situations, they benefit even of the attention of the authorities (in order to obtain advantages, facilities or other support);

- SMEs prefer to hire generalists, able to accept rapid change at the expense of specialists, preferred by large companies;
- SMEs create usually jobs as these companies “grow”, they are developing, expand their business, associate with other companies, enter into other businesses;
- SMEs sometimes stand for stronger competitors even for large companies, especially on short or medium term;
- SMEs generate some new institutions or companies whose activities are partially or totally dependent on their very existence and functioning (credit institutions, financial, legal or management consultancies, government agencies or civil society, employers).

Among features (only) of small and medium private Romanian companies, we mention a few that we consider, in fact, responsible both for their success and failure in the current period (Istocescu, 2008, 125):

- SMEs are created, often without mature consideration, without careful analysis of the business environment, even without a very strong motivation of the entrepreneur himself;
- SMEs are based too heavily on current business opportunities and no future perspective;
- SMEs are burdened by cumbersome legislation, dozens of types of taxes they must pay, usually by state bodies or by various types of “funds”;
- SMEs use employees not having, most times, the necessary training and motivation suited to the task;
- SMEs are empirically driven, not scientifically, at the mercy, at random, often by entrepreneurs confused and without knowledge of management;
- SMEs do not use elements of scientific management unless the exception, especially when management is guaranteed by the developer;
- SMEs do not seek the transfer of managerial knowledge, although it is relatively easy and less “expensive” than

technology transfer.

### 3. SMEs in the Romanian economy

It is widely acknowledged that SMEs are currently the most generous source of jobs, both in Romania and in Western countries. Turning our attention to SMEs only as a means to absorb labour is to considerably reduce their role in the economy and society. SMEs help to develop a culture of competition based on high flexibility and productivity. Extending the approach angle, SMEs promote changing the individual and organizational behaviour (Romanian Government SMEs Annual Report, 2007, pp. 45-53).

SMEs contribute largely to the achievement of fundamental objectives of any national economy. They play an important role in the economy for the following reasons (Sima, 2009):

- Structure flexibility that give them high capacity to adapt at the changes of the economic environment;
- They can integrate relatively easy into a regional industrial network, which contributes on the one hand to the economic development of the region and secondly to reduce unemployment and improve living standards as they provide jobs;
- Their small size helps to avoid excessive bureaucracy and dehumanization;
- SMEs form at individual level a set more easily to control/manage;
- SMEs foster innovation and flexibility;
- Are practical created in places where staff are improving;
- Stimulate competition;
- Help at the good functioning of large companies providing various services or producing different parts;
- Manufacture products and provides services in terms of efficiency.

For small or medium-sized private organizations should be given extra attention in order that inherent disadvantages in this type of company to not get worse, but to be transformed into potential benefits by the adequate assessment of the most appropriate business opportunities generated by knowledge-based economy.

In fact, there will be a natural separation

so that some opportunities will be preferred to the attention of large organizations; others will be used almost exclusively by small or medium enterprises. Ownership does not matter in this situation, but “understanding” business opportunity that can generate.

For Romania some exceptions have to be made, as the speed and pace of transition to knowledge economy are much lower than in developed countries (EU countries or other geographical or economic regions) and will remain so for many years, even decades. In Romania, both quantum and qualitative leap must be produced for the economy to move in the end (meaning after making necessary efforts), in a committed and determined manner, towards a knowledge-based economy (Istocescu, 2008, 121-122).

By quantum leap we can understand, in the context of preparing the Romanian economy for the opportunities generated by knowledge-based economy, one (possibly more, cumulated) of the following conditions/assumptions:

- creating conditions (legislative, administrative, social, financial) necessary for strong growth, in numeric sense, so quantitative of the entrepreneurship, especially in young people, educated, willing to engage in business;
- increasing the number of small and medium private enterprises established annually, number that is going to reach the average European country with economic and social conditions identical or similar to those in Romania;
- growing concerns for development in the education system of the initiative spirit, curiosity, concern for innovation, research, change;
- achieving a massive, even aggressive management knowledge transfer from economically developed countries, especially from those countries where there is already (strong) positive effects, beneficial, of the opportunities generated by knowledge-based economy.

By quantum leap, in sense of moving from the Romanian economy to enhance the capitalization of knowledge in turn, it should understand the insurance, at least on medium-term (but more secure, on long term), of one/some of the following assumptions/conditions :

- “selecting” (based on excellence criteria),

among the potential entrepreneurs through education, counselling or specific training, those who have the necessary potential to intuit, sense, adapt, apply and exploit rapidly and advanced a business opportunity specific to knowledge-based economy;

- creating, especially, those small and medium private organizations, that by the potential of entrepreneurs, managers, shareholders, employees, business partners, interest holders, can turn into true assessors of business opportunities generated by knowledge-based economy;
- associating small and medium private Romanian companies “followers” of the knowledge-based economy with organizations in other countries, who are already familiar with this guidance.

The increased flexibility of SMEs, the entrepreneur’s permanent contact with the organization, the ability to produce goods and services to meet different needs and demands, the organizational environment favourable to change and innovation, are the elements that explain the increased performance of the SMEs’ sector. Unlike large organizations, SMEs enjoy of a number of advantages such as reduced number of employees, which fosters communication and propagation of changes in the organization, a smaller proportion of tangible goods, simple and economic management, entrepreneurship, adaptability and changing the changing external environment, growth potential, and intense interpersonal relationships and cohesion (Sanchez et. al., 2011).

To perceive more accurately which is going be the position and role of these enterprises in the 21st century, we point out the main factors that determine their economic and human ascent to the forefront of economic development (Nicolescu, Nicolescu, 2008, 403):

- Congruence of SMEs’ features and the knowledge-based economy;
- Increase the preparedness of the population and new economic and social culture;
- Increasing individualization and customization of products and services;
- Technical and technological changes;
- Computerization of the economy and

society;

- Outsourcing organizations’ activities;
- Regionalization and local development;
- Internationalization of economic activities;

Even if Romania is, at this time, disadvantaged compared to other European countries especially in terms of preparation and ability to capitalize business opportunities and create specific knowledge-based economy, the recent accession to the European Union (accompanied by a much longer integration) created an important prerequisite for the amplification process. It is understood, however, largely that the internal efforts are those that can provide, in time, the success of the Romanian economy adaptation to the requirements/demands of the knowledge-based economy.

#### 4. Conclusions

The SMEs’ sector has a definite identity in configuration of the Romanian economy, contributing to structure renewal and to increase its competitiveness. Moreover, the organization and operation of an articulate and dynamic SME sector, conditions in a large manner the health and vigour of the Romanian economy.

Small and medium enterprises are a balance factor at micro and macroeconomic level. Having as correspondent the middle class society, small and medium enterprises counteract monopolies and oligopolies, reducing the ability of large companies to control the market. After rising in the last three decades, it is estimated that, in the period ahead, small and medium enterprises will be the key driver of economic development both in developed countries and those in transition. On the one hand, small and medium enterprises’ features situate such organizations at the forefront of economic development. On the other hand, the coordinates that define the new configuration of the global economy are favourable to the expansion of small and medium sector.

Thus, change is needed both internally, related to rethink the company’s management system, and also support measures from local government and central government and especially support SMEs financing programs. Without this support, efforts made by firms will have a temporary effect.

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# The Role of Leadership in Knowledge Organizations: Advanced Methods in the Management of Technology and Innovation

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## Abstract

*Leaders play a central role in the process of managing organizational knowledge. Leaders provide vision, motivation, systems and structures at all levels of the organization that facilitate the conversion of knowledge into competitive advantages. Examining the role of leadership in converting knowledge into competitive advantages is important to our understanding of leaders and organizations. The aim of this research is to investigate the critical role of leadership in identifying the knowledge organizations and to give an increased understanding of what the main barriers are that stand in the way of examine the basis for rewarding employee performance at result of knowledge leads to innovations. Today, the role of leadership in knowledge organizations is regarded as more vital, less vulnerable and more successful.*

**Keywords:** leadership, knowledge, innovation

**J.E.L.:** D22,O32

## 1. Introduction

Managing knowledge requires a conscious effort on the part of leaders at all levels of the organization to manage three key knowledge processes: creating, sharing and exploiting knowledge. Transformational leadership theory and transactional leadership theory provide a foundation for understanding how leaders impact the cultivation of knowledge (Bass, 1985; Conger & Kanungo, 1998; House, 1977; House & Aditya, 1997). Conger (1999) recently argued that researchers should continue developing transformational and charismatic leadership theory and doing exploratory research in this

area.

The new concepts of knowledge organizations are knowledge building, knowledge sharing, knowledge creation, knowledge management. Is this just another fad? New buzz words for the millennium? They could easily become so unless we understand the role of leadership in knowledge organizations in organizational performance and set up the corresponding mechanisms and practices that make knowledge sharing a cultural value.

A new perspective in roles of managerial behaviour proposed. It is built upon an emerging view of the organization as a matrix for knowledge creation. In this context in a modern organization the leadership interact with other people of their organization and create knowledge.

The objective of this paper is to emphasize the importance of the role strategic leader's play in forming a company's social structure, and improving corporate power and profit through technological innovation.

As a result, that more the 60 percent representing the value and importance of training and producing effective leaders, and the processes of management innovation.

The methodology of research was focused on two directions: first, we tried to probe the existing literature regarding how the transfer of knowledge within modern organizations is influenced by leadership; second we analyzed the barriers that stand in the way of implementing advanced methods in the management of technology and innovation by the firms.

## 2. Literature review

In the international literature there are few studies on how well known to exploring the impact of transformational and transactional leadership on organizational knowledge. This

paper builds on the knowledge-based view of the firm (Boisot, 1998; Grant, 1996; Teece, 1998) as a foundation for understanding why managing knowledge helps firms create sustainable competitive advantages. It then explores the connection between leadership and three keys organizational knowledge processes-creating, sharing and exploiting knowledge-and suggests that firms can use both transformational and transactional leadership styles to effectively manage knowledge. Several propositions connect leadership styles with organizational knowledge processes.

Knowledge resources are an especially valuable category of resources and meet Barney's (1991) criteria for resources capable of providing sustainable competitive advantages: valuable, rare, inimitable and unsubstitutable (Edvinsson and Malone, 1997). Knowledge resources and capabilities include worker know-how, product designs, customer knowledge and efficient processes (Boisot, 1998; Grant, 1996; Teece, 1998; Davenport & Prusak, 1997). Organizations that manage their knowledge more effectively than their competitors will be able to achieve competitive advantages (Boisot, 1998).

Organizational knowledge includes all the tacit and explicit knowledge that individuals possess about products, systems and processes and the explicit knowledge codified in manuals, databases and information systems. Organizational knowledge also includes the tacit knowledge that is shared collectively in the firm in the form of routines, culture and know-how embedded in social processes (Nahapiet & Ghoshal, 1998; Grant, 1996; Nonaka & Takeuchi, 1995). There are several key organizational knowledge dimensions to consider: tacit and explicit (Polanyi, 1966; Nonaka, 1991; Boisot, 1998); individual and social (Spender, 1996; McEvily, et al, 2000); public and private (Matusik & Hill, 1998); and the nature of knowledge at multiple levels of the firm (Crossan, Lane and White, 1999).

Nonaka & Takeuchi (1995) provide four modes of knowledge creation, and Crossan & colleagues (1999) provide four learning processes that operate at each level of the organization and impact strategy. We can examine the role of leadership styles in

managing knowledge creation, sharing and exploiting processes at different levels of the firm (individual, group, and organization).

A review of research demonstrates that leadership has been regarded as one of the most important factors to determine organisational learning and creativity (e.g., Berson, Nemanich, Waldman, Galvin & Keller 2006; Bryant 2003; Shin & Zhou 2003, 2007). Little research attention, however, has been given to further our understanding of the implications of leadership for effective knowledge-creation and its underlying processes (e.g., Jung, Chow & Wu 2003).

Another good example from the review of literature on managers is Gagne (2009), who examines management tasks by employing leadership theories.

On this basis, the existing literature appears to suggest that both open-mindedness norms and LMX relationships are equally important and each plays an important role in the knowledge creation process.

### 3. Methodology

The survey instrument used in this study was a model in which we propose open-mindedness norms and leader-member exchange (LMX) relationships as mediators linking the relationship between transformational leadership and knowledge creation. There are seven propositions illuminating the theoretical logic of each of the proposed relationships between the variables in the model. The propositions were developed based on the mediation procedures outlined by Baron and Kenny (1986) including the following steps:

1) Independent variable (transformational leadership) needs to relate to outcome (knowledge creation) - P1;

2) Independent variable (transformational leadership) needs to relate to mediators (open-mindedness norms and LMX relationships) - P2 and P3;

3) Both mediators (open-mindedness norms and LMX relationships) need to relate to outcome (knowledge creation) - P4 and P6; and

4) The effect of independent variable (transformational leadership) on outcome (knowledge creation) will reduce when

mediators (open-mindedness norms and LMX relationships) are included as part of the test.

Given that this is a theoretical article, we only focus on discussing how open-mindedness norms and LMX mediate the leadership-knowledge-creation relationship for P5 and P7 instead of testing the mediating effect.

#### **4. Results**

This study analyses the transformational leadership behaviours strengthen the open-mindedness norms, which in turn influence followers' perceptions and experiences about the importance of knowledge creation, and behaviours that are likely to lead to knowledge creation in their organization.

The effect of LMX on knowledge creation is premised on the idea that LMX between a leader and follower is an interpersonal exchange relationship that constitutes social capital enacted in a larger social system in organizations. Of particular relevance to LMX effect is the relational dimension of social capital, which refers to assets created and leveraged through interpersonal relationships - the 'bonds' that influence the behavior of both parties within relationships.

For each aspect of the methods associated variables used to construct a scoring variable for the respective aspect. In the same time, the constituents of the scoring variables was undertaken a factor analysis, and the resulting factors would be the input of the management of technology and innovation.

#### **5. Practical implication**

We attempt to make three contributions to the literature on leadership and knowledge creation. First, as Peteraf and Barney (2003) and Zollo and Winter (2002) suggest, although research on knowledge creation has been studied extensively over the last decade, the relationship between leadership and knowledge creation has not been explicit and fully established.

Second, our model provides insights into the role of open-mindedness norms and LMX relationships in the underlying process of transformational leadership and knowledge creation. In addition to this, the exact nature

of how dyadic exchange relationships are developed within a knowledge creation process is largely unknown in the literature.

Third, the relative importance of open-mindedness norms and LMX as underlying mechanisms determines what leaders should rely on to optimize individuals' abilities and experience for knowledge creation in teams.

The practical implication is related to the idea of LMX quality as an underlying mechanism of transformational leadership and knowledge creation. It appears to be essential that leaders learn how to develop high-quality LMX relationships with their followers by exhibiting transformational leadership in training programs.

Such programs can be specifically designed to educate managers to better exhibit transformational leadership behaviors and develop effective LMX relationships over time.

Future research should examine whether the relative importance of open-mindedness norms and LMX relationships as underlying mechanisms for knowledge creation are contingent upon the size of teams.

#### **6. Conclusion**

This study provides insights into the role of transformational leadership in knowledge-creation processes. We developed a model theorising the differential mediating effects of LMX relationships and open-mindedness norms in the relationship between transformational leadership and knowledge creation. The model suggests that both open-mindedness norms and LMX relationships are important underlying mechanisms illuminating the effectiveness of transformational leadership for knowledge creation. So, those managers need to form open-mindedness norms and develop dyadic interpersonal exchange relationships with followers, as well as engage in all aspects of transformational leadership in order to better leverage their time and resources for knowledge creation. The proposed model will stimulate more research attention to exploring the theoretical and practical implications of transformational leadership for knowledge creation in organisations.

Whatever knowledge is, wherever it resides or however it is managed, few would disagree that knowledge is an essential part

of our individual and organizational ability to innovate, compete and succeed. Given that, few would doubt that the roles and responsibilities of knowledge leaders are an essential ingredient of competition in the next millennium.

In future every national jurisdiction has to answer to questions like: "Do I need knowledge leadership?", "What kind of leadership do I need?"

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## Proposed Legislative Changes in Romanian Higher Education System

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### Abstract

*“Bologna objectives” mean not only the adoption of necessary legislative changes, but also increase institutional autonomy and accountability, ensuring adequate funding for higher education and a strong culture of quality in all institutions of higher education. The proposed amendments to the Romanian legislation presented in this article aims to describe a general legal framework to ensure the functioning of higher education institutions in order to meet the requirements and objectives for European higher education and to meet the identified global trends in knowledge society.*

**Keywords:** higher education-Romanian legislation, higher education-European legislation, development of the Romanian higher education.

**J.E.L. Classification :** I23, A22

### 1. Introduction

The governing bodies of the European Union have long supported the creation of a European Higher Education Area. But this is not meant to impose rigid patterns to the EU members or candidates.

In order to harmonize national specificity and autonomy of universities to the achievement of the European Higher Education Area, subject to rigor and community constraints, there were many rounds of meetings between the stakeholders of European higher education, so that in 1999, it was drafting the Declaration of Bologna. Bologna process meant for all participating countries profound reform of higher education, marked by changes in legislation and reconsideration of the basic principles of the educational process for a knowledge society.

Bologna objectives mean not only the

adoption of necessary legislative changes, but also increase institutional autonomy and accountability, ensuring adequate funding for higher education and a strong culture of quality in all institutions of higher education.

### 2. Strategic development projects for the Romanian higher education

The strategic development projects involve various national agencies and institutions of higher education, national and international experts who will continue and intensify transformation processes that takes place in the Romanian university space. Below is a list of strategic projects co-financed by European Social Fund through the Sectorial Operational Programme Human Resources Development 2007-2013 which are being implemented in 2011 and their main objectives:

- 1) *Quality and Leadership for Romanian Higher Education.* The overall objective of this project is that by involving all relevant partners to develop a vision for the Romanian higher education, which to base policies and medium and long term actions - contributing essentially to the improvement of the strategic, financial and human resources management and to the educational resources of the universities – to promote innovation, cooperation and partnership between universities, businesses and research centers for knowledge society in Romania. The specific objectives of this project are:
  - Building a vision document with time horizon 2025 and set strategic recommendations for higher education in Romania.
  - Develop the capacities of foresight and leadership of the decision-makers in higher education through specific training of "learning by examples".

- Develop a methodological framework for institutional differentiation of the Romanian universities through the establishment of typologies which ensure diversity in higher education service offerings.
  - Developing a transnational collaborative platform for the knowledge society foresight - FORwiki ([www.forwiki.ro](http://www.forwiki.ro)).
- 2) *Improving academic management.* The project aims to improve academic management through the design and implementation of an adequate training system of the representatives of universities with different decision-making responsibilities, in order to streamline the management activities of higher education institutions. The specific objectives are:
- Improving the capacity of managerial decision by improving the staff training in the management structures of higher education institutions.
  - Development of the integrated information system and making it operational.
  - Strengthen cooperation intra-university and between universities.
- 3) *The Unic Matriculation Registry.* The project aims to develop and implement a unique integrated national system regarding the participants in the higher education system, that will provide timely, reliable and objective information and findings to the decision makers and other interested individuals or institutions, following the first contact of the student with the institution of higher education until the labor market placement in the first three years after graduation..
- 4) *PhD Studies in Romania - Organization of Doctoral Schools.* The overall objective is the restructuring and strengthening of the national system of PhD studies in order to identify and develop appropriate institutional infrastructure and to support and improve the implementation of Bologna third cycle. The specific objectives are as follows:
- Develop and pilot models of integration of doctoral programs in Bologna cycles in the research, development and innovation and in the European area by defining, developing and piloting a specific model of an advanced, flexible, networked Doctoral School.
  - Supporting the implementation of doctoral studies cycle by improving the structure of the national system of doctoral studies and construction of a adaptable, modern institutional infrastructure, in accordance with the requirements of knowledge society.
  - Development of training capacity and strengthen cooperation within the networked Doctoral School through the construction of an e-learning platform to help support doctoral students and researchers to participate in PhD programs.
  - Strengthening of PhD studies by identifying strategic tools, including assurance of performance, common pillars of a successful partnership structures.
- 5) *PhD in Schools of Excellence - Evaluation of research quality in universities and increasing the visibility through scientific publication.* The project's overall objective is the elaboration, testing and implementation of a methodology to ensure the international evaluation of research quality in universities, support the schools of excellence as well as increase the capacity of scientific publication at institutional and individual level, with impact on the quality of doctoral programs. The specific objectives are as follows:
- Developing, testing and implementing an evaluation methodology at international standards, in areas, of scientific research quality in Romanian universities, taking into account their classification based on performance in research and propose a model to support performance.
  - Developing and testing methodology framework for implementing a program of excellence in universities in Romania.
  - Strengthening the editorial capacity of a group of 30 Romanian publications in order to enter the

mainstream of knowledge through indexing in scientometric database. Is intended to create the REP platform ("Romanian Editorial Platform"), a platform compatible with internationally prestigious platforms SpringerLink, and ScienceDirect.

- Developing the capacity of scientific authoring to publish in scientific journals of mainstream knowledge of more than 1,000 young researchers.

6) *The graduates and labor market - National Monitoring Study*. The purpose of this project is the development of tools to monitor the socio - professional path of higher education graduates for their implementation at national and institutional level. The specific objectives are:

- Identify the competencies of the graduate at the completion of his educational path.
- Establishing the correlation between educational route and skills acquired and socio-biographical profile of the graduate.
- Setting the level of use in professional career of skills acquired during educational path of the graduate.
- Developing, piloting and strengthening the institutional tools at national and university level, to carry out regular monitoring of labor market insertion of the higher education graduates.
- Promote and support methodological approaches at national level, on the studies of entering of the graduates in the labor market.

### **3. The identified trends in the Romanian higher education system change**

According to the existing definition in Education Law, the knowledge society is a society where knowledge is the main resource being created, shared and used to generate prosperity and welfare of its members. Education is seen as a path to sustainable development and, in fact, this process of change and development of education is about looking for innovative solutions to ensure the country's international

competitiveness.

At the higher education institutions these solutions require increased customize training, diversity and institutional responsibility. These goals may not appear only under conditions of new organizational forms or in the context of changing existing organizational structures. Given the organizational arrangements in force in the Education Law at present and trends identified in different studies, in the future would be made legislative changes aimed at:

- Clear policies and strategies developed on medium and long term, that would offer more predictability and anticipatory spirit.
- Institutions capable of evaluation in a flexible higher education system, allowing many types of education.
- Quality assurance systems that meet international standards, but that also take into account the peculiarities of each type of institution of higher education.
- Establish a framework to ensure the diversity of missions to be assumed by universities.
- Partners that are not necessarily in the education system, but are keen to enjoy the fruits of it, partners to participate directly in designing policies, strategies and institutional objectives.
- Development of consortia and partnerships to increase efficiency through joint management of resources, but also to develop expertise in a particular field.
- Strategic management, performance-oriented.

### **4. Proposed legislative changes**

Relaxation of rules relating to the organizational structure of higher education institutions will lead to the emergence of several forms of organization needed to achieve different missions assumed by universities. The following proposed amendments relate to changes in legal status, tax and administration status of higher education institutions:

- *Creation of thematic consortia* - for example to achieve a certain goal on research, or to purchase certain types of

resources and sharing them, or simply for reasons of business efficiency.

- *Outsourcing of various services:* management, marketing, accounting, etc. A management specialized company can lead university activities better in terms of revenue and expenditure management, but also of existing business opportunities. Thus, a specialized team will turn to maximize existing incomes (this component is currently associated with the number of students), but perhaps more importantly, to find new revenue sources (sources that are not allowed in the current law).
- *Giving up rigid organization in faculties and within the faculties in programs of study.* Possibly, for institutions with very large coverage range of fields of study can be arranged flexible, consultative structures, each covering an area sufficiently large
- Given the above proposal, the law may specify *the existence of types of higher education other than the Bologna type.*
- The existence in the structure of universities of *specialized departments*, other than those specified in the current law. These new departments can take over and organize in another form the activities of former chairs, but also other offices, services and existing departments such as: quality assurance department, department of academic evaluation, internal audit, training department, marketing office, technical service, secretarial etc.
- *Freedom of human resources management* as needed, without the constraints of current legislation on the mandatory existence of a number of certain academic degrees, the number of enrolled students or other criteria. Also, recruitment and remuneration of teachers should be differentiated according to criteria established by each university management team individually.
- *Autonomy in the administration of financial resources*, both in the private universities and in the state universities.
- *Encourage attracting and diversification of funding sources*, coupled with financial incentives that

would increase the attractiveness of cooperation between business and academia (donations, service contracts, partnership agreements, training their own employees in the process of lifelong education, etc.).

- *Changing the ARACIS methodology* in terms of flexibility and differentiation depending on the specifics of each university individually.
- Establishing a general framework with principles and rules that allow *new ways of defining internal evaluation* that takes account of the mission undertaken by each university individually.
- *The obligation to provide quantitative data* (about the resources available to students and the results of those who have graduated) and *qualitative* (ie nature of the results of those who attended the courses and their professional course) for each university to ensure transparency in relation to all stakeholders: students, Ministry of Education, Ministry of Labor, business. These data will be integrated into complex databases, allowing searches by different criteria and thus obtain different types of required aggregate information

## 5. Conclusions

For the future, in accordance with objectives set by the Bologna Process and the Lisbon Agenda, it is desirable to have university structures to be strong suppliers of higher education and research, competitive both nationally and internationally. Thus, Romania's scientific potential can be better exploited and promoted in Europe but also worldwide.

Proposals that have been made in this article aim to describe a general legal framework to ensure the functioning of higher education institutions in order to comply with the requirements for European higher education and to meet the global trends identified in the knowledge society.

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## Relationship Marketing in Educational Services

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### Abstract

*This article aims to analyze the existence of relationship marketing in educational services. This type of marketing focuses on building a lasting relationship with the customer and continuous communication with it. Relationship marketing can focus on the university's relationship with the end consumer (companies that hire graduates) and other client organizations (schools, universities, research centers).*

**Key words:** relationship marketing, educational services, university, student

**J.E.L. Classification:** M31, I21

### 1. Introduction

Relationship marketing has been first evidenced in 1983 by L. Berry. Beside him a decisive contribution to the conceptualization of the relationship marketing have had U.S. researchers (A. Parasuraman, Ph. Kotler), and Western European experts, especially those of Nordic school (Gronroos C., E. Gummesson to), UK (A. Payne, M. Baker) and more recently in Germany (T. Henning-Thur, U.Hansen). The strategic orientation that focuses on preserving and improving current customers rather than attracting new ones is called the relational marketing. The relational marketing objectives are to "identify and establish, maintain and develop relationships with customers and other stakeholders in smooth running of the organization, achieving a profit so that the objectives of all parties involved are met" (Gronroos, 2005). Another related view is that the relational marketing is: "... a policy and a set of tools for determining individual and interactive relationships with customers, suppliers and stakeholders for creating and maintaining a positive attitude to them and on sustainable company, the products and

brands that" (Pop. Al, 2000). Pathmarajah (1991) has defined relational marketing as "a process by which the seller and buyer join into a profitable, personal, professional and mutual long term relationship".

In the educational services, especially in the higher education, relationship marketing philosophy changes meaning that consumer retention can be on definite term. The customer is the undergraduate student who will remain in the university to study the master, doctorate and eventual postdoctoral studies. In the field of educational services we can talk more competitive advantages than financial benefits. Competitiveness is achieved by strengthening the university to university status and placed in echelon traditional universities nationally and internationally, by improving the quality of teaching and research. It can be achieved by encouraging students to a more accountable, participatory and constructive criticism, as key partners in university life.

### 2. The advantages of implementing relationship marketing in the universities

To persuade the universities of relational marketing implementation is necessary to be shown the benefits they bring to the organization (university) and its customers (students, graduate and PhD). Finally, the university has gained, because its advantages to the customer satisfaction increases, which mean it will become loyal to that university.

#### Advantages for customers

Customers have the power to decide who "buy" educational services, customers will remain loyal to those universities that offer a higher value than its competitors.

The customer is the result of what he gives and what he receives back from the university. The customer is the result of what he gives and what he receives back from the university. This meant customers private

universities or state university students who pay fees in exchange for educational services received. Many students go to universities abroad because they believe that they will get what they're looking for (quality, satisfaction, specific benefits). A part of the former students continue to be teachers or university researchers. In this case, a lasting relationship is when family members are at the same university over a period of time. The relationship with the university can continue when graduates are employed on the labor market in large companies and provides practice at the university where they have studied.

### Benefits to universities

This category includes many benefits for the university: the increase of student's number thus increase income growth, recommendations for existing students, keeping teachers and research staff the most deserving students. Also, universities are promoted for free, which is much more effective than any other type of promotion used by the university, also leading to lower costs and attract new customers. Keeping employees is a side benefit. It is easier for the university to keep employees when there's more and more satisfied customers. It forms a spiral of satisfaction, because a happy employee leads a satisfied customer and vice versa.

### 3. Characteristics and relationship marketing objectives

#### Characteristics:

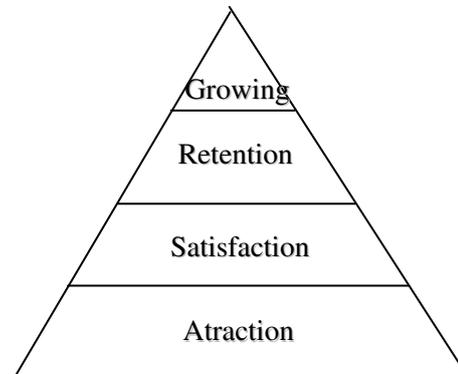
- Focus on customer loyalty
- Ensuring good positions in the customer's expense budget
- Permanent dialogue with the client, which is included in the act of purchasing
- Custom Marketing
- The focus is on a brand with high recognition level
- Managing customer oriented resources

#### Relationship marketing objectives

Relationship marketing objectives are determined and succeeded each other. To be able to achieve the objective, that of building and maintaining a client base of universities

has the following objectives: attraction, satisfaction, retention and improvement (increase) the relationship with consumers.

Fig. 1. Relational marketing objectives



Source: Zeithaml, 2000, p. 140

a) **Attraction** First, universities need to attract those "consumers" with which most likely will build long term relationships. This can be achieved through market segmentation, choosing university and most profitable market segments where it operates. For example: universities to promote their economic profile and try to attract high school students economic students have already formed economic thinking. Technical universities reach out to high schools of mathematics - computer science or technical profile. Other universities have faculty with different areas of specialization, biology, chemistry, law, geography, history, foreign languages can "attract" customers among all schools. With the increasing number of relationships, loyal customers and they will become tools for attracting potential new profitable customers, acting as personal sources of information for them. Here we refer to relatives and friends who have graduated from the university.

b) **Satisfaction** Once attracted by the offer of the university, students can be convinced that its offer is that university and what fits best. In other words, customers are satisfied with the offer and the relationship they have with the university. Satisfaction leads to customer loyalty, which translates into return to university to graduate students remaining here all educational levels. A solid foundation for customer loyalty is to good portfolio of customers, to attract good students, future students from among the

Olympians and those with very good school to create competition that university. This can be achieved by building social ties or loyalty rewards (financial and non-financial recognition and appreciation). In universities this is done through merit scholarships, scholarship or social as well as participation in various scientific events where students are rewarded with prizes consisting of books, diplomas and money. Fundamentals of fidelity based on customer satisfaction. Satisfied customers will most likely become fidei university and also promote its offer in the relatives, acquaintances, family.

There are three areas of loyalty, influenced by customer satisfaction. The first area, called the "failure" which customer satisfaction goes from "very dissatisfied" to "whatever", and on a scale from 1-10, loyalty does not exceed the number 3. Customers in this category changes common service provider, except where this exchange involves a high cost or when no other alternative service provision. The dissatisfied customers can be even dangerous for the company because they take their bad experience to share with other potential customers. Is the case of scandals from universities, with corrupt professors and students who pay bribes to pass the exam.

The second area, the "indifference", includes satisfied or very satisfied customers, with a degree of fidelity between 3 and 7 (on a scale from 1 to 10). Here we talk about students who have not studied for the exam even though they "lucky" to get high marks for "having failed" on the subject. Here we talk about students not necessarily interested in the note but which assimilates during the studies. Although their grades are not the best, they are satisfied that they learned something useful that will help further their careers.

A third area, the "condition" includes very satisfied customers with high fidelity over 8. Customers in this area are not looking for alternatives for switching current. They praised the university's public services, trying to convince others to become its customers. Here we talk about Olympic students, the scholarships, who know exactly what they want for their future career. They dream of small banks to reach the respective university and once there, make the most of knowledge of teachers, libraries and reading rooms to

their goal. They also engage in activities administration in, express their views and public advocates representing their colleagues.

**c) Retention.** If you are satisfied with the university and its offer, students will be tempted to remain in relationship with it as long as they receive quality services, in other words become loyal customers of the company. So it reduces the likelihood that these customers would be attracted by competition if they feel university that understands the changing needs and is prepared to invest in relationship with them by constantly improving its services. This is for students who complete undergraduate studies and remain at the university to graduate and doctoral courses that remain as to its employees (teachers, IT services, research).

**d) Growing.** Regarding the objective of increasing customer service, we can say that. loyal customers not only a sound basis for the university, but they can bring growth potential. For example, students who attend a university, their friends, relatives knowledge to study there if satisfied with its services.

#### **4. The customer and time evolution stages of customer-company relationship**

As products or services, and client relationship goes through several stages, moving from stage to stage to become a relationship becoming stronger and lasting. This indicator is calculated based on the concept that customer's contribution to company revenue and profit over their relationship.

Can be identified 5 stages of customer life cycle: contact, attraction, conversion, retention and loyalty.

Ideally, a prospect (lead) going through all these stages, the company trying to, through its offer to meet his needs and so the client to repeat steps when it launched a new offer to the company. In our case this cycle is carried out since she is promoting university in schools. Prospective customers are attracted by the university offer, although that is a private university offers scholarships and fellowships abroad, offers attractive base material and tuition fees are acceptable. Others prefer public universities because they offer more security. In reality, there are

"leaks" at all stages of this cycle, some consumers prefer to "buy" from competition. It is important that these "leaks" to be as rare as possible, the university retaining most of the customers, who are loyal to the company and its offer.

**Contacting** potential clients is by sending messages, often advertising, through which the university presents its current offer. It is assumed that there has been contact with potential client when he noticed the message, be it broadcast on television, radio, online or in print, the university managed to attract attention with the offer made. Also, young teachers not only promote their university profile visits to high schools which have educational offer.

**Attracting** customers requires adding it to the company's sphere of influence. Many service professionals say that this happens only when a series obtained customer identification information such as name, address, telephone number. If universities We believe that attracting a customer when it register at our university and you pay a subscription fee.

**Conversion** of a person paying customers is by highlighting the potential customer if eligible purchases. Here is an integrated part students have already paid the first installment of tuition and those who are different courses in the departments university (eg Training Department Teacher or Department of Foreign Languages).

Following acquisition of customer service get a greater or less satisfaction. If the customer was satisfied, it tends to tell friends, acquaintances, family is satisfied with the service that brings new customers or more courses of the university is concerned.

The next step is customer loyalty programs designed for this purpose. University student becomes a loyal and wants to share the positive experience of other consumers of educational services, highlighting the advantages to becoming a client focus and to develop a long-term relationship with it.

## 5. Conclusions

Educational services "need" marketing relational. What is worthy to remember is that an organization, a university should be concerned to build and maintain a

relationship with the client. It should always investigate demand, preferences and competition for its students in order to adapt always to dynamic market environment. A loyal customer may be lost if the company does not offering him the expected services.

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## An Estimation of the Influence of Relational Factors on Loyalty

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### Abstract

*The main objective of relationship marketing is to establish and maintain long-term relationships that translate into customer loyalty. Following the above introduction of describing the significance of customer loyalty, this article discusses the conceptualisation of relational determinants of loyalty within the three common approaches used in the loyalty literature, for business to business market. This represents the theoretical framework that is the basis for formulating the research hypotheses that emphasize the connections between relational determinants of loyalty. This discussion is then followed by an empirical test of a model of business loyalty on a sample of 60 clients of accounting firms.*

**Key words:** loyalty, business to business, service quality, Relationship marketing, Trust  
**J.E.L.Classification:**M31

### 1. Introduction

Relationship marketing has developed as an area of marketing that analyses the building of long-term relationships with customers and other parties. The process of establishing a relationship with a customer, involves first the attraction of the customer and then the building of the relationship with that client so that the economic goals of that relationship are achieved[1].The main objective of relationship marketing is to attain high levels of customer satisfaction through collaboration of the parties involved[2].

The relationship-marketing literature focuses on the agreement that the quality of the relationship between the client and the firm is an important determinant of the permanence of this connection and the

consequent success of relationship-marketing practices[3]. Initially, the concept of relationship marketing emerged within the fields of service marketing and industrial marketing. Nowadays, relationship marketing is considered as a strategy in which it aims at enhancing long time relationships and profitability[4]. A profitable sales revenue for an accounting service provider can be achieved by having superior market performance outcomes such as a good position on the market. This indicator of market performance outcomes is directly related to service loyalty[5].

Oliver defines loyalty as “a deeply held commitment to re-buy or re-patronize a preferred product/service consistency in the future, thereby causing repetitive same-brand or same brand-set purchasing, despite situational influences and marketing efforts having the potential to cause switching behaviour”[6]. Under these conditions, the concern for maintain the existing customer base and retaining customer loyalty appears to be an important competitive advantage. Customer loyalty can be considered a key component for a brand’s long-term viability. Further, the meanings associated with “customer’s loyalty to a service provider” and “brand loyalty” are used synonymously in this study because the product is the primary brand for packaged goods, while the company itself serves as the brand for services[7].

Achieving and maintaining loyal customers particularly significant in a business-to-business market. Nevertheless, there are opposing viewpoints in that loyal customers are not always seen as profitable despite arguments that loyalty makes customers less price sensitive.

In loyalty literature there are several models that centre on constructs closely related to brand loyalty that explain why customers stay with their product or service providers. Some of these include

commitment, switching costs, relationship quality, relationship commitment, and satisfaction of the relationship. The major underlying consideration throughout most of these constructs and research streams is the development of a relationship between a firm and its clients that leads to continued exchanges. Thus it could be argued that loyalty research now occurs under disguises such as relationship marketing, loyalty, relationship commitment [8].

The determinants of service loyalty and their effects on loyalty in a business-to-business context are at the centre of this research. The conceptual model of loyalty as well as the specific hypotheses tested in this research are discussed in detail in the following sections.

## 2. Service quality

Service quality is an important determinant of loyalty and it is a relational latent variable that is widely used in the construction of loyalty models. The study conceptualises the construct of relationship quality by providing a theoretical framework that constitutes the heart of the present research model. The main purpose is to bring together various relational variables that have been widely used in the relationship-marketing literature under the one umbrella of relationship quality. These various elements can also be conceptualised individually, and they represent wide-ranging tools of relationship measurement. This study is a pre-test of the interdependence of these variables and, at a higher level, their importance is emphasized in building business loyalty.

The relationship marketing theory considers that relationships are not just about the goods and services that customers buy from a supplier. In consequence, the various aspects of service quality are not the only elements that influence business loyalty.

Nonetheless, service quality is often considered in the literature as an antecedent of customer/service satisfaction[3].

Delivering quality service is considered to be an essential strategy for success in today's competitive environment[9]. In the present study, the service quality construct is presented on five dimensions: “commercial service”,

“communication”, “administrative service”, “delivery service” and “service provided”, proposed by Parasuraman et al. (1985). This approach identifies many of the dimensions proposed by Parasuraman et al. (1985) in Gronroos' (1984) two-dimensional proposal: the technical and functional dimensions. It is apparent that evaluations of service quality are complex processes that operate at various levels of abstraction[3].

Some authors have also argued that service quality is an industry-specific concept[4]. Taking these views into account, we can consider that these dimensions are adequate for the case of accounting services.

The following hypotheses are therefore proposed:

H1. The service quality is a multidimensional construct;

H2: Service quality has a positive effect on business loyalty.

## 3. Relationship commitment

Commitment is positively related to loyalty and repeated purchase and, because relationship performance is critical to repurchase decisions in a relational exchange, business loyalty is similar to relationship commitment [10].

The concept of commitment is included in the definition of loyalty. This is described as “a deeply held commitment to re-buy or repurchase a preferred service consistently in the future, thereby causing repetitive same-brand or same-set purchasing, despite situational influences and marketing efforts having the potential to cause switching behaviour”[6]. Oliver describes the consumer who “ferently desires to re-buy a product or service and will have no other”, as a consumer who will pursue this quest “against all odds at all costs”. These latter conditions define the concept of “ultimate loyalty”.

The following hypothesis is therefore proposed:

H3: Relationship commitment has a positive effect on business loyalty.

## 4. Relationship trust

The concept of trust plays an important role in relationship marketing, and in particular in the context of business to

business markets. In consequence the construct of trust has received great attention in the research literature. Trust plays an important part in maintaining profitable relationships[2], thus understanding the nature of trust and the importance of its contribution to loyalty is of particular interest to managers and has a major impact on how business to business relationships are developed and managed.

Relationship commitment involves achieving a considerable degree of trust in the service provider. The relationship between the two constructs was empirically tested and demonstrated by many authors beginning with Morgan and Hunt (1994).

Trust has been recognized as an important factor in relationship commitment and hence in customer loyalty[4]. The argument is that, if one party trusts another, it is likely to develop some form of positive behavioural intention towards the other. In consequence, when clients trust their service firms, they are also likely to have positive buying intentions towards them.

The following hypotheses are therefore proposed:

H4: Relationship trust has a positive effect on business loyalty;

H5: Relationship commitment has a positive effect on relationship trust.

## 5. Switching costs

Switching cost is formally defined as the cost involved in changing from one service provider to another[11]. According to Jackson, it represents the sum of economic, psychological and physical costs. These perceived penalties for disloyalty deter customers from switching to another firm[12].

Switching costs include not only those that can be measured in monetary terms but also the psychological effect of becoming a customer of a new firm, and the time and effort involved in buying new brand[11].

Economical or financial switching cost can be thought of as a “sunk cost”, which appears when client changes the collaboration firm[11].

Switching cost confers some advantages for firms, and they have a direct effect on client loyalty level. It can decrease clients’ sensitivity to price and satisfaction

level, and they perceive the functionality of an activity in changing costs.

These arguments state that switching cost is the factor that most directly influences clients’ sensitivity to price level and therefore influences customer loyalty.

The following hypothesis is therefore proposed:

H6: Switching costs have a positive effect on business loyalty.

## 6. Methodology

In order to obtain valid results from a scientific study and to test the proposed hypothesis, it is very important to choose the adequate method. The model tested in this article is an theoretical one, and it was tested in other fields of activity. The chosen model of loyalty was developed by Caceres & Papanoidamis (2005) and it was empirically tested on advertising agencies. In order to adopt this model to the case of accounting firms we added the construct of switching costs because it is a factor that influences loyalty presented in the literature of financial services.

The research instrument was a questionnaire containing 35 items. The measuring scale was a ten-point Likert-type scale that ranged from “1” (“completely disagree”) to “10” (“completely agree”). Items evaluated the following constructs: *commercial service, communication, administrative service, delivery service, trust, commitment, switching costs* and *loyalty*.

The methodology presented in this article represents a pre-test of the research instrument which will be used for testing the loyalty model in the case of accounting firms. The first step consists in choosing an adequate scale for each construct that forms the model.

To measure the constructs, procedures were derived from the research literature, and multi-item scales were employed. Caceres & Papanoidamis (2005) developed a customer loyalty scale based on a two-dimensional model of loyalty : service quality and recommendations. Trust commitment and satisfaction form the construct of relationship quality.

The construct of loyalty is measured by using a five item scale focused on the likelihood of continuing doing business with

the supplier and recommending the supplier to a partner. This scale is also used in business to business domain of activity by Lam, Shankar, Erramilli, & Murthy(2004).

The functional dimensions of *service quality* construct were measured with scales fervently used in the service literature and the technical aspects were operationalized during the interviews of the accounting experts.

The construct of *commitment* was measured with a scale used by Caceres & Paparoidamis (2005) for business to business domain. This scale was adapted after the one build by Morgan and Hunt in 1994.

The construct of *Trust* was measured using a scale adapted from Morgan and Hunt (1994).

For the construct of *satisfaction*, a single item is used and it is focused on the global perception of the relationship. The method based on the use of a single item for measuring the concept represents a limitation if we compare it with the multi-item scale. The results of the studies of Yi & La (2004), who compared the reliability of various scales of satisfaction with one or more items, showed that those using one item are acceptable.

The construct of *switching costs* was measured using a scale adapted for the specific of financial services from Bell, Auh, & Smalley (2005).

For the latent variable of *communication* it was chosen a scale tested by Dwaine, Coelho and Vilares (2006), on the business to business sector of activity. This scale was adapted after the one used by Morgan & Hunt (1994).

The sample consisted of 60 companies which are clients of accounting firms. Because the relationship between relational factors and loyalty was demonstrated in other research studies as well, it is appropriate to test the theoretical model proposed in this article with confirmatory factor analysis.

This method is used to verify if each indicator can comprehend the dimensions of latent variables. In this manner the validity of the scale is verified.

Confirmatory factor analysis was conducted using the statistic software called AMOS 18. This demonstrates that the hypothesised model fitted the data reasonably well (see Table 1), and that the overall fit of

the model is adequate.

For testing the goodness of fit of the model GFI (Goodness-of-Fit index) and RMR (root mean square residual) tests were used. These represent absolute indicators that can be interpreted in order to establish the correspondence of the empirical data with the structural theoretical model.

GFI test is one of the tests that are generically called GOF “Goodness of fit”, which assesses the model degree of correspondence and its prediction value. RMR test or “Root Mean Square Residual” represents the absolute value of the average of covariance errors. For the GFI coefficient the optimal value must be higher than 0.9 and for RMR it is recommended a value close to zero[13].

Table no.1-Test of goodness of fit

Scale	RMR	GFI
Loyalty	0.354	0.765
Commitment	0.217	0.995
Commercial Service	0.158	0.855
Administrative service	0.024	0.997
Delivery service	0.215	0.891
Communication	0.042	0.978
Switching Costs	0.024	0.997

Source: Amos Output

In table no. 1 we can observe that the values for the two indicators are close to value of zero respectively 0.9 for *Commitment*, *Commercial Service*, *Administrative service*, *Delivery service*, *Communication*, *Switching Costs* scales, which means that each scale has an appropriate goodness of fit. For the *loyalty* scale we obtained values of these coefficients that are significantly different from the optimal values. Because the Cronbach-Alpha test for this scale showed a good level of reliability, we decided to keep this scale because the problems could be explained by the dimensions of the analysed sample(only 60 cases).

For testing H1 hypothesis, a confirmatory factor analysis was conducted on the structural model of *service quality* which has five dimensions: *commercial service*, *administrative service*, *delivery service*, *communication*, *service provided*. These are measured through observable variables that are grouped as constructs. In

table no. 2 we can observe that the value of the coefficients for each dimension is significant. For the analysis and the interpretation of the results we must consider the value of the regression coefficient. This means that an increase with one unit of *service quality* leads to an increase of 1.000 units above the *communication* component, 1.113 units above the *delivery service* component, 1.122 units above the *Administrative service* component, 1.126 units above the *commercial service* component and 1.157 units above the *service provided* component.

Table no.2- Estimated coefficients of Service Quality

Relationship			stimate	
communication	---	quality	.000	.001
delivery	---	quality	.113	.001
administrative	---	quality	.122	.001
commercial	---	quality	.126	.001
service provided	---	quality	.157	.001

Source: Amos Output

For testing H1 hypothesis, we also checked goodness of fit for the *service quality* construct by using GFI and RMS tests. The result show that the value of these indicators are lower than the optimal values (0.225 respectively 0.725). We can conclude that, at these stage of the research, H1 hypothesis is not confirmed. This situation could be explained by the use of a small dimension sample of 60 cases.

In table no. 3 we notice that all the coefficients are statistically significant at the level of 0.001, less the one that defines the relationship of *trust* and *commitment*. As a result, H5 hypothesis is not confirmed for this stage.

H2 hypothesis is not confirmed because the value of the regression coefficient is negative. Therefore, at an increase with one unit of the *service quality*, *loyalty* decreases with 1.547 units.

The rest of hypotheses are confirmed for this stage of the research. Thus, the influence of the relational factors on loyalty is given by the value of the regression coefficient (table no. 3). Thus, when *commitment* increases with 1 unit, *loyalty*

increases with 0.12 units (H3 hypothesis-confirmed); when trust increases with 1 unit, *Loyalty* increases with 0.800 units (H4-confirmed); when switching costs increase with 1 unit, *Loyalty* increases with 0.279 units (H6-confirmed).

Table no.3 -Regression Coefficients

Relationship		P	H	Result
loyalty-quality	-,547	0.001	H2	unconfirmed
loyalty-commitment	0,120	0.001	H3	confirmed
loyalty -trust	0,800	0.001	H4	confirmed
commitment-trust	0.095	0.580	H5	unconfirmed
loyalty-switching costs	0.279	0.001	H6	confirmed

Source: Amos Output

As regards the model goodness of fit, the results were not favourable, the indicators having GFI and RMS values that show that the data are not adequate to the specified model.

## 5. Conclusions

From the researches on loyalty presented in the specialty literature, we analysed the business to business sector and the financial services market because these fields of activity, through their specificity, are relevant for the particularities of the financial-accounting services. A synthesis of the models tested in this framework emphasized the variables most frequently used by the researchers: service quality, trust and commitment. In order to complete the proposed model, we added a frequently used variable on the financial services market: switching costs. The results obtained show that the relations between relational factors and loyalty, as they are presented in the research literature, are not confirmed in the case of accounting firms.

In conclusion, there are many ways to measure loyalty . Choosing between them is a difficult decision. Even after the choice is made, there are many tests to run to ensure the validity of the used instrument. This study presents a summary description of the relational factors and some instrument test results.

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## Methods of Measuring Competitiveness

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### Abstract

*Any approach to measuring competitiveness and competitive advantages must take account of one hand of the covered analysis: microeconomic, mezo-economic, macroeconomic, and on the other hand that they are the result of many variables that are interconditioned directly or indirectly. Measurement methods attempt to quantify the impact of competitiveness and the variables considered relevant. Among all methods of measuring global competitiveness stands Global Competitiveness Index and Economic Freedom Index.*

**Key words:** Competitiveness, Global Competitiveness Index, Economic Freedom Index

**J.E.L. classification:** M10; M21

### 1. Introduction

Issue of competitiveness of national economy is highly disputed in economic theory and practice. Beyond the many debates and diversity of the criteria used, we believe that the economy is competitive if its market share increases (in particular, its export share in the world), thanks to its price with a relatively favorable development compared with those of competitors (so, it has a competitive, price, and consequently inflation, below) and the quality, diversity and timeliness of goods offered.

Beyond the company's specific and specific factors of the branch economic, in recent years globalization emphasized the importance of country specific factors as determinants of performance. As an example we mention the following specific factors that influence a country's performance: institutional and regulatory framework, access to markets, resources, labor and production factors' costs, financial and

technological infrastructure, etc.. Different dimensions of competitiveness are strongly linked: for example, competitiveness factors of a country determinates the factors of international competitiveness of a company.

### 2. Index for measuring competitiveness

For over thirty years, the World Economic Forum published annually the Global Competitiveness Reports which studies and compares the factors that determine national competitiveness. The goal is to find the best strategies and policies to improve national competitiveness. Since 2005, World Economic Forum analyzed competitiveness based on the Global Competitiveness Index (GCI). This indicator examines and evaluates the economies' potential worldwide, noting the areas of sustainable growth on medium and long term being centered on three fundamental elements: a stable macroeconomic environment in each country analyzed, the quality of public institutions and their policies and technological efficiency country level.

*Table 1. Romania's Global Competitiveness Index*

Year	Rank	Score (1-7)
2011	77 (from 142)	4.1
2010	67 (from 139)	4.2
2009	64 (from 133)	4.1

Source : The Global Competitiveness Report 2011-2012

We notice that Romania's scores between 2009 and 2011 are almost constant, which means that it failed to become more competitive on international market.

The concept of competitiveness involves static and dynamic components: although the productivity of a country determines its ability to sustain a high level of income it is also a central determinant of investment performance, which is one of the key factors explaining growth potential.

Global Competitiveness Index includes a number of components each measuring different aspects of competitiveness. These components are grouped into 12 pillars of competitiveness as:

#### *1. Institutions*

Quality of institutions has a great contribution to the competitiveness and growth. This affects investment decisions, playing a role in how companies distribute their profits and costs for developing policies and strategies.

#### *2. Infrastructure*

An efficient and extensive infrastructure is critical to ensure effective functioning of the economy. A well developed infrastructure reduces the distance effect between regions, integrating national markets and connecting them to lower prices in markets in other regions and countries. Quality infrastructure provides entrepreneurs purchasing goods and services market in a reliable and punctual, facilitating the movement of employees to the most appropriate job.

#### *3. Macroeconomic environment*

Stable macroeconomic environment is important for business and also for the country's global competitiveness. Although it is known that only macroeconomic stability can not increase productivity of a nation, the macroeconomic instability has a bad effect on the economy. Government can not provide efficient services because it has to make very important payments or outstanding debts. Companies can not operate efficiently if inflation is elevated.

#### *4. Health and primary education*

Health workforce is vital for the competitiveness and productivity of a country. Sick employees can not rise to the desired level and will be less productive, resulting in increased business costs. Primary education increases the efficiency of employees. Employees who have little education can make only simple manual tasks and adapt more difficult to the advanced techniques production processes.

#### *5. Higher education and training*

High quality education and training are essential for economies that want to develop. In the globalized economy, higher education employees adapt quickly to the changes of environment and of the production system.

#### *6. Goods market efficiency*

Countries with efficient goods markets

have a good competitiveness, because they produce the right mix of goods and services according to the demand. Market efficiency depends on consumer trends and their refinement. For Cultural or historical reasons, consumers may be more demanding in some countries to others. This may create an important competitive advantage because it forces companies to be more innovative and customer oriented.

#### *7. Labor market efficiency*

Efficiency and labor market flexibility are critical to ensure that employees are allocated in the best way in economy and are provided with appropriate incentives for their efforts. The labor market must have the flexibility to change employees from an economic activity to another quickly and at low cost and to allow wage fluctuations without social disruption.

#### *8. Financial market development*

The recent crisis has highlighted the central role that it has a well-functioning financial sector for economic activities. An efficient financial sector allocates financial savings in the most productive way. It will channel resources to those investments or business projects that have the highest rates of profitability and not to those who have political interests.

#### *9. Technological development*

For a company to develop and prosper is essential to develop technology. Companies with activities in a country should have access to advanced products and have the ability to use them.

#### *10. The market size*

Traditionally, companies were limited by available markets across national borders. In the era of globalization, international markets have become a substitute for domestic markets, especially for small countries. Trade liberalization is positively associated with economic growth

#### *11. Business sophistication*

Business sophistication focuses on two elements which depend on each other: the quality of a country business networks and quality of operations and strategies of individual firms. These factors are particularly important for countries that have achieved a high level of development and who have exhausted the sources of productivity improvement. When companies

and suppliers form a particular sector and are interconnected geographically in close groups called clusters, the efficiency is very high, opportunities are created for process and product innovation and entry barriers for new firms are low.

12. Innovation

The last pillar of competitiveness is technological innovation. Innovation is particularly important for economies that are closer to the frontiers of knowledge. Although less advanced countries can improve their productivity by adopting existing technologies or making improvements in other areas, for countries that have reached the stage of development of innovation is not enough productivity. Firms from these countries must design and develop next generation products and processes to maintain a competitive advantage. This development requires an environment that is favorable to innovative activity, supported both by the public and private sectors. This means investment in research and development, especially by the private sector, the presence of high-quality scientific research institutions, expansion of cooperation in research between universities and industry, protection of intellectual property rights.

These twelve pillars of competitiveness are not independent, they support each other, and a weakness in one of the areas has a negative impact on other areas. For example, a strong capacity for innovation (pillar 12) will be very difficult to obtain without a healthy workforce, better educated (pillar 4 and 5), without appropriate technological development (pillar 9) or without sufficient funding (Pillar 8).

Next we present the most competitive countries in 2011:

Table2. The Global Competitiveness Index rankings

Rank	Country	Score
1	Switzerland	5.74
2	Singapore	5.63
3	Sweden	5.61
4	Finland	5.74
5	USA	5.43
6	Germany	5.41
7	Netherlands	5.41
8	Denmark	5.40
9	Japan	5.40

10	United Kingdom	5.39
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Source : The Global Competitiveness Report 2011-2012

It has been made a survey to determine the factors that hinder business development. From a list of 15 factors, respondents were asked to select the five most problematic factors hindering business development in their country. Next we present factors that impede business development in Romania and Switzerland, which is the country which ranks first in terms of the Global Competitiveness Index.

Table3. Factors that hinder business development in Romania and Switzerland

Factor	Respondents from Romania (%)	Respondents from Switzerland (%)
Tax rates	15.5	7.1
Inefficient government bureaucracy	13.0	14.6
Policy instability	11.9	5.8
Access to financing	10.8	10.3
Corruption	9.7	0.3
Inadequate supply of infrastructure	8.9	4.4
Tax regulations	8.7	12.1
Inflation	5.5	2.5
Poor work ethic in national labor force	4.4	3.6
Inadequately educated workforce	3.6	18.3
Restrictive labor regulations	2.8	14.6
Government instability	2.3	0.7
Foreign currency regulations	1.8	4.2
Crime and theft	0.5	1.1
Poor public	0.5	0.4

health		
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Source: The Global Competitiveness Report  
2011-2012

It is noted that in Romania, the main factor hindering business development is the level of tax rates, with 15.5% of respondents, while in Switzerland the main factor is inadequate education of the workforce (18.3% of respondents), factor in Romania is ranked 10 with only 3.6% of respondents. Corruption is the 4<sup>th</sup> factor that impede business development in Romania with 9.7% of respondents, but in Switzerland is the least important factor that impede business development with only 0.3% of respondents.

Heritage Foundation and Wall Street Journal determines the Index of Economic Freedom starting from the axiom that economic freedom is a condition for prosperity of individuals and a factor of competitiveness. Economic freedom is defined as the absence of state coercion on the production, distribution or consumption above a threshold considered necessary to protect citizens and freedom itself.

Economic freedom index is based on 50 variables grouped into 10 categories:

- Trade policy;
- Tax rates;
- Government intervention;
- Monetary policy;
- Capital flows and foreign investment;
- Finance and banking;
- Wages and prices;
- Property rights;
- Regulations;
- Informal market activities

Table4. Ranking countries according to the  
2012 Index of Economic Freedom

Ra nk	Country	Score (1-100)	Growth rate compared to the previous year (%)
1	Hong Kong	89.9	0.2
2	Singapore	87.5	0.3
3	Australia	83.1	0.6
4	New Zealand	82.1	-0.2
5	Switzerland	81.1	-0.8
6	Canada	79.9	-0.9
7	Chile	78.3	0.9
8	Mauritius	77.0	0.8

9	Ireland	76.9	-1.8
10	U.S.A	76.3	-1.5

Source: 2012 Index of Economic Freedom,  
[www.heritage.org/index/](http://www.heritage.org/index/)

In classification, Romania is ranked 62 of 184 countries with a score of 64.4 in 2012.

For global competitors, innovation has become one of the factors that help companies keep competing. The core of this approach is the development of skills and abilities.

One way to use the knowledge and skills in innovative ways is to create new products and gain good positions in the market or new markets. Another way is to create an innovative organizational structure by maintaining a balance between structure and strategy adopted by the company.

### 3. Conclusions

Competitiveness is a complex concept, long debated by economists worldwide and is one of the key dimensions of business performance. Considered as Michael Porter, “competitiveness is the key factor of success or failure in business”.

Creating and strengthening the competitive advantages –of costs, technology, quality, brand image, etc. became the strongest strategic weapon in facing international markets and is based precisely on progressive specialization of economic entities listed, on the essential idea that the acquisition of a higher level of competitiveness is conditioned by deepening specialization in areas that have actual or potential competitive advantage against competitors.

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## Considerations Regarding the Relevance of Failures in Entrepreneurial Development

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### Abstract

*Economic, sociological and even psychological research revealed that entrepreneurship is a process, a dynamic phenomenon, a science based on evident models of manifestation and development. And entrepreneurship represents a behavioral characteristic of an entity.*

*As a result of that, a research became necessary regarding the role and importance of failures in entrepreneurial individual success and, of course, to promote and develop entrepreneurship. As such, this paper focuses on this topic, based on identifying the determinants of entrepreneurship and how it contributes to their failures.*

*In the context of the knowledge economy, entrepreneurship at the individual level is crucial, is essential for development of entrepreneurial phenomenon at organizational and societal level. Failure is the most highly motivated individuals' only steps to success.*

**Keywords:** antrepreneurial spirit, success, failure, entrepreneurship, entrepreneurial culture

**J.E.L.:** L26, L25, M14

### “1. Introduction”

Known is that, currently, to achieve a competitive economy, focus is on three key factors: *knowledge, innovation and entrepreneurship*. Obviously, competitiveness is the productivity growth in resource use and the use of knowledge generation and exploitation of innovations. In this context, the developer/contractor is a

source of innovation, creativity and change, generating economic growth. The concept of business or entrepreneur is related to knowledge, relevant information, flexibility, adaptation, creation of conditions and opportunities in the hope of ensuring a real competitiveness.

Entrepreneurship contributes to job creation and competitiveness, and therefore generates a point of interest to local communities. In fact, studies have shown that poor or developing countries, the main obstacle to economic growth is lack of entrepreneurship that can trigger synergy of those countries resources (capital, labor, information, etc.). Of course, entrepreneurial developing implies not only creation of new enterprises, but also developing existing ones. In both cases, entrepreneurial development involves activities improvement, encourage boost skills, knowledge enrichment, creative development, relationship inventory, etc., of the individual in the organizational framework. Obviously, same importance is allocated to the existence of competitive markets and specific mechanisms, absolutely necessary event to successful entrepreneurship[10].

The literature on entrepreneurship studies conducted from different perspectives: sociological, psychological, economic, managerial etc. have revealed key aspects of the elements in the entrepreneurial process, personality traits of the entrepreneur and entrepreneurial skills[1], entrepreneur skills, the role of entrepreneurs[3, 4, 7], culture influences entrepreneurship, business events, factors that influence entrepreneurial behavior, etc.

Obviously, knowing the relevance of failures in entrepreneurship requires a detailed analysis to identify those determinants that may contribute to the development and successful entrepreneurship. In this respect, consider that entrepreneurship is dependent expression of direct and indirect action on the environmental conditions of the entity (internal and external), how to deal with failure-successful relationship is directly influenced by the personality and culture considered entity, failure is defined differently depending on the scope of the entity, personality and culture, each entity had at least one failure.

The study was based on interviews conducted with different entities in different industries, but also the analysis of documents (Curriculum Vitae and the various certificates, diplomas, etc..) (Including personal, where the case), in order to reveal how the failures contribute to the development (through learning) of entrepreneurial skills.

## **“2. Issues concerning the promotion and development of entrepreneurship in the context of the knowledge economy”**

Although there is no accepted definition of the entrepreneur in the literature [2], mainly due to changes in economic theories on this subject, however it is estimated that functional-descriptive definition is presented by Wennekers and Thurik in 1999: “... *ability and willingness of individuals, on their own, in teams within and outside existing organizations, to perceive and create new economic opportunities (new products, new production methods, new organizational schemes and new product-market combinations ) and introduce their ideas on the market, despite the uncertainty and other obstacles, by making decisions on the location, form and use of resources and institutions.*”(46-47). Starting from such a definition of the entrepreneur, it is assumed that any individual who manifests his ability and willingness to create new economic opportunities, new ideas, new combinations and even new opportunities and guidance in achieving the targets is the entrepreneur (as theoretically frame of Global

Entrepreneurship Monitor are entrepreneurs in training or in early stadium).

Entrepreneurs are motivated by the need for independence, largely financial, need to contribute to the family and therefore to society, to have free time for family, not to be unemployed in the crisis conditions. They have initiative and ambition to succeed, anticipate change, are willing to change, and feel inclined to profit again. In other words, the entrepreneur is the person who creates, organizes, manages and assumes the risks of an enterprise. In this context, the entrepreneur assumes all responsibilities for the effective functioning of the entity. It must be creative, inventive, innovative and courageous in making best use of the opportunities offered by that act. He is a bearer of value; culture, capital, governor, and chief factor of resource allocation. As such, the entrepreneur has a multitude of roles: creative, innovative, organizer, coordinator, owner, manager, leader, motivator, etc.

That is why real interest for this phenomenon is revealed even by the fact that the first of the essential principles of the “*Small Business Act for Europe*” European Commission (EC) - which underlines the political will to recognize the fundamental role of small businesses in the EU economy and establish for the first time, a strategic framework for the Union and its Member States - refers to “*create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded*”. Thus, one of the measures the European Commission aimed at *promoting entrepreneurial culture and facilitating exchanges of best practices in entrepreneurship training*[11]. Moreover, entrepreneurial culture and entrepreneurship are recognized and promoted in Europe 2020, as some of the basic skills that involve innovation, creativity, risk taking and the ability to start and manage a business in order to create an economy based on knowledge and innovation. Culture of competitive entities must be an entrepreneurial culture in which innovation and creativity are fundamental cultural component. Therefore, the EC states that entrepreneurship is the key to job growth, reflected in economic development and ensuring prosperity.

In the knowledge economy entrepreneurship requires perseverance, ingenuity and a predisposition to take towards the objectives set. Also, entities must be based on power and their ability in order to identify and exploit opportunities arising in the environment in which they occur. Obviously, the entity must have a certain attitude, personality (temperament) to take something and be successful. In fact, any entity to generate changes that affect not only the entity, but also other entities, and even society in general.

Known is that spirit and entrepreneurial potential exists in all environments and fields, identifying OECD in this regard a number of specific indicators, namely:

- *determinants of entrepreneurship*, namely the contextual factors that may positively influence attitudes, actions, innovation, start-ups, new markets: access to finance, entrepreneurial skills, market conditions, specific regulations, entrepreneurial culture, entrepreneurial climate etc.;
- *entrepreneurship performance*, showing that elements of the dynamics and evolution of new business: establishing a firm rate, the rate of bankruptcies, types of firms, employment, etc. working population;
- *impact generated of entrepreneurship*, i.e. economic and social effects in long term: job creation, economic growth, poverty reduction.

Entrepreneurship manifestation is directly dependent on internal environmental conditions (organizational culture, characteristics of the organization, work group, managers, owners, personalities within the organization, processes of recruitment, socialization and integration, the beneficiaries of the organization, the organization's philosophy, the motivational, management organization, models of organizational behavior, organizational relationships) and external (technical, technological, socio-demographic, economic, legal, institutional).

Therefore, ways to promote and develop entrepreneurship can be structured at both national and organizational/community and individual. At national level, all major policies to stimulate entrepreneurial capacity focus on macroeconomic conditions and access to finance. But the study shows that

entrepreneurship requires a shift to reward nationally operating entities, seeking new methods and models for success and develop their skills, capacities and positive attitudes towards objectives. And the reward system requires certain specific framework conditions appreciation primarily values (data including entrepreneurial skills). Framework to ensure these conditions are relevant legal regulations, administrative and specific markets and support programs of governments and other organizations.

The literature states that one of the key ways to promote entrepreneurial spirit and culture refers to strengthening the entrepreneurial traits of individuals.

### **“3. Relationship failure-successful in development of entrepreneurship”**

Entrepreneurship, whether learned or inherited, is a matter of choice of entity, according to the theory of "administrative man" by Herbert Simon[6], applying its innovative concepts of the theory of human choice and administrative decision that solve specific organizational problems. Theory that proposes "administrative man" instead of "economic man" of Taylor, an individual seeking to educate themselves, knowing only a few alternatives for the decision and decided to apply appropriate solutions than to seek the best solution[6].

Entities decide to have an attitude, to do something to achieve success in their field of action. Often, the difference between achieving or missing goals is given by the attitude. Failure is a way of strengthening entrepreneurship, the accumulation of knowledge, models and learning success.

According to experts, the classical elements of the entrepreneurial process are: identification and opportunity (idea) evaluation, developing the business plan, defining and determining the necessary resources and business management. Regarding the first step: identifying and evaluating the idea, Peter Drucker, in "Innovation and Entrepreneurship" believes that a new business opportunity may occur as an unexpected event: success, failure or unexpected action in the environment of the entity. Obviously, favorable opportunities arise as a crisis, a situation seemingly hostile or as a failure. History shows that in fact,

many successes arose from failures. "Failure is the stepping stone that life offers you to help catapult you to success - favorable to new opportunities"[8].

Considering the failures importance in developing entrepreneurial spirit is leading in the fact that entrepreneurial events goes to the elimination of economic equilibrium, according to Schumpeter[7], which can lead to some failures, on the short terms.

Also, entrepreneurship can be approached as an entity in the direction of environmental action that reveals at least three dimensions of the phenomenon of entrepreneurship: innovation, risk (assumed to be calculated) and proactive orientation. Innovation intends to generate creative solutions to problems faced by the entity (individual or organization) and to all involved. In this respect, the entity shall allocate the resources required to implement the solutions found, taking into account the probability of failures, of course, to a reasonable level. Proactive orientation refers to the fact that an environmental cause changes so that these become favorable to them to ensure high performance.

Failures are nothing but **real opportunities for personal and professional development**. Success is the result of lessons learned from failures. Of course, failures should not become obstacles to recovery potential available to each individual. Any success inevitably means taking a risk, that fail to approach, but that does not mean that people should no longer act for fear of mistakes. Therefore, in the context of the economic crisis have been forcedly imposed the need to include failures **in the statement of activity of each individual (CV)[5]**. Once made, **failure experiences are necessary to achieve success**. Failures say about each individual's aspirations, the efforts made to achieve the objectives, the will, perseverance and dedication they have shown.

However, analysis of CVs subject research subjects revealed the fact this component dedicated to professional failures is missing. So the interviews were taken to address professional failure in several ways: number, size, mental, relationship with the effects and causes of failures (causes: fear of change, giving easy, goals and unrealistic goals, lack of motivation, unrealistic expectations, self

ignorance, lack of planning, etc.; effects: changing direction, individual introspection, understanding and accepting the consequences, identifying new resources, skills and competencies, etc.) and triggers (business: insufficient resources, limited time, unquantifiable objectives; contextual: general economic crisis, unusual family situations, social, organizational: organizational change, mismanagement, etc.).

Generally, it is considered that failures are the fault of others, bad luck or fate and no fault of our own. Of course, this is because people are afraid of failure, and often refuse to talk about it. It is noted that individuals who knows themselves very well (they know their capabilities, capabilities, skills, etc.) have no registration of failures, i.e. they have not considered their experiences as failures, but periods of stagnation in their path to success or benefits to ensure future success. On the other hand, failures of some subjects are the result of their own limitations that were submitted, but these findings were favorable entrepreneurial skills. This is because failure is a period of stagnation, the reassessment of the past and looking for new prospects. It states that an individual has more chance of success each has accumulated failures. Failures have generated some new ideas, trends, development, new capabilities, knowing the success in other fields. Each individual has a spirit (mindset), the power to choose, to decide what to do, to think, to take. Is said to make good decisions every individual must learn to make choices and failures are ways to learn to decide to face the consequences and choices, but also to anticipate them.

Sooner or later, subjects had learned something from their failures in life (personal and professional). Moreover, in interviews they were self-analysis, revealing the limits that they have imposed and the potential they have, identifying consequently new resources and directions of action and development.

#### **"4. Conclusions".**

The main idea of this paper is to underline that entities exhibiting entrepreneurial spirit are those socially responsible and achieve high performance and have successfully overcome failures, learning from these

mistakes and failures as steps marked success. Although the approach is the notion that entrepreneurship is a necessity in certain situations, such as rapid changes in the technology, the customer values, situations of uncertainty, chaos, crisis, etc. high complexity. However, from the direct relationship between failure entrepreneurial orientation and entrepreneurial success is essential to any entity and economy.

In the knowledge economy considering failures as steps to entrepreneurial success requires developing a learning system failures, including a subsystem for generating and storing knowledge, ideas and information, a subsystem of developing attitudes, skills and behaviors of a entrepreneurial successful, a subsystem to communicate with other entities from the same action or in different environments and a subsystem for disseminating knowledge and entrepreneurship development models to all concerned.

The study provides a broad framework for action and practical scientific approach of analyzing entrepreneurship, offering courses of action to develop successful models of entrepreneurship based on failure to provide ways of enhancing the human potential and change all the entities attitudes. In this respect, require at least the following lines of research: analyzing the relationship between entrepreneurial orientation and performance of the entity, identifying the basic conditions for successful transformation of failure, identifying patterns of learning entrepreneurship in terms of failures (this is because few entities learns from their mistakes).

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## Aspects Regarding the Importance of Organizational Social Model of Romanian Smes in Providing Organizational Intelligence

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### Abstract

*In the current socio-economic context, the importance of SMEs derives, at least, of their fundamental role in any economy. Therefore, in the knowledge based economy, it is necessary to complete the organization of these small and medium entities according to the social model, which integrates cultural model of organization based on intelligence, creativity and knowledge, the emphasis is being put on individuals making up the entity, to a higher performance insurance.*

*Currently, in Romania, most SMEs are profit-orientate, not to people, despite that exists some entities driven by performance, creativity and innovation; but also exist SMEs in which entities and employees' goals are inconsistent and do not take anything for the purposes of changing the status quo. There are also SMEs which not assumes great risks, but respond quickly to changes in their environment action or, conversely, firms that do not take risks intelligent nor adapt quickly to environmental requirements.*

**Keywords:** organizational intelligence, social model, SMEs, organizational culture

**J.E.L.:** L26, M14

### "1. Introduction"

Known is that intelligence it is both a real fact and potential one, can be considered and addressed as a process or phenomenon, skill or ability. Obviously, intelligence can be defined so as a mental organization attribute (in psychology), but also as a behavioral organization. The study is based on research

undertaken specialist John McCarthy and Patrick J. Hayes, who in 1969 define entity intelligence closely related to the existence of an appropriate model of the world, to help it respond to a variety of questions, with the necessary information acquired from outside world and to conduct certain activities to achieve objectives, taking account of its possibilities[4]. Obviously, there are now several studies on models that underlie the emergence and development of organizational intelligence: social, structural, systemic, etc.

The research involved case studies of different models of organization of Romanian SMEs, cultural diagnosis (analysis of organizational cultures) and analyze their collective capacity to generate, integrate and apply knowledge to achieve high performance.

Currently, the Romanian economy is based on the existence and development of SMEs, due to their presence in large number in all the areas of activity. Of course, in order to develop a competitive economy, SMEs need to develop and turn into very large companies having high performances. A sure way to success is due to the development of these SMEs intelligence, a strong culture, creativity and individual and organizational innovation. In this respect, it is necessary organization, coordination and effective management of SMEs, to generate and develop strong organizational cultures and multiple intelligences. It also appears necessary to develop emotional intelligence[3] in the Romanian SMEs. This is because the Romanians, the collectivist Latin people, have symptoms of excessive emotions. Developing the ability to

use emotions intelligently requires not only knowledge and management of their emotions, that emotional self-control, but also recognizing emotions in others (empathy) and social competence (positive interaction with others and handling relationships). Developing emotional intelligence is necessary for Romanian SMEs because they are usually a first job, a first step in career and a first step towards world entrepreneurs to individuals. Obviously, any individual under the first employment or business position itself as the family, emotional, experiencing organizational relations under the impact of family relational experience. Hence it becomes necessary to organize the Romanian SMEs as models to ensure the development of individual and organizational intelligence, to achieve high performance.

## **“2. Romanian SMEs in global crisis - sources of organizational intelligence?”**

Importance of SMEs derives from their fundamental role in any economy. Thus, SMEs meant for large firms, the world they came from and where their competition will occur tomorrow, as individuals, is a first job, a first step in career and a first step towards world entrepreneurs. Also, for any economy, SMEs are generating new ideas and new assembly processes, which accelerate growth on more efficient use of resources. The information economy SMEs are:

- carriers offer the most products and services needed by the population of a country;
- main value-added in any country;
- entities that have a major contribution to the GDP;
- generating jobs for most of the population;
- units by their performance, condition and performance status of each country's economy and living standards of its population within;
- factor of micro and macroeconomic balance (counteract monopolies and oligopolies, reducing the ability of large companies control the market);
- entities with a flexible and adaptable than favored by small size and rapid decision making;

- entities that fosters innovation and flexibility, helping to avoid dehumanization;
- businesses which easily adapts to the needs and demands of consumers, being closer to the market;
- entity that generates a large proportion of the applicable technical innovations in the economy.

SMEs are the engine of the European economy, the most important generator of jobs and economic growth. As such, the European Commission, through its actions, put the needs of small businesses in the center of its policies: improving the financial environment, enrich regulations to SMEs in Europe in terms of facilitating their work, increasing EU funds for SMEs.

Regarding the Romanian SMEs, they are manifested now in a negative social and economic context, very dynamic, with significant changes in all areas. According to experts, over 90% of Romanian SMEs have bigger or smaller problems in the economic crisis. SME records progress during 2007 - 2009 shows that, when economic crisis hit since September 2008, the number of registered SMEs decreased in 2009 compared to 2008 with 17.50%, while the number of erasures increased with 146.75% and the number of suspensions increased by 109.59%.

Year 2010, characterized by instability legislative tax changes and the impossibility of making realistic predictions made the SME sector in Romania still being in decline. Also, in the first quarter of 2011 versus the same period last year, the number of companies struck up 7%, because there were 10,656 of canceled, the canceled 9950 to first quarter last year. SMEs represent 99% of all companies registered with the Trade Register, i.e. 630,000 SMEs.

In the first quarter of this year were only 32,298 registered SMEs, which represents an increase of 15% over the same period last year[6]. The largest number of newly established SMEs registered in the distribution of water, sanitation and waste management and the insurance and financial intermediation.

Obviously, is looking for solutions to get out of the SMEs crisis, SMEs being those which support over 60% of the existing jobs[7]. In this respect, employers relate

positively with governments, social partners, financial and banking institutions and all interested entities: nonprofit organizations, communities, outside businesses, etc., in order to define a coherent sector development of micro, small and medium.

For survival and development of SMEs is given special attention financing from structural funds, looking at the same time, new ways of lending and help from other decision makers at national, European and international. This government strategy to support development of SMEs in 2009-2013 includes principles to guide the design and implementation of policies to support the Romanian SMEs.

However, an analysis of the culture of SMEs shows that organizational culture is both positive and negative organizational culture within SMEs. There are also SMEs with driven performance, creativity and innovation, and organizational cultures in which the objectives of the entity and employees are in disagreement. Moreover, there are SMEs for which the term "organizational culture" does not exist or is unimportant. Whether or not entities are aware of the existence of organizational culture and its importance in providing high performance, within each organization *there is a more dominant culture and subcultures that occurs depending on the characteristics of different subunits within the organization, the members of the occupation as training, etc.* There are also SMEs which not assumes great risks, but respond quickly to changes in their environment action or, conversely, firms that do not take risks or no risks and adapt quickly to environmental requirements.

Also, in most SMEs with flexible and functional structure, management style is democratic - participative. These managers present organizational problems to employees, receive suggestions and make decisions based on them. Even democrats, some managers define limits and ask employees to make decisions. Democratic managers allow subordinates to act in certain clearly defined limits to them, encouraging employees to become more creative and full of personal initiative. Many managers - owners of small businesses assume the role of mission leaders, because they are directly interested in the mission on which he assumed, and socio-emotional leadership

role, is interested in reducing tensions, conflict resolution, resolving disputes and maintaining morale in the company they manage.

The analysis undertaken reveals that Romanian SMEs development requires the creation of favorable environment for organizational intelligence. And one of the key requirements is the focus on people. But SMEs oriented employees should not ignore the purpose, but rather must be alert and discharge of the company. Thus, developing a strong culture that not only offer environmental adaptability, but also the ability to act proactively (influencing the environment to create favorable conditions, finding new outlets and building solid ensembles to join).

### **3. “ Factors and considerations to ensure organizational intelligence development in Romanian SMEs ”**

Due to the small number of employees, it is clear that the central axis of the appearance, manifestation and development of organizational intelligence is individual SMEs. It may be a verbal/ linguistic intelligence, logical/ mathematical, visual/ spatial, bodily/kinesthetic, musical/rhythmic, interpersonal, intrapersonal, and naturalistic emotional as Gardner's theory of multiple intelligences[2]. Individual intelligence being manifested in a certain context, having the following dimensions: *the organizational dimension, technological dimension, the cultural and linguistic dimension.* These entire dimensions include factors to ensure and develop the organizational intelligence in Romanian SMEs: skills and individual skills, experience, individual/ organizational, organizational culture, leadership (crucial in creating positive relationships), organizational learning, communication, innovation and creativity.

Obviously, all entities (individuals and organizations) have a certain amount of absorption and inclination to oblivion, absolutely necessary for the renewal of knowledge and organizational learning efficiency. Of course, management and leadership SME is responsible for organizational effectiveness, processes and activities within the organization.

Thus, the *organizational context* concerns a framework defined by a system of organization, structure and communication, open, dynamic and adaptable. So, individual form a dynamic organization, evolving under the effect of three forces: individual impulses of each individual, indirect impulses transmitted by the actions of other members, internal changes caused by management decisions and changes in the external environment of the organization. This means that the system is SME, there are changes, voluntary or involuntary, resulting in a process of generating knowledge and new skills to solve problems and carry out specific activities and field profile company. The organizational learning in SMEs most naturally created in stocks of knowledge and experience to solve problems, accumulated cultural elements.

In small firms, due to the easy interaction of all employees is remarkable the benefits of networking (transfer of ideas, information, knowledge, know-how) in the development of organizational intelligence through organizational members roles and position, technology, and by the influences and power each employee separately. Also, in the flexible structure of the Romanian SMEs, individuals get to work together, to know and to interact positively and become capable of transmitting information and knowledge, but their development (personal and professional).

Romanian SMEs benefit is the interest of individuals to knowledge and development, based on the native intelligence of the Romanian people. People fear change, but are willing to learn to cope with, as demonstrated by the current. Of course, all those because in the organizational context, employees are being specialized and each of them evolves (through learning and permits organizational culture) knowledge and skills that others do not possess. At the organizational level, all individually developed intelligences have obvious synergy capable of performance that any intelligent individual would not be able to get one.

In the context of the global crisis and the knowledge-based economy, in which the individual is a carrier of culture, knowledge, being creative and innovative model that can be successfully addressed in the development

of organizational intelligence in Romanian SMEs is an integrated social model. This model explains the emergence and manifestation of organizational intelligence impact on increasing the profitability of SMEs in the current context.

#### **”4. The social organization of SMEs - crucial in the development of organizational intelligence”**

Developed as a reaction to the knowledge economy, where innovation is more important than the production, that model emphasizes on people and their knowledge. Although addressed simplistic, definition of organizational intelligence organization as collective capacity to generate, integrate and apply knowledge[1] is relevant for the model under investigation.

In this sense, considering intelligence entities as something that they have by inheritance, but also as something that can be through learning is a basic assumption of the model. It is obvious that some people have interpersonal skills and/or intrapersonal. They develop easily a friendly relationship inventory, given that they can relate with others. Of course, others can learn how to develop positive relationships with other entities. Evolve, through qualitative and quantitative leap, the result of learning in a specific cultural context, can occur in all aspects of the development entity.

In SMEs organized social (integrated) employee takes the lead, but in terms of a single cell living organism that is firm, but the complexity of the individual who has, in addition to social and organizational life has a inner life, fears, is expected, has prospects, has attitudes and behaviors, has values that are reflected in the way that works, they connect and is identified with the organization.

SMEs with an organic structure can develop such models. An organic structure allows the generation and development of interpersonal relationships through communication, and developing a strong organizational culture. It is known that any entity has a certain culture, which can be defined from several perspectives and guidelines. Successful entities that have demonstrated a strong culture, positive, adaptive strategy directly relate to high

organizational performance. Also, these entities have successfully developed culture based on cultural differences and systems; the focus is on value, knowledge, innovation, creativity and learning. Model characteristics are:

- flexible organizational structure;
- high degree of creativity in their activities;
- high degree of cooperation between sub-entity, based on teamwork. If the entity is an individual, it is clear that intelligence is a prerequisite for the development of good health, although there were times when just physical problems have generated a development of some kind of intelligence (emotional intelligence, naturalist, music, etc.);
- proactive environmental approach;
- diversification and flexibility in tasks and approaches and points of view;
- effective leadership and strategic management participation;
- entity based on knowledge, innovation and creativity;
- transparency in disseminating information and knowledge;
- the individual is most important for the organization and the focus on human capital development through training and personal development;
- philosophy, mission and vision of the organization are based on people;
- entity is socially responsible and has an ethical behavior;
- individuals are properly motivated performance, creativity and innovation;
- communication is strategic, with a communication strategy and policy in this area.

SMEs have analyzed in greater or less integrated social model characteristics, but cannot say that their organization is conducted in accordance with that model.

This social integrator model is crucially emphases on values, knowledge, intelligence and creativity. Integrator aspect of the model aims in fact to address organizational culture and communication in systemic perspective and as a system entity. Obviously, socio-economic entities are primarily unique due to cultural differences and differences in communication systems. Systemic approach of an organizational culture reveals the

complexity of cognitive, emotional and behavioral.

*Systemic approach of communication* not only trying to make sense of actions within the entity or to provide all important communication, which coordinates its components in a precise meaning, but to exploit and capitalize elements of communication process, revealing interdependencies and internal connections communication, generating synergies and complex structures needed to develop intelligence entity, especially in the current context[5].

*Communication systems are of a great diversity in time and space in relation to many human groups and ways of combining elements of communication process.* The communication is developing not only the personalities of individuals but also socio-economic entities, regardless of the context of occurrence, although bear influence that context. Sure, effective communication system is based on many determinants that make the difference between these systems. This means that differences in communication systems lies at least in: culture employees, all members knowledge, technique and technology, language (scientific and technical) used, the media, the value system of each member and the organization, role each employee and the entity, the entity and employee ethics.

Important factor in ensuring organizational intelligence through its components, organizational culture affects most policies, decisions and activities of the company and thus has a major effect on business success. The organizational culture focuses on two types of components: components visible members of the organization (beliefs, values, rules, etc.) and members of the invisible components (premises). In other words, cultural values, customs, traditions, symbols, especially to cultural differences influence perceptions of interpersonal relationships at individual and thus organizational intelligence dimensions. Cultural differences are results of fact that there are procedures, formal rules, norms and values stated in each organization's impact on performance actants. Thus, cultural differences are highlighted by the many existing organizational culture types. The main cultural differences of entities can be

considered socio-economic climate, norms, values, human goods, material, financial, information, activities, policies, organization and management.

Culture transmits in which measure its employees assimilate values and behaviors, but also assesses the extent to which top management company declared values sent to employees so that they are assimilated and internalized by them, to develop organizational intelligence and thus the efficiency of the organization.

Also, this model of development of organizational intelligence shows that the individual is the bearer of culture, abilities, skills, experiences and, especially, generating innovation and creation. Innovative and creative spirit, man is the difference between success and failure of various businesses.

## “5. Conclusions”

It is rightly states that the development of organizational intelligence is more complex than individual or collective, but it can be addressed as the development of intelligence entities (and individuals) to be placed into an organizational context, culture, technology and language. Identifying and summarizing the determinants of organizational intelligence to ensure the Romanian SMEs need to develop a social model reveals integrated organization to develop their intelligence and achieve high performance.

We can sustain the idea that intelligence entities partly inherited, partly learned underpins the development of integrated social model of organization of SMEs, which provide, at least, the conditions of occurrence and development of organizational intelligence, thereby ensuring organizational competitiveness increased.

The study opens new avenues for reflection on the importance of the organizational entities of any kind in providing intelligence and organizational development, thus ensuring high performance.

Also, given the different cultural and communication systems can be configured specific organizational models that determine the development of organizational intelligence.

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## A Good Practices in Outsourcing Management

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### Abstract

*Outsourcing may be the present and the future of the companies, speaking of the globalization. Based on the idea of delegation, service specialized enterprises can bring something extra to the companies, thanks to the IT solutions they propose. We will explain the success of outsourcing, speaking of Egypt, a country that invested in the preparation of human resources and maintained a stabile economic environment, based on the Business Process Outsourcing solution. Also, Brazil offered a different perspective, investing in the make-up of the country, by introducing IT at all levels, while the success is expected at World Football Championship in 2014. Analyzing, the ideas promoted by outsourcing of these two countries, we gathered a few points about what Romania could do to reduce the differences between our country and the rest, when we refer to outsourcing management.*

**Keywords:** Outsourcing, BPO(Business Process Outsourcing), IT, Brazilia, Egipt.

**Jel Classification:** J5, M15

### 1. Introduction

**Outsourcing from theory to practice.** Outsourcing can be defined as the delegation of tasks or objectives of organizational segments belonging to foreign entities, which offers an excellent quality - better price, or have expertise in the fields. Another definition states that outsourcing is "a strategy by which an organization entrusted major functions to external providers,

specializing in certain areas and makes them partners, „valued business”.

Currently, most managers consider outsourcing as the most convenient solution for a company interested in becoming more efficient by reducing costs and access to the latest technology without spending significant funds for research and development. Moreover, outsourcing is the simplest solution to the problem of lack of specialists facing occidental countries[1].

**The advantages** of outsourcing are low cost (company no longer has to devote resources to activities not related to the activity of the enterprise, more spending can be planned and anticipated), access to technologies, methods and qualified personnel, focus company (different segments of business requires a great deal of time and attention of company management, hazardous situations hangs somewhere in the "middle management", which means a financial loss for the company, so the idea of leaving some details to an expert seems more than relevant), improvement of production and delays, resources diverted to other purposes, risk reduction (companies turn to outsourcing, soon become more flexible, more dynamic and more willing to change to make with the new changes imposed by the current economy)

Globalization of business has been possible due to the elimination of all traditional cultural barriers, time and space. Labor can be distributed through mobile technologies that allow coordination and communication of people working together to achieve a set objective. As we said earlier, outsourcing is a top trend in business and requires the acquisition of specialized services of any kind, from external

companies[2].

If we were to classify them, we highlight two main categories, which have merged over time, making outsourcing as it is today. There are:

- *Information Technology Outsourcing* (ITO in English, Information Technology Outsourcing), this classification refers to outsourcing of services related to computers and the Internet, as, for example, create or improve programs software companies.

- *Outsourcing of business services* (BPO, Business Process Outsourcing). This classification criterion is associated generally with activities that require fewer technical skills than ITO, and results in the transfer of activities and responsibilities of a company to a third company, specialized.

## 2. The recipe for success in outsourcing: Egypt

**Partnership with business.** Egypt's road to success in outsourcing began with a limited number of steps. The first experience was developed with IBM. The company began operations in Egypt through a small application development center, which was a forerunner of outsourcing. It has grown faster in the late 1990s with the development of IT outsourcing. The first project undertaken by IBM in Egypt was to "arabic" some IT projects, followed by other software development projects.

**The outsourcing strategy's components and initiatives.** A more detailed analysis of Egypt's strategy related to BPO market offers important lessons on how a country can become a regional leader in outsourcing, while maximizing benefits within their national economies. The key components of this strategy, worth to analyze are[3]:

- *National strategy* set for market development in Egypt, is defined by key strategy of ADIT including the following pillars:

- ✓ Ensure that all requirements (human resources, infrastructure, legal issues, etc.) are available.

- ✓ Increase in amount and quality of local talent, the training of 4500 students to enhance their skills in order to make them able to contribute to market development;

- ✓ Offer incentive packages tailored to suit all investors, according to the number of jobs

that will be implemented in Egypt, staff training costs and telecommunications, and others;

- ✓ Encourage local companies in cooperation with foreign investors;

- ✓ Provide government licenses, in cooperation with government agencies and authorities.

- *Key initiatives* are related to:

- ✓ Preparation / vocational talents: National Telecom Institute (INT), Information Technology Institute (ITI), and E-Learning Competence Center (ECC-L) provide specialized training in ICT.

- ✓ Developing research: MCIT has promoted the establishment of Nile University, an institution of high-tech, non-profit research and development, specializing in engineering and business administration.

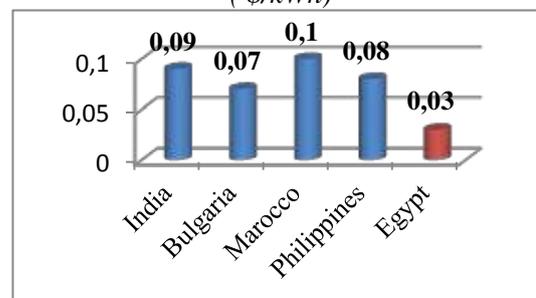
- ✓ Provide strategic training: Competence Center for Software Engineering (CCIS) provides services to improve internal processes model entitled "Capability Maturity Model" (CMM), and "Capability Maturity Model Integration" (CMMI) for local companies software.

### Success in BPO

- **Operating costs attractive**

The cost of competitiveness of Egypt is not only durable, is expected to grow. Is due primarily to low cost human resources, telecommunications and infrastructure (Figure 1). It may be employed in Cairo high quality BPO agents pay with 225 to \$ 250 per month, while in developing countries - like the Philippines and India - with up to twice as much. Market costs of electricity and communications are also competitive.

Figure 1. The cost of electricity in 2008 (\$/kWh)

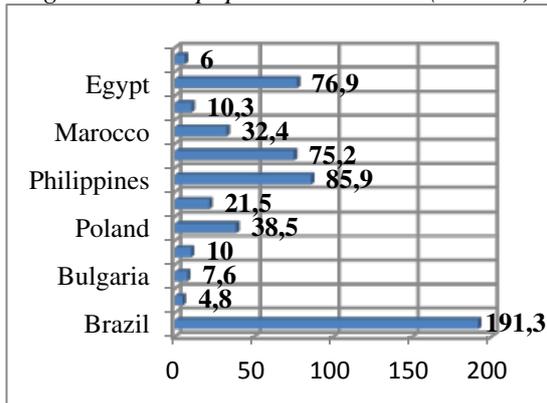


Source: McKinsey Global Institute, 2008

- **A strong emphasis on human resources** Egypt's population (80 million) is young, with a average age of 24 years (Figure 2).

This is a major advantage in a world where talent must be built or upgraded at a rapid pace. Egypt is rich in skilled and talented workers who are eager to work and build their skills. Egypt was able to rely on his familiarity with Western culture and education institutions established for a long time (universities and high schools teaching in English, French and German).

Figure 2. Total population in 2008 (million)



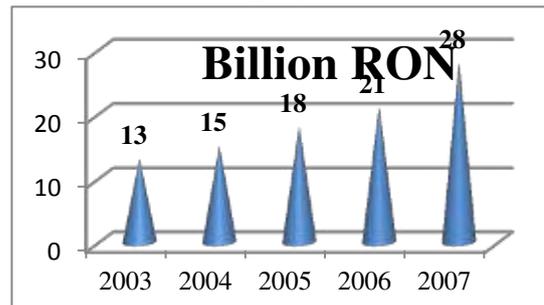
Source: UNFPA (UNFPA), 2008

Furthermore, about 330,000 students graduate each year in Egypt, so the total number of students who speak languages talent willing to work in BPO industry in Cairo is estimated at 24,000 people. In combination with a solid IT knowledge and technical skills, it gives Egypt a wide range of talent for global BPO industry. In addition, an advantageous geographical position (Egypt lies at the crossroads between Europe, Middle East and Africa, with a favorable time zone for companies based in Europe) have helped Egypt to become an attractive proposition for global BPO industry.

• **guarantee a stable macroeconomic environment;**

With an average growth rate of 7-8% per year (Figure 3), a relatively stable currency, a strong financial and credit market, Egypt has been an attractive business location and investment in the last decade. This was reinforced by government policy to dedicate a substantial public investment in developing and improving infrastructure, especially telecommunications[5].

Figure 3. Evolution of total investment, 2003-2008



Source: McKinsey Global Institute, 2008

**3. Brazil - a different approach to outsourcing**

**Brazil in figures.** Brazil has a population of approximately 200 million inhabitants and 85% in cities. GDP per capita is about \$ 7,000 and has recently been growing at an annual rate of 4 percent. The trade surplus has allowed the country to raise 188 billion in reserves by 2008 and helped the government to survive tough global economic crisis[4].

The country has over 150 million mobile lines in 2009, this number is growing by an incredible 1.3 million per month, despite the economic downturn caused by the global economic crisis. Although the number of computers has increased dramatically, helped by government credit programs (until the last quarter of 2008) the favorable exchange rate developments, Internet access is growing, but at a slower pace. Only 20% of households now have Internet access. But there are differences on household Internet access by both regions and income classes as data highlights for 2007 provided by the national samples (Table 1).

Table 1. Households with Internet access

Region of the country	Number	% Population	Percentage of Internet use
<b>Brazil</b>	<b>56.344</b>	<b>100,0</b>	<b>20,2</b>
South-East	25.151	44,6	18,9
South	8.879	15,8	16,9
Central-West	4, 163	7,4	12,1
North-East	14.252	25,3	5,4
North	3.900	6,9	4,4

Source: Government Brazilian Institute of Geography and Statistics (IBGE), 2008.

**Electronic voting and tax system.** Development of e-government (electronic government) in Brazil and the full use of information and communication technologies (ICT) by the population highlight the paradox of this country: one of the most elaborate electronic voting systems in the world and an online tax system operations coexist with the introduction of the Internet across the country and related to the illiteracy of computer use in many parts of the country, especially among the poor. There are two major projects, drawing hearts and minds of all, projects that can help reduce the social gap with ICT and e-government: e-Brasil Project and Programme Bis 2014.

**Brazil's electronic voting system.** In 1986, ESC (Brazilian Electoral Supreme Court) has initiated a process leading to municipal elections, electronic territory of Brazil. Since that year, all elections in Brazil were conducted on electronic voting and full results are available the same day, when elections were held. At the last municipal elections in October 2008, the electorate numbered nearly 129 million votes, registered 400,558 voting sites.

**Electronic tax filing of income tax in Brazil.** Almost all tax returns in Brazil, are submitted on-line. Even in 2003, 95.6% of statements were filed electronically, either online or on disk. In 2008, 23.9 million statements for that calendar year, or 98.8% of the total, were filed on the Internet, using software available from federal tax agency.

**The E-Brasil Project.** E-Brasil project aims to raise awareness about the benefits of e-development strategies consistent. This will help in building a fair and economically competitive society. The project is a joint effort of a network of over 61 international and Brazilian practitioners, united by the belief that with intensive use of TIC's, it is possible for Brazil to overcome the obstacles that prevent to be among the most developed countries .

Of activities we can mention: digital inclusion and e-development, e-education and lifelong learning, e-public safety, e-health, e-public services and management, e-procurement of goods and services, e-justice, e-commerce, encourage the development of ICT sector strategy coordination and management.

**The BIS -2014.** The program was called, 2014-BIS program, in conjunction with the first aircraft ever flew - the 14 Bis, piloted by inventor Brazilian, Santos Dumont in Paris, in 1906. Program motto is "How to amuse the world in 2014". The idea would be to present all that is creative and innovative in Brazil, coming from two sources: new based initiatives that any country trying to achieve, and projects that exist only in Brazil. The main activities of the 2014-Bis Program: electronic passport, experience the Amazon, virtual soccer game, play green, green football, social guides, Brazilian music for all.

#### **4. Five lessons for Romanian management**

**Investing in talent.** Investing in talent development can increase the opportunity of our country, and has a vital character to ensure long term sustainability of the country's service delivery strategy.

**Expertise - the decisive factor.** International companies and expert advice should be used in launching and implementing the initial phase of the strategy so as to bring the country much needed know-how and open up different opportunities[6].

**Promotion - the key.** A promotional campaign is essential after make sure all requirements are already addressed. Many impact programs such as stimulus packages, you can encourage BPO foreign investors, and for this you need to be prepared to develop the industry.

**Fair and transparent legislation.** There is a clear need to focus on a fair and transparent policies, without forgetting the international law. A good example may come in the regulations on the supply contract, web services, covering the provider's speed or the minimum and maximum price.

**Safety economic system.** According to data taken from the Economist Intelligence Unit, IT spending in Brazil have a rate of 1.7% of total GDP. However, it is estimated that the country will record a third of world economic growth rate by 2020 - which brings good news for local technology industry, since it is known that GDP growth will lead to an increase in IT market demand. In Romania, the cost ranges between 20 439-42 430 EUR for IT staff costs are lower in

countries such as Czech Republic, Slovenia and Hungary[8].

## 5. Conclusions

TIC offer companies the opportunity to access new markets regionally and globally and to promote and sell products and internal services electronically. Development will cause a decrease in production costs, administration and sales from the use of TIC can result in a significant increase in productivity of the factors used. Following this work, we can conclude a few ideas[7]:

○ With globalization there is a gradual and complete interconnection of all economic activities worldwide, affecting not only national economies as a whole, but any business activity;

○ IT and the emergence of global networks radically change the mobility equation by introducing new ways to combine talents across borders, outsourcing (especially the business process) is one of the main beneficiaries of this phenomenon;

○ Egypt's efforts to build a first class competitor in the outsourcing led to measurable success;

○ How Egypt chose to follow this path can be a source of inspiration and reference for other emerging economies. A central feature of Egypt's strategy was to focus on several strengths (its young population, high education and the availability of a source with knowledge of youth taletate international languages) and combine them with a series of specific government measures;

○ Brazil's key to success is strategic communication in all media, especially television and the Internet;

○ 2014-Bis Program intends to create a stronger country brand, demonstrating the evolution of Brazil in terms of technology, scope, approach, and social impact, while preparing the 2014 World Cup.

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# Corporate Social Entrepreneurship as an Incubator for Tomorrow’s Leaders

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## Abstract

*This paper aims at analyzing and identifying the core aspects of Corporate Social Entrepreneurship (CSE) as a process able to bring about radical organisational change. The supported assumption is that the business world needs to evolve into a stage where the new generic type of organization puts financial and social objectives on the same strategic level, by implementing this into its core models and processes. Consequently, it focuses on the specific characteristics defining Corporate Social Intrapreneurs (CSIs), the change agents within organisations able to initiate and carry through this transformation. At the same time, we look at CSE as an advanced approach to Corporate Social Responsibility (CSR), implying a total alignment between corporate mission and values and employees’ personal values, all with the purpose of creating an enabling environment for CSIs, one in which they can develop and the leaders of a new generation. Last but not least, the article offers an overview of how this is done in the practical case of Sandbox, the leading global network for the most inspiring leaders under 30, offering a viable pattern for other organizations to follow.*

**Key words:** Corporate Social Responsibility (CSR), Corporate Social Entrepreneurship (CSE), Corporate Social Intrapreneurs (CSIs), shared value, generation Y

**J.E.L. classification:** M14

## 1. Introduction

Reflecting upon our complex socio-economic context at a global scale, we find ourselves forced to admit to the vicious cycle

characterizing the relationship between business and society at large. This is the cause of a misfortunate development over the past few decades, during which business has been increasingly viewed as creating profits at the expense and not in the benefit of the communities, leading to it being perceived as the root of all social, environmental and economic evil. And what probably accentuated this perception problem even more was the way in which business chose to respond to it. The trend of corporate social responsibility (CSR) widely embraced by business in recent years has been understood as a defensive, almost falsely apologetic approach, which obviously didn’t manage to restore the legitimacy of business, but it only accentuated the diminished trust and its blaming for society’s failures.

It must be said, the core of the problem lies with companies themselves. From this point of view we haven’t come a long way from old Milton Friedman’s times (1970), when maximizing profits was equivalent with the social responsibility of business, so what was good for business was axiomatically good for society. Over the last 20-30 years businesses have argued that, with increasing profits as their primary goal, most of the time there isn’t much more they can do for the benefit of society than maybe giving back at some point. Actually this is how classical CSR ideas were born, on this almost exclusively philanthropic logic of “first do well, then do good”. But beyond this, it is clearer than ever that companies are trapped in an outdated approach, like in a bubble where optimizing short-term financial performance is elevated to primary concern. In this narrow view, the real important aspects like customer needs and broader external influences that determine a

company’s long-term success remain at the periphery or ignored.

On the other hand, it is true that government and civil society have also often amplified the problem. During decades we assisted at the instauration of a false dichotomy between economic efficiency and social progress, with policy choices undermining economic progress in an attempt to solve social weaknesses.

Hence we found ourselves in the middle of this complicated debate and realized it’s about time for a shift of paradigm. The socio-economic context we live in may be complex and tangled everywhere we look around, but we also have the capacity to analyze and understand what was wrong in the past, as well as innovative minds proposing promising alternatives. Why not trying to find the synergies between business and society instead of constantly focusing on the presumed trade-offs between them? Why not identify the wrong directions that have been followed in the past and replace them with new viable strategies?

We intuitively started off from the idea that companies must take the lead in bringing business and society back together and that it should be done in way that also brings social responsibility at the core of their preoccupations. So after devouring entire pages of change management and CSR literature we came across Porter & Kramer’s thorough analysis of the exact problem we were trying to figure out.

In “Strategy and Society. The Link Between Competitive Advantage and Corporate Social Responsibility”, the two authors are arguing there is no point in focusing on all those aspects increasing tension between two partners that in the end are actually dependent on each other – business and society. Instead of getting lost in the unending vicious circle of what’s good for business is not good for society, they plead for a different manner of thinking, one according to which we embrace that what’s good for society is actually good for business. This may sound like a play on words, but there is a profound difference in perspective there. Creating societal benefit is a powerful way to create economic value for the firms. There are so many opportunities for creating profits “in the *right* way” that have been missed so far, profits that come

from meeting fundamental societal needs. The obvious example is the environment – businesses can be more than just compliant, they can reduce energy costs and unnecessary logistics, while creating products that are good for the consumer, thus achieving the right way to make economic profit (Porter & Kramer, 2006).

Attacking this sort of subject might seem like a very strange preoccupation coming from Porter, after all one the most renowned contemporary strategic management scholars. But when thinking better about it, it is actually just another proof of the fact that we can no longer function as before, that our socio-economic system is ripe for evolution. This is the next chapter of thinking about strategy, competitive value chains and creating competitive advantage; involving societal needs as a value dimension in the company’s strategy is maybe one of the most important development axes in the years to come.

But who will be guiding all of these efforts and under which framework? Who are tomorrow’s leaders and how can we train them today so that the goal of reconciling business and society becomes an attainable one? The moral beauty of this purpose, as well as the theoretical linking framework proposed by Porter & Kramer inspired us to reflect beyond just the general principles level into the realm of putting it into practice. What are the resources at our disposal and what innovative processes need to be implemented so that we bring this paradigm shift into the concrete world? We proposed ourselves to analyze the complexity of these subjects and hopefully shed some light on a few interesting aspects that might play a bigger role than apparent in the overview.

## **2. From creating shared value to Corporate Social Entrepreneurship (CSE)**

Departing from Porter & Kramer’s view, we completely embrace the idea that it is in the self interest of the company to think about the right way to do things, a way that not only satisfies their intrinsic profits maximization calling, but also takes into very serious consideration the underlying societal needs. This translates to the principle of “shared value”, which involves creating economic value in a way that also creates

value for society by addressing its needs and challenges (Porter & Kramer, 2006). Creating shared value thus becomes synonymous with identifying the copious opportunities that companies have been missing so far to reconnect company success with social progress and escape the old trade-off conviction.

Theoretically, it all sounds great, elevating, it is clearly the right thing to do and it almost makes us wonder how come businesses are not there yet? Well, the recognition is there among sophisticated business and thought leaders and promising elements of a new model are emerging. What is still missing is an overall framework for guiding these efforts, like a salvation compass much needed in order to break the generic patterns of social responsibility / philanthropy / sustainability stuck in a façade mind-set in which societal issues are kept on the outside borderline of a company’s pursuit, not at its core.

Therefore, in our attempt to dissect the problem, we realized that, in order to create shared value, companies must first change their attitude towards the whole concept of corporate social responsibility and CSR practices at large. This means going beyond charitable initiatives, beyond trying to be the “good guy”, beyond anything that in the end can be labeled just as a marketing exercise and that actually encompasses what we would like to call the “old” CSR.

We have only come around to talking about Corporate Social Responsibility over the past two decades, which in itself represented a significant evolution labeled in many different ways, such as corporate citizenship, triple bottom line or strategic philanthropy (Carroll, 1999; Zadek, 2001; Visser, Matten et al., 2007; Googins, Mirvis and Rochlin, 2007). But in spite of obvious concern and affluent literature dedicated to this subject, too little has been achieved in practice beyond the simple compliance level. As Googins and Rochlin (2006) assert, “what is clear is the widespread agreement on the need for a more active and strategic citizenship”. Unfortunately, there is no dominant model or framework to follow and doing more of the same will not bring about the needed changes.

Consequently, we believe it is the perfect timing to inaugurate a parallel with the

concept of Corporate Social Entrepreneurship (CSE) as the “new”, improved form of CSR. We dare to call CSE the “new” CSR because we believe it stands for mobilizing the whole business in a sustainable direction, as opposed to the more superficial work done in this sense nowadays in any regular company only by the CSR department. But actually this formulation might be a little bit forced, as what CSE aims to provide is only a different approach, one that will accelerate the CSR journey; it is not another form of CSR but rather a process for invigoration and advancing the development of CSR to the new, escalated standards and into the role we needed it today, that of primary engine for creating shared value.

According to Austin & Reficco (2009), the ultimate purpose of CSE is that of “enabling business to develop more advanced and powerful forms of CSR and to accelerate companies’ organizational transformation into more powerful generators of societal betterment”. Fully adhering to this opinion, we will further on use it as a strong basis for our argumentation according to which CSE might just be the answer everyone is looking for in achieving this major paradigm shift amply described in the first part of our paper. But before explaining why that is and how it can be practically achieved, we will proceed by first of all elucidating the complexity of such an interesting concept – corporate social entrepreneurship.

### **3. Corporate Social Entrepreneurship (CSE): conceptual roots and underlying premises**

In their article with the homonym title, Austin & Reficco (2009) explain that corporate social entrepreneurship (CSE) “emerges from and builds upon three other conceptual frameworks: entrepreneurship, corporate entrepreneurship and social entrepreneurship”. The first one takes us back to Schumpeter and his “creative destruction” necessary to fire a nation’s innovation and technological change (1912 / 1934). Schumpeter foresaw the shift of entrepreneurial spirit from individuals to corporations with more resources, something that did happen. At the same time, no matter their size or organizational structure, companies will always be more rigid and

resistant to change than individuals and over time corporate bureaucracy was especially seen as stifling innovation. This is how Corporate Entrepreneurship emerged within companies, from a need to maintain the presence of that innovation-baring *unternehmergeist* (fiery spirit) with the objective of “rejuvenating or redefining organizations, markets or industries in order to create or sustain competitive superiority” (Covin & Miles, 1999).

Accordingly, corporate entrepreneurship represents a renewal process, changing the organization over time by taking advantage of its existing capabilities, while also pursuing sufficiently divergent initiatives to stimulate organizational learning (Burgelman, 1991). The process begins with autonomous activities usually at middle and operating level, where change and inertia collide, retained within the organization as part of official strategy only if they prove to be efficient in the face of organizationally-relevant criteria (Burgelman, 1991; Venkatamaran, MacMillan and McGrath, 1992).

Concomitantly, the concept of Social Entrepreneurship was also born, describing the recognition of a social problem and the uses of entrepreneurial principles to organize, create and manage a social venture in either the private or non-profit sector, or across both, in order to achieve a desired social change (Munoz, 2010; Abu-Saifan, 2012).

Integrating this last social component into the concept of corporate entrepreneurship we close the loop and arrive at a deep understanding of CSE, defined by Wei-Skillern, Austin, Leonard and Reficco (2006) as “the process of extending the firm’s domain of competence and corresponding opportunity set through innovative leveraging of resources, both within and outside its direct control, aimed at the simultaneous creation of economic and social value”. The key word here seems to be simultaneous, the same one we find in Porter’s definition of shared value: “policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the social conditions in the community in which it operates”.

So then can’t we really say that we are dealing with the same thing here? Isn’t shared value creation just another phrase for

CSE and what it actually means? We believe it is and we intend to use what we know from the literature about CSE in order to map out the way of transcending shared value creation from a conceptual to a practical state. The main aspect we will be focusing on next is the effects of individuals in the CSE process, as in our view the purposeful behavior of individuals is central to understanding and successfully implementing initiatives that are beneficial for both business and society.

#### **4. The distinct breed of Corporate Social Intrapreneurs (CSIs)**

Looking at young professionals today, it can be said that we are witnessing an interesting set of characteristics defining an entire generation and playing a very important role in choosing the direction in which we, as society, are looking together towards the future. With the power shifting in the working place from generation X (the baby boomers) to generation Y (“why?”), a new breed of innovating leaders emerges right under our noses. These are people functioning according to a different mindset, people who question things and who want to put meaning into what they are doing because they need this to be relevant for those around them and for society at large.

We believe the CSE process is powered exactly by this kind of people, by true change agents with high morality and socially-oriented personal values. We can call them *Corporate Social Intrapreneurs* (CSIs), after the term “intrapreneur” first coined by Gifford and Elisabeth Pinchot in the beginning of the ’80 for defining the intra-corporate entrepreneur<sup>1</sup>. According to Austin & Reficco (2009), a CSI is “an employee of the firm who operates in a socially entrepreneurial manner, identifying opportunities for and / or championing socially responsible activity, in addition to helping the firm achieve its business targets”. Austin, Leonard et al. (2005) identified some other key attributes of CSIs beyond just being cost-conscious and mindful of the bottom line, while at the same time

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<http://www.intrapreneur.com/MainPages/History.html>

continuous advocates for the integration of the social component as a central tenet for the company. CSIs are also highly effective communicators and coordinators. They are very articulate in expressing their beliefs and convictions, they manage to initiate and consolidate relationships based on mutual respect with different stakeholders and they are able to effectively reach across internal and external boundaries, mobilizing and aligning interests and incentives.

All of these characteristics make of corporate social intrapreneurs the right persons at the right time, in the right place. They are the catalysts for change, the true leaders of a generation who might at last be able to inspire all of us to create the long dreamed synergies between business and society and expand shared value creation to the rank of general reality. The reason we are so optimistic about this scenario is being able to spot many different clues around us that this generation is unique in the sense it is characterized by an incredibly strong, positive, disruptive force unseen before. We believe this has a lot to do with a particular blend of personal values and the courage to stand up for them by taking adequate action no matter the external conditions.

In her article “Personal Values as a Catalyst for Corporate Social Entrepreneurship”, C. A. Hemingway (2005) speaks about the employee (at any level) as a moral agent and how sometimes this individual moral agency is sacrificed at work, compromised in deference to other pressures. This study shows us how personal values may act as drivers of our behavior and pays particular attention to the values of the corporate social intrapreneur. It suggests that, according to their dominant individualistic or collectivist personal values, individuals may be categorized as Active CSIs, Concealed (or Frustrated), Conformist and Disassociated (or Apathetic) CSIs. First of all, this underlines the fact that not everyone has the inner configuration for being a true corporate social intrapreneur. Second of all, we must emphasize that what we consider as true corporate intrapreneurs are mostly the individuals in the first category, that of Active CSIs. These are the highly principled moral leaders we’ve been talking about so far, who enlarge their own role to encompass a socially responsible agenda at work, who

demonstrate both awareness of ethical issues and involvement in them, the courage to speak and take initiative in this sense. This is because Active CSIs are driven first and foremost by their dominant self-transcendent values, while their self-enhancement personal values remain on a secondary place and usually come more into play outside of the working arena.

At the same time, Active CSIs are also characterized by the independence and risk-taking commonly associated with entrepreneurship, not shying away from operating regardless of an organizational context that is predisposed towards enhanced CSR. Therefore, they will not necessarily have a formal socially responsible job role, nor do they necessarily have to be in a senior management position to progress their socially responsible agenda. Acting like this, they are predisposed to creating innovative solutions, new configurations of resources, new disruptive status quos. And this is where real change actually begins.

But why should they have to do all this in spite of rigid, outdated organizational structures? Why is it that, for the first time, history makes us contemporary with this very rich socio-economical context, boosted up by the incredible openness all these amazing technologies offer us – all of which represents the most fertile soil so far for the emergence of active, determined corporate social intrapreneurs – and they are still pulled down by the weights of a system too reluctant to evolution? We have to admit that organizations as wholes also have to reassess and upgrade their current ways of functioning to better accommodate the needs of CSIs and the establishment of corporate social entrepreneurship as a core business pillar.

This is completely dependent on current leaders’ capacity to understand the complexity of the times we are living and to act accordingly, adapting visions, missions, processes, hierarchies. We felt the need to make the extra step into showing this is actually possible, that there are organizations out there who not only grasp the ideal of creating shared value through corporate social entrepreneurship, but who are also striving to create the practical structures allowing this ideal to become reality.

The following analysis is based on a qualitative study of Sandbox, the leading

global network for the most inspiring innovators below 30. Our information comes from secondary sources such as interviews, presentations and (guest) lectures delivered mainly by Christian Busch, co-founder of Sandbox, head of Sanbox Live!, special advisor for social entrepreneurship and community matters at the National Consortium of University Entrepreneurs (NACUE) and professor of entrepreneurship at the London School of Economics (LSE).

### **5. Creating new organizational models for a new generation**

We have been talking a great deal about the personal values and missions empowering those expected to bring about the change we want to see in the world, a world flourishing on principles of collaboration between business and society, and not mutual exclusion. What we haven't really touched upon are the organizational values and everything else that is built upon their foundation. In order to benefit from the powerful impact of motivated, effective change agents within organizations and bring corporate social entrepreneurship at their focal point, these have to align their set of values to that of the individuals of generation Y, the leaders to propel them into a successful future. John Chambers, the CEO of Cisco, was showing a few years ago that he is perfectly aware of this, saying: “It's not an options anymore to have a mission to change the world. In 20 years from now it will be an absolute necessity to have this, otherwise you will not attract the best people, you will not be among the most innovative ones and you will for sure not be among the ones who will survive. “

Getting organizational values right is vital to advancing into a world of reinvigorated CSR. What this means is ensuring that words are translated into action, that values are not just a shiny business card with no backing-up credentials, but rather a structural component, a cornerstone of the organizational identity. Empowering and unleashing the creative energies of true corporate social intrapreneurs involves adapting organizational strategy to a strong, authentic set of values, and not the other way around. This is no longer just an ideal, or a straight way to compromise, as it might have

been seen in the past. This is a deeply rooted need in the moral fabric of this new generation we've been describing and whose representatives we see advancing into position powers more and more nowadays.

Therefore, redesigning the organizational models we have today becomes an imperative in order to satisfy the needs of this generation and not cut the wind beneath its wings. The problem with the existing organizational models is rooted in the departing issue of our paper, the dichotomy between business and society. Consistent with this dilemma, organizational models follow two very distinct patterns: the preponderant profit-oriented organizations and their alternative, the socially-oriented organizations or traditionally social enterprises, like charities or foundations. With respect to how they can satisfy the needs of their employees, the former are very good at providing a clear professional trajectory and both personal and professional development, but the meaning is missing a lot of times, which is why a lot of brilliant graduates who go over to work for big banks or consultancies experience frustration and some degree of job dissatisfaction (Hemingway, 2005) because they usually don't do anything relevant for society. On the other hand, socially-oriented organizations fully respond to this need, putting meaning into what employees are doing, but lacking to offer a clear career path and real professional development, while the degree of personal development could also be improved.

Christian Busch, the co-founder of Sandbox, was very prompt in understanding that, although these two models either focus on profits or social impacts, both of them find their rationale in Abraham Maslow's old hierarchy of needs (1943)<sup>2</sup>. This says that everyone functions according to a linear progression of needs, from physiological / material needs to safety needs, to love / belonging needs, to (self-) esteem needs and in the end, if we still have time and energy, we can self-actualize ourselves.

What Busch implies is that this linear thinking in terms of needs is no longer valid

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<http://psychology.about.com/od/theoriesofpersonality/a/hierarchyneeds.htm>

for representatives of generation Y. It's not that we evolved into some sort of superior beings whose elevating needs come first, it's simply that our ideals managed to transform Maslow's hierarchy into a *cycle* of needs, meaning out needs should be fulfilled at the same time. Departing from this idea, we can very well see how employees, admitting to a cycle of needs to be simultaneously satisfied, will no longer be happy working in organizations guided by the “first do well, then do good” logic and will tend to break loose from such limitative environments and replace them with those where a “do well while doing good” logic characterizes the general mindset and course of actions.

But the beauty of it is yet to come. People at Sandbox recognized themselves as people with a cycle and not a hierarchy of needs and they also discovered that this cycle is relational. This means that everyone's cycle of needs depends on the cycle of needs of others, especially in respect to co-creation / collaboration. A simple realization like this one can be the creator of unlimited synergies. Once people realize that the fulfillment of their needs depends a lot on how the other person's needs are fulfilled, the incentives for them wanting to effectively collaborate and give meaning to their shared actions will be immediately propelled. And this is how we come to the idea of enlightened self-interest, something that Sandbox based its entire organizational culture upon.

But looking at Sandbox's example there is something much more interesting dawning upon us than the mere ideological epiphany. It seems that they found a way of translating these ideals into actual routines and processes and they've done it with the help of innovative technologies. They are convinced that the use of technological development and social media not only is a great way to accelerate individual and organizational impact, but it is also a very interesting way of holding people accountable. Through technology our actions become very visible, the digital footprints we leave become more and more decisive in terms of what we are able to do. Examples are countless, but think only about the very common practice among recruiters nowadays of checking out a prospective candidate's profile on different social networks in order to gain a little bit more insight on that person.

Bottom line is that it is in our deepest self-interest not to be very self-interested but to function according to a “lateral accountability” principle. Coined by David Stark (2001), this concept refers to a certain self-regulation on the horizontal level, rather than in hierarchical frames, where people self-regulate each other on a peer-to-peer base. Technology enables transparency, which allows people to observe each other so that they can correct themselves, not wait for some kind of an authoritarian, hierarchy-imposed figure to do it. Further on, flattening hierarchies for building leadership teams who hold each other accountable is the next step in creating an impact organization such as Sandbox. Last but not least, after hiring the right people, who embody the organization's key values, it is very important to reward their talent / success with opportunity, rather than only monetary means, to have the right people incentivized by the right means.

Looking at Sandbox's culture and organizational model we can thus easily identify the 5 key pillars of the impact organizations: impact mission, enlightened leadership, genuine values, lateral accountability, KPIs/incentives. The only remaining issue is how to make big corporations function along these same pillars. It's easy for start-ups, they just need to build it right from the beginning. But for the giants out there it surely will be more complicated, but the foundations consists of the same core principles. Orin Smith, former president and CEO of Starbucks, expressed it this way: “Aligning self-interest to social responsibility is the most powerful way to sustaining a company's success”. So the answer is incrementally working on building up each of these pillars. This will first lead to more innovativeness and increased employee motivation and with time, as Christian Busch puts it, “to an enlightened, self-interested model of capitalism, where we understand that ideally individuals and businesses contribute to society and society doesn't have an incentive to regulate them in any way, so that we get a virtuous cycle in the end”.

## 6. Conclusions

We departed our journey with the proud purpose of identifying all the details of an intricate puzzle. The goal was to arrive at an

image pointing us exactly towards how business and society can be at last reconciled. They have been pitted against each other for too long, partly because economists have legitimized the idea that to provide societal benefits, companies must temper their economic success. Moreover, firms have taken the broader context in which they do business as a given and resisted regulatory standards as invariably contrary to their interests. Corporate responsibility programs—a reaction to external pressure—have emerged largely to improve firms’ reputations and were treated as a necessary expense. Anything more was seen by many as an irresponsible use of shareholders’ money.

Fortunately, our academic inquiry brought us face to face with Porter & Kramer’s concept of shared value, which seemed to be the first attempt to a reconciliation. This concept recognizes that societal needs, not just conventional economic needs, define markets. It also recognizes that social harms or weaknesses frequently create internal costs for firms—such as wasted energy or raw materials, costly accidents, and the need for remedial training to compensate for inadequacies in education. And addressing societal harms and constraints does not necessarily raise costs for firms, because they can innovate through using new technologies, operating methods, and management approaches—and as a result, increase their productivity and expand their markets.

Our idea was to take this concept to the next level by analyzing the prerequisites and implications of putting it into practice. In other words, how exactly can we create shared value in today’s corporate environment, who are the leaders powering this movement, what motivates them and what conditions need to be fulfilled to support their actions? Reflecting upon these questions, we realized that companies need to rethink their current approaches to Corporate Social Responsibility (CSR), tapping into the creativity of every individual. This was the connection point to a tangential realm of literature, that of Corporate Social Entrepreneurship (CSE). Like all entrepreneurship, CSE is not about managing existing operations or CSR programs, but about creating disruptive change in the pursuit of new opportunities.

Most importantly, CSE is carried through by Corporate Social Intrapreneurs, a distinct breed of highly self-driven individuals with a unique set of values, with both entrepreneurial and managerial capabilities. They are the key vehicles for moving the company towards a more advanced state of CSR, fostering innovation and organizational transformation from within. The interesting thing here is that there is a very complex connection these individuals’ internal resources, or what actually makes them fit for such daring tasks, and the organizational environment meant to enable them to do just that.

This is how we have come to talk about Sandbox and value-based organizations in general. These see themselves as trustworthy, moral agents, capable of generating trust based on sustained ethical behavior and innovative solutions to social problems. Their goal is not just to comply with the law or to be responsive to key stakeholders; they seek to lead through example, to exceed expectations and to set new standards. They do that mainly by cultivating an entrepreneurial environment and fostering corporate social intrapreneurs. In parallel, corporate purpose and values are amplified, while vision and strategy are accompanied by changes in the company’s structures and processes.

Sandbox’s example shows us that all of this is not an unattainable goal from a practical point of view, as difficult as it might sound. Visionary leaders at Sandbox realized the key lays within corporate social intrapreneurs themselves, and more specifically in the fact that they need to operate in a purposeful environment where their entire cycle of needs are fulfilled simultaneously. Using technology to foster lateral accountability and flattening hierarchies to create enlightened leadership seem to be the main guidelines in their recipe for success.

Yet organizational transformation towards shared value creation is still in its genesis, facing many challenges. While start-ups such as Sandbox found the right way rather easily, more complex organizations have a long fight ahead of them with old, rigid organizational structures. Accelerated, fundamental change can be found particularly threatening and resisted.

However, it is continually becoming more evident that values-based leadership and synergistic generation of social and economic value are key ingredients to achieving sustainably successful business. Corporate Social Entrepreneurship is an incredibly interesting process that will greatly contribute to our collective quest for superior organizational performance and societal betterment. And because of all this, we believe it is also a sifting process for those who truly have what it takes to bring us there; or, in other words, CSE can be seen as an incubator for tomorrow’s leaders.

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## Trends in Advertising Budgets

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### Abstract

*The purpose of this article is to determine which were the global marketing budgets trends and also to establish how the Global Economic Crisis influenced the investments in advertising.*

*The investments in advertising can increase or decrease not only due to the Economic Crisis, but also due to other factors like: the development of technology, changes in consumer's media behavior and so on. We will see if the investments in the main media (print, TV, radio, internet, outdoor) were affected or not and which were the trends for the estimated expenditure starting from 2006 and up to 2012.*

*We will also debate the latest trends of the marketing budgets in 2012 as a result of the improvement of the global confidence.*

**Key words:** marketing, advertising, budget, trend, media.

**J.E.L. classification:** M37

### 1. Introduction

The Global Economic Crisis 2007–2012 also known as the Global Financial Crisis (GFC) or the second "Great Recession", is considered by many economists to be the worst financial crisis since the Great Depression of the 1930.

The Crisis had a global impact, affecting the financial systems of many countries all over the world.

One of the segments which were affected by the Global Economic Crisis was the marketing budgets. In the next chapters we will see how the global marketing budgets evolved between 2006 and 2012.

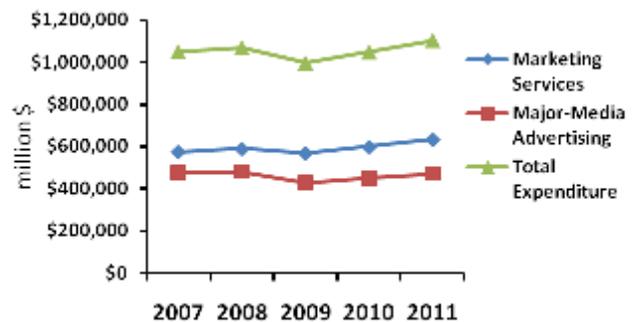
### 2. Global Marketing Expenditures

The total expenditure in marketing fields divides in 2 parts: media advertising expenditures and marketing services. In the category of marketing services we will include: directories, direct marketing, telemarketing, sales promotion, market research, public relations, event sponsorship.

The total investment increased by 2% from 2007 to 2008, but then in 2009 decreased by 7% from 2008. The global expenditure in 2010 were approximately at the same level as they were in 2008.

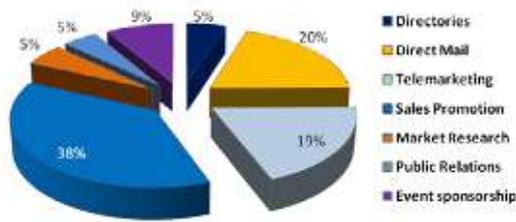
A more obvious decrease we can observe for the major media investments. The expenditure in this segment decreased by 11% in 2009 versus 2008, by 6% in 2010 versus 2008 and by 2% in 2011 versus 2008. Starting from 2009.

Figure 1. Global Marketing Expenditure  
Source: Advertising Expenditure Forecast  
December 2011. ZenithOptimedia



In the chart below it can be noticed the share between the marketing services in 2011. The most important one is sales promotion (38% of the total), followed by direct mail (20%) and telemarketing (19%).

Figure 2. Marketing Services in 2011



Source: Advertising Expenditure Forecast December 2011. ZenithOptimedia

### 3. Media Expenditure

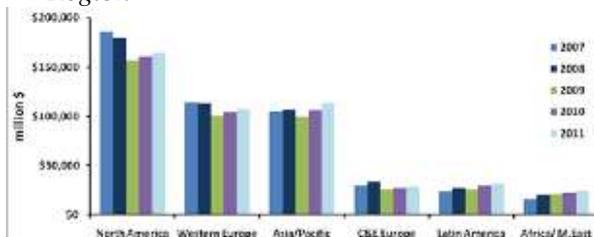
The media expenditures differ from one global region to another. The main investments in media are done in North America, followed by Western Europe, Asia & Pacific, Central & Eastern Europe, Latin America and Africa& Middle East (Figure 3).

For North America and Western Europe the trend was almost the same: decrease starting from 2007 to 2009, and then by 2009 small increases (between 2% - 4% from year to year).

We can observe even from the media budgets trends which global regions were the most affected by the Economic Crisis: just in North America and Western Europe there has been a drop in 2008 versus 2007 (in all the other regions there has been an increase).

The main media budget cuts were in 2009 in Central and Eastern Europe (25% decrease versus 2008).

Figure 3. Media Expenditure by Global Region



Source: Advertising Expenditure Forecast December 2011. ZenithOptimedia

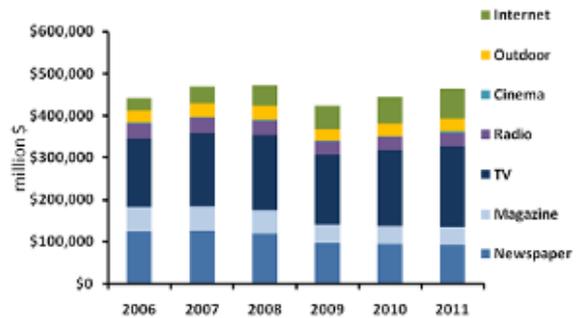
Figure 4 shows the investment in internet, outdoor, cinema, radio, TV, magazine and newspaper from 2006 to 2011.

The advertisers invest especially in TV followed by newspapers. Depending on the year, the share for TV is between 37% and 41% in all the media expenditure. (and the

share is going up according to the analysis for the last three years).

The share for the internet has doubled in the period between 2006 (7%) - 2011 (15%). At the same time the share for internet, outdoor, cinema, radio and TV improved between 2006 and 2011, the share for newspaper and magazine has dropped.

Figure 4. The Global Investment in each Medium



Source: Advertising Expenditure Forecast December 2011. ZenithOptimedia

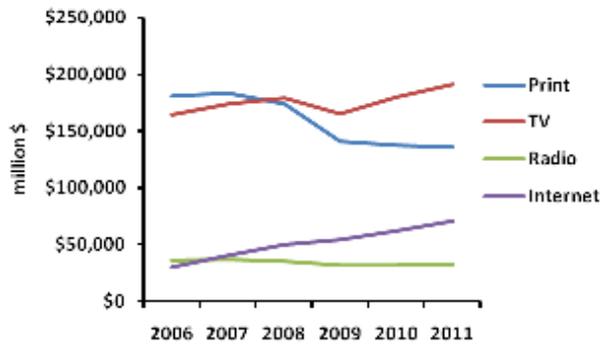
In the chart below (Figure 5) we can observe the evolution of print, TV, radio and internet expenditures between 2006- 2011.

Due to the Economic Crisis, TV expenditures had an important fall in 2009 versus 2008 (by 8%), but since 2009 they are following an ascending trend.

The most affected media due to the crisis was print (magazine & newspaper) . It has been registered a decrease of 5% in 2008 versus 2007 and 19% in 2009 versus 2008. Unlike the other media, print expenditures are following a descending trend. The crisis is not the only factor that caused the “fall” of the print; there are also other factors like: the development of technology which determined the change for the media behavior of the consumer. Nowadays consumers are more likely to read a book or the news online. This caused the increase in share for the online advertising, which had a continuous growth starting from 2006.

Radio had a descending trend starting from 2007 till 2010, but in 2011 it had a slight increase. The budgets allocated on radio had a share between 7% and 8% in the entire media expenditure during the analyzed period.

Figure 5. Global Media Advertising Expenditure



Source: Advertising Expenditure Forecast December 2011. ZenithOptimedia

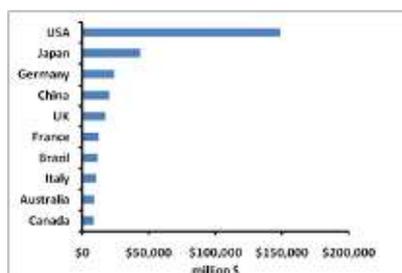
#### 4. Situations regarding the advertising expenditures for different countries

In Figure 6 we can notice which countries invested the most in advertising in 2009. As we expected, USA is the first country in this top, with an advertising budget 3.4 times bigger than the second one, Japan and 18 times bigger than the tenth country in the top, Canada.

This situation gives a clear conclusion about the importance of USA regarding the investment in advertising.

As we also expected from Figure 3, the countries that invest the most in this category are especially from North America (USA and Canada), Western Europe (Germany, France and UK) and also from Asia (Japan and China).

Figure 6. Top 10 Countries – Advertising Expenditures in 2009



Source: Advertising Expenditure Forecast December 2011. ZenithOptimedia

It is very interesting to compare the ten top countries from the point of view of advertising expenditure with the ten top

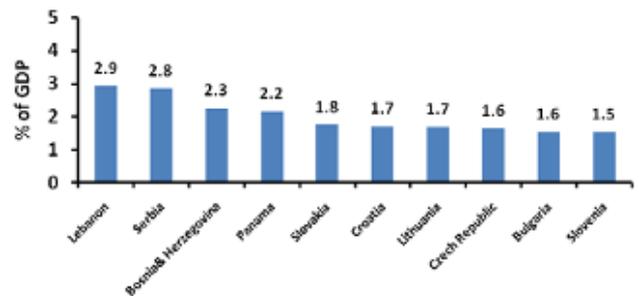
countries from the point of view of advertising expenditure as a % of GDP. (For the same analyzed year – 2009).

Not one country from Figure 6 is also in Figure 7.

The countries that have the higher advertising expenditures as a % of GDP are mainly from Central & Eastern Europe (Serbia, Bosnia & Herzegovina, Slovakia, Croatia, Czech Republic, Bulgaria, Slovenia, Lithuania).

To conclude, in absolute values countries from North America, Western Europe and Asia are very well positioned regarding the advertising expenditures. But media investments have a very important role in the economy of countries from Eastern and Central Europe.

Figure 7. Top 10 Countries – Advertising Expenditure as a % of GDP in 2009



Source: Advertising Expenditure Forecast December 2011. ZenithOptimedia

According with the chart below (Figure 8), Switzerland is the country with the highest advertising expenditure per capita in 2009.

USA which is the first country with the highest advertising expenditures is placed on the third place in advertising expenditure per capita.

Figure 8. Top 10 Countries – Advertising Expenditure per Capita in 2009



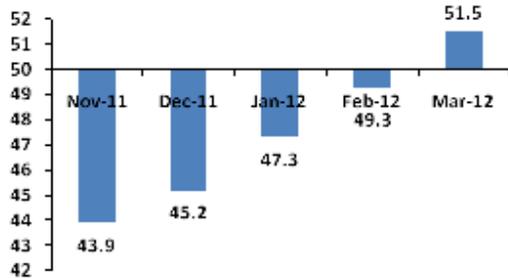
Source: Advertising Expenditure Forecast December 2011. ZenithOptimedia

## 5. Where are we heading for?

Global marketing budgets had a positive trend starting from March according to Warc’s Marketing Index. Although we are experiencing an increase with the marketing budgets, there are some discrepancies between the investments in traditional media versus the investments in digital or mobile for instance.

The global marketing budgets recorded an increase in March 2012 the first time in the last five months.

Figure 9. Global Marketing Budgets

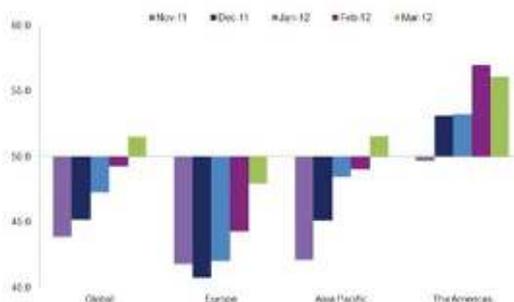


Source: Global Marketing Index, March 2012, [www.warc.com](http://www.warc.com)

A value of 50 indicates “no change” from the previous month. A index value of 58 reports a faster rate of increase than 52, while an index value of 40 reports a faster rate of decrease than 47. A value of 100 means the all the respondents indicated an increase.

The marketing budgets increase or decrease depending on the global region (Figure 10). For instance in the last months, the global marketing budgets in America and Asia Pacific had gone up, instead of Europe where they had dropped.

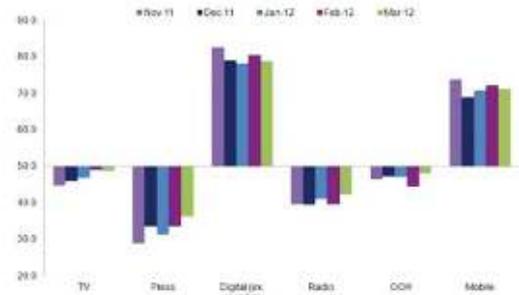
Figure 10. Global Marketing Budgets by Region



Source: Global Marketing Index, March 2012, [www.warc.com](http://www.warc.com)

While the global marketing budgets have increased, for some traditional media we notice a continuous decrease. More precisely, the budgets allocated for print and radio in the last months are dropping (Figure 11).

Figure 11. Global Marketing Budgets by Medium



Source: Global Marketing Index, March 2012, [www.warc.com](http://www.warc.com)

Digital (78.9) and mobile (71.2) continue to attract budgets while in the past they were allocated to other media. (Traditional media like press or TV). TV and out of home are just under the threshold of 50, but press and radio continue to have severe reductions in expenditure.

The allocation of marketing budgets varies from region to region. In America the trend for TV expenditure is positive (52.6), although the Global Index is under 50.

## 6. Conclusion

The Global Economic Crisis is influencing the global marketing and advertising budgets in a very clear way. Until 2007 all the investments in media followed a positive trend.

Along with the crisis, the marketing budgets began to drop.

The Global Regions were affected differently. Central and Eastern Europe was the most affected zone from this point of view (25% budgeting cut in 2009 versus 2008). With the exception of Africa and Middle East, all the other important regions had an important drop in 2009 versus 2008 due to the crisis.

Regardless the Global Crisis the most important medium continues to be TV (between 37% - 41% of the entire media budget). The only expenditures which were

not affected by the crisis were the ones for the internet. The internet continues to attract the budgets. The digital and mobile advertising are in a continuous development.

Along with the development of the technology the media behavior of the consumer has changed. So the drop of the print that continues nowadays comes as a natural reaction to this change. The trend for the investment budgets in newspapers and magazine is negative.

The country that invests the most in advertising is USA (approximately \$150.000 million in 2009), very much distanced from the second one, Japan (approximately \$43.000 million in 2009).

Although the Global Economic Crisis affected the advertising budgets, the investments in this category in 2011 are almost the same as the investment in 2007. That means the global confidence has improved. So, that means the forecast for 2012 is that the media advertising expenditures will follow this positive trend and will be above the level of those from 2011 or of those before the crisis.

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## Intelligent Systems and Accounting Knowledge in Forestry Units: A Qualitative-Heuristic Approach.

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### Abstract

*Our paper aims to establish a referential framework for optimal management of forestry accounting knowledge, in order to develop an intelligent system for forest accounting units. In our approach we pointed out advantages of using intelligent systems in accounting, and established forest accounting knowledge management areas that can be improved, within using intelligent systems in forest units, into a qualitative approach, with hermeneutic perspective.*

*Our research results are useful for researchers in the following areas: applied accounting in forestry, intelligent solutions for decision support, forest management, information technology management, knowledge management.*

*Our study is also useful in forestry accountants work, given the presentation of new technologies from their field of interest.*

**Key words:** accounting knowledge management, knowledge-based technologies, forestry decision support systems, intelligent accounting systems.

**J.E.L. classification:** M40, M14, O33, Q50

### 1. Introduction

United Nations established in 1992 that sustainable forest management is one of the main goals of humanity. In 2011, the Ministerial Conference on the Protection of Forests in Europe, *Forest Europe*, have redefined sustainable forest management, as follows: „the stewardship and use of forests and forest lands in a way, and at a rate, that maintains their biodiversity, productivity, regeneration capacity, vitality and their potential to fulfil, now and in the future, relevant ecological, economic and social functions, at local, national, and global

levels, and that does not cause damage to other ecosystems.”

The same European Conference decided that the priority for protecting Europe's forests is sustainable forest management, to ensure multiple functions of forests, and increase the sustainability of goods and services provided by them [17].

Already operating under EU Council Secretariat, the Organization for Cooperation in Science and Technology (COST) is developing the project FP0804 - Forest Management Decision Support Systems (FORSYS). Under this initiative, by the end of 2012, researchers will make a comparison between the strengths and limitations of intelligent systems; they will identify ways of implementing innovative processes to extracting knowledge held by forestry experts, or from existing knowledge information systems; they will evaluate the methods of acquisition, verification and validation of knowledge; they will, also, evaluate the representation, inference and knowledge dissemination.

The purpose of these actions is to define and provide guidance and standards on forestry decision support systems. These intelligent systems should be a foundation for processes and information regarding the application of sustainable forest management. The goal of this action is to create standards for models and systems design, quality control, integration, sharing and use of intelligent technologies, in the field of forestry decision, to facilitate the sustainable forest management [6].

Being researchers who believe that institutional changes related to transition to sustainable forestry, are development framework to frequent uncertainty and error, to long debate and very slow progress, Thomson, Rauscher, Schmoltdt and Vacik [21] aim to optimize the interdependencies between knowledge management, the forest

inventory, effects of pollution on forests monitoring, statistical modeling and methodological regulations.

In their efforts to achieve a hierarchy of knowledge systems, useful for solving real problems, researchers noted that in this transitional period, we facing difficulties in terms of introducing new software for knowledge management and modeling, new sets of indicators or criteria on inventory and monitoring of the effects of pollution, new management policies or novel interpretations of existing ones. Therefore, the authors consider as a necessity of sustainable forest management developing "knowledge ecosystem", namely the multifaceted, complex and adaptive system, that includes people, institutions, organizations, technologies and processes, through which knowledge is created, performed, distributed, absorbed and used.

Throughout our research, we propose specific examples of practical forestry measures for sustainable knowledge, that are based on tools provided by intelligent technologies. In our view, sustainable knowledge depends on the adoption of technological innovation, which is also a prerequisite for adaptability imposed by the rapid changes taking place in social, economic or the natural biosystems.

According to Myers [18], in qualitative research, hermeneutics is an approach that contributes to a profound analysis of social and organizational aspects of management and economics. The author also believes that the purpose of hermeneutics is to clarify and understand a subject. Researching a phenomenon from inside, when a experienced researcher approaches a familiar topic, is considered most objective form of hermeneutics [5].

Using this methodology, we want to establish a framework for accounting knowledge management approach in the forestry units, and to determine coordinates of realizing a forestry accounting knowledge-based intelligent decision support.

## **2. Receptivity of forest units in intelligent systems**

International concerns for sustainable forest management creates the conditions of globalization in forestry field. Along with

climate change, contemporary economic realities require, themselves, adopting an adaptive behavior in forest management.

While on the one hand, the European institutions is developing projects on standardization and harmonization of forestry decision support systems, and, in this process, intelligent technologies are integral part, on the other hand, Romanian forestry authorities face practitioners' reluctance to adopt new computerized solutions. It also noted the absence of research or initiatives for the implementation of intelligent systems to forest management.

Although the economic component is an important basis for decision-making process, using a wide range and variety of accounting information, however, are preferred traditional channels of accounting information request and transmission, through orders and documents, to cross all the links in the classical information system, so that, at the operational level, in each subunit, the accountant to be the last link that extract, process in various forms available accounting information and submit it to the information system as required.

Unfortunately, this organization of accounting information system, losing much of the potential recommendations and existing expertise in decision making. If the sale of raw materials is less efficient than processing and selling the finished product, so the accounting information provided by described above information channels are "gross", or insufficiently processed, and does not give maximum efficiency of decision making. Intelligent systems are able to remove this shortcoming.

Practical development of such an intelligent system, involving potential users in the design, prototype testing, development, and testing of the final solution, will be able to bring in the practitioners attention its valences.

Lawrence and Stewart [13] argue the importance of participatory decision making and technological progress, while the technical and social complexity of the decision forest is steeped, with the aim to provide forest goods and services on sustainable basis. In this vision, the conditions for technologies "usability", to assist decision are:

- designing a friendly interface that can be intuitively used;
- the analysis to understand users needs and abilities;
- participatory development, involving collaboration of potential users;
- application rating from the potential users[13].

### 3. Advantages of intelligent systems in forestry accounting

By using intelligent systems in accounting forestry units, these organizations can benefit from certain advantages, which we describe below.

Accounting regulations, accounting principles, internal working procedures, accurate models and certain recommendations of the expert accountant, in each important process (standing timber sales, timber harvesting, harvested timber sales, registration and settlement in forest injury, registration and settlement in forest contraventions, turnover planning, financial preventive control, etc.) can be stored, easily retrieved and updated even by the chief accountant, by an economist or an accountant, whenever needed. It is the advantage of *structured accounting knowledge accumulation, systematised according to specific processes and activities*. Thus, stored information and knowledge can be accessed anytime, whether, or not, at that time, there is a professional accountant at work, whether, if the accounting department employees are beginners, or having advanced knowledge.

In a forestry district, decisions made by leaders arise, in many cases, in consultation with internal technical specialists and from proposals coming from them. Formulation of a proposal by a technical specialist involved, sometimes a decision at this level. The decision from lower level, must be informed and must be consistent with regulations and accounting legislation. *Informed decision, at any level*, resulting from the intelligent system use.

Stored knowledge within the intelligent systems is very useful in *training new employees*, both for rapid familiarization with diverse specific activity, within a forest district, and to update the legal and procedural knowledge, that they have

acquired previously. Whether they will work in accounting department, or that they will provide the technical forestry activity, financial and accounting knowledge acquired from intelligent systems will help their efforts to achieve personal efficiency, but will contribute to unit economic efficiency, too. We must keep in mind that *continuous training of employees* is necessary, for the proper conduct of business, and an intelligent system that benefits from checking and updating the knowledge base, can do this easily, either by its use in instructor demonstration, or in each employee *self-directed learning*.

Intelligent system reasoning *can help procedural normalization*. Currently there is high heterogeneity in forest procedural normalization, each subunit following their internal procedures. A feedback recommendations component from intelligent system can provide "best practices", and can assist in normalization. Can be reached generalized procedures, as they are recommended by intelligent technologies.

Thus, intelligent systems can be very useful in "reduction of distance", promoting *intra-organizational collaboration* and *inter-organizational cooperation* (between practitioners, researchers and teachers). They have an important role in the optimal knowledge management and, also, in design of documented procedural rules.

Another possible advantage can be achieved using intelligent systems: *the auditors' work efficiency*. Structured knowledge stored within the intelligent systems gives auditors the ability to track the risks, in a fast and informed manner. *Standardization in auditors evaluation* can be achieved.

With working procedures storage functionality, and reasoning from legal field storage, intelligent systems *documents can provide legal evidence*, in case of commercial litigation, or the financial part of penal litigation.

The correct drawing of future work guidelines determine, in good measure, its success.

*Assisting managers in the financial and economic forecasting* is done by intelligent systems. This shall provide management specific judgments scenarios for achieving certain financial indicators, or even

forecasting recommendations drawn from past experience.

Romanian regulations on the annual accounts state that *the principles, policies and methods* should be part of the component called "Notes to the annual financial statements." Intelligent systems can be used in *designing and maintenance of accounting policies*, so that the National Forest District - Romsilva can provide to authorities a well documented set of accounting policies, with wide practical application in its subunits.

#### 4. Impact on improving accounting knowledge management in forestry units

More recent studies and official documents [3], [7], [8], [14] have emphasized that the implementation of the noble vision of sustainable forest management requires new knowledge, and dissemination of knowledge gained from the previous activity. It is considered that, so far, knowledge in this area is limited, and exchanges of experience between regions and sectors are limited. New knowledge extraction, from the various case studies, has proven to be useful in their cross-disciplinary approach.

According to Grundstein [11] *knowledge management* is the management of activities and processes that improve the use and creation of knowledge, within an organization, to achieve two objectives strongly interconnected, with all their sides (economic, strategic, organizational, socio-cultural and technological):

- increasing wealth;
- sustainable innovation.

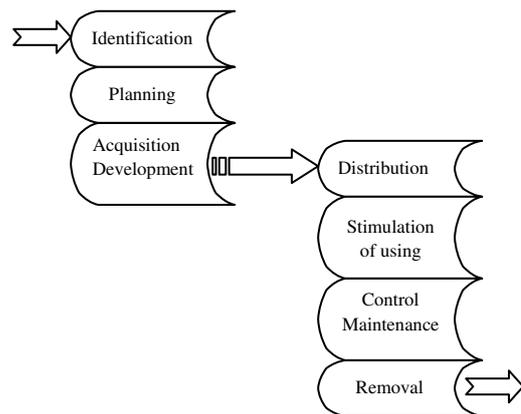
While Malhotra [16] made the following definition of the concept: *a collection of activities that are organized and arranged in accordance with the objectives of the organization*, in Darroch opinion [9], knowledge management is a function of management, through which the organization creates, identify and organize knowledge, taking into account long-term benefits.

Jennex's concept definition is more comprehensive [12]. It advances the idea that knowledge management *is the practice of selective application of knowledge, acquired in previous experiences, in current and future decision-making activities*, for the express purpose of improving the effectiveness of the

organization.

Among the tools used in modern knowledge management, could not miss knowledge technology, using intelligent systems to create, capture, convert, store, organize and disseminate knowledge [10]. Intelligent technologies support improving of the seven basic activities of accounting knowledge management (Figure 1).

Figure 1. Knowledge management activities



(source: Andone, I., et al., [2])

Developing such a system has strong impact on improving accounting knowledge management in forestry.

The work for *identifying appropriate and timely knowledge*, necessary for the proper functioning of economic activity, can be improved by using an intelligent system.

The administrator of intelligent system is considering setting up a viable knowledge base. He must design the intelligent system so as, continuous updating, to take into account the opinions and recommendations from experts and users. They can complete a small questionnaire, built on the intelligent system, helping technology itself to "learn" how to identify and filter knowledge.

This tool can assist managers in *planning of knowledge development and knowledge improvement*, using suggestions from the feedback process. Intelligent systems can be developed and dedicated to assist planning in knowledge management, offering management recommendations for various solutions, that can be taken in individual cases, to develop and improve both individual knowledge and collective knowledge. The use of an intelligent system

contributes to *knowledge acquisition and knowledge development*, because in this manner, each user enriches their knowledge.

Organizational knowledge develops, with increasing number of users, that have contact with the recommendations and explanations offered by the system, when users themselves actively participating, in developing the knowledge base. In this way *knowledge distribution* takes place, by knowledge translation from one person to another, from leaders to subordinates, or conversely, from trainers and researchers to practitioners, or conversely.

An intelligent system can provide the knowledge needed to make work easier or to improve economic efficiency, in an easily accessible form, using a friendly interface. In these conditions *the system users will be encouraged to enrich their knowledge* and even to improve system performance.

Accounting knowledge becomes visible through its inclusion in a structured intelligent system widely distributed, possibly with Internet or Intranet technology. In this case criticism from large numbers of users interferes. This improves *control and maintenance of accounting knowledge*, but also eliminate the knowledge that are outdated in domain progress, or no longer useful.

## 5. Conclusions

Management of forest areas involves a wide range of activities, subject to sustainability, due to the mission of forestry. A feature of the field is that many of these activities enjoy the benefit of natural environment. On the other hand, long distances and large surfaces determines the specificity of this sector.

Therefore, management of this sector must consider multiple ways of concentration of information and knowledge in key areas, permanently interconnected, so that the forestry decision to exploit the advantage of documented assisting, at any level, at any time.

In our work we have shown, in a heuristic-hermeneutic approach, the impact of intelligent systems use, on accounting knowledge management, in forestry units.

We emphasized the usefulness of intelligent systems for forest accounting, by

listing the advantages that this technology offers to forest units.

Our study showed the usefulness of incorporation of an feedback component into intelligent system framework, through which the user can evaluate the qualities, weaknesses and usefulness of intelligent solutions, and he can provide recommendations for system improvement.

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## An Organizational Strategy Conceiving Phase

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### Abstract

*During the strategy conceiving phase, the firm identifies an environment trend favourable to applying a certain strategy and altogether is a strategic potential within the functionality parameters of a certain strategy. The environment trend is given by the conditions of the socio-economic environment in which the organisation activates. The strategic potential analysis must give, on one hand, the description of the least requests to apply each strategy, and, on the other hand, it must describe the situation which the company is in..*

**Key Words:** conceiving phase, environment trend, strategic potential.

**J.E.L. Classification:** M10, M 21, P 13

### 1. Introduction

In general, a strategy's efficiency is evaluated upon the results it produces. But that moment is too late to have corrections, because the result is produced. Knowing the life cycle of a strategy would allow prior to producing some results the signalling of some aspects which show if an organisation is on the right track or not. Practically, the strategy's life cycle brings a series of check-points which offers an image of the strategy's stage and of the steps need to be taken in order for the strategy to maintain its efficiency for the organisation.

We consider that the strategy's life cycle should be made by the following stages: conceiving the strategy, launching the strategy, strategic sustainability, redesigning/abandoning the strategy.

The most difficult phase is that of conceiving the strategy because within the latter are defined the analysis guidelines for the subsequent demarches.

During the strategy conceiving phase, the firm identifies an environment trend favourable to applying a certain strategy and altogether is a strategic potential within the functionality parameters of a certain strategy.

### 2. The environment trends analysis

The environment trend is given by the conditions of the socio-economic environment in which the organisation activates. The phrase “environment trend” means the evolution of the environment factors, analyzed as a whole, in a certain manner, a certain period of time. The environment trend is the activity constant from the analysis of the strategy's life cycle meaning it has to remain favourable even until the phase of strategic sustainability. But considering it is a starting condition for the success of each strategic step, we will analyze it within the second stage, the launching one.

If it is foreshadows that the socio-economic environment is favourable, expansion and development strategies will be developed. If the socio-economic environment will show constant or decreasing levels, strategies of activity consolidation or restriction will be conceived.

We consider that, from the perspective of adaptability to environment trend, this typology of strategies can be as follows:

Within the expansion and development strategy category we may include the ones that lead to market development, product range development, activity efficiency or have a multiplying effect favourable to the set objectives:

*Table 1. Typology of expansion and development strategy*

Strategies of expansion or development	Motivation
Volume strategy	Must consider the

(cost domination)	growth of total physical output and the expansion of the market
Frontal attack strategy [1]	New competitive advantages and investment in their support – efficiency growth, must be identified
Strategies of extensive specialization by diversity	It considers a geographical expansion of the markets or the development of new couples of product-market.
Strategy of specialization by re-concentration (re-focusing)	Rethinking the strategic power and influencing centres at company level in order to reconfigure the success key factors and finding new solutions of market offering must be considered.
Strategies of vertical integration	It considers or the development of new supply or distribution chains, or their acquisition.
Amelioration strategy	It considers a perception of the offer at the whole market level, leading to its segmentation process according to the positive or negative value of this perception. Within this strategy, the focus is on the progressive decrease of the prices at the same time as achieving a certain difference in growth [3].
Strategy of concentric diversification	It considers entering a sector of activity relatively different to the existing one, from the activity portfolio's or products' or markets' perspective [3].
Strategy of diversification by conglomeration	It considers approaching certain different business sectors that have very few or none elements in common with the main sector [4].

Entrepreneurship strategies	Their purpose is business development by innovation, specialization or opportunity valuation.
Internal market expansion	It consists in using the forms of external transfer of the offered products or services made in their origin country.
Multiple markets strategy	Diversifying the markets geographically, by maintaining a relatively standard offer, or diversifying the offer with the purpose of adapting it to each local market particularities make this strategy.
Network strategy	The purpose of network strategy is identifying the development strategic axis. As it follows, the organisation applies integration, diversification or association strategies with the purpose of creating the affiliates network [3].
Offensive competitiveness strategies	It is meant to create competitive advantages of any nature in relation to the main competitors, by development actions.
Relational strategies in any form [5]: - complementary strategic alliances (horizontally or vertically); - strategies of reducing the uncertainties - strategies of reducing the competition - strategies of competitive reactions (strategic answers of	These are expansion strategies of win-win type in order to develop: - resources partnerships - production capacities partnerships - key competences partnerships - research&development partnerships

competitive kind).	
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a) The category of consolidation strategies considers those steps that aim the conservation and the strengthening of existing market position, the organisation’s profitability and the maintenance of planned strategic objectives. The following strategies are included in this category:

Table 2. Typology of consolidation strategies

Consolidation strategies	Motivation
The strategies of market leader companies in order to defend the occupied position	The company tries to maintain the existing market shares and the achieved technological advance.
The strategies of the adapting companies	It achieves the limitation of powerful competitors’ attacks at the same time as the adaptation of the offer, by a passive approach of the price and distribution policy.
The horizontal integration strategy	It considers the merger or acquisition of some companies that have products or services similar to the organisation’s ones or companies that have a similar technology or know-how.
The selective or global standardization	Selective standardization considers the adaptation of the offer to each market, at the segmentation level considered optimum by the company. Global standardization considers the offering in a global scale of the same products or services, their level of adaptation being null or very low.
The passive specialization strategy	It considers maintaining the existing level of

	specialization or its slight deepening, if possible.
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b) The category of restricting the activity strategies will include those options that limit or modify the area of deployment of company’s activity, of markets, that reduces the production rhythms or the strategic objectives. There are the following strategies of restricting the activity:

Table 3. Typology of restricting the activity strategies

Strategies of restricting the activity	Motivation
The strategy of starting in another market or industry	It means the change of sector of activity or the market.
The strategy of regrouping by segmentation	It considers letting go those unprofitable or hard to protect segments of market and concentrating the forces on the markets the company can excel on.
Abandon strategy	It considers letting go the business from imposed or own reasons.
The strategy of restrictive specialization, niche kind	It considers implementing a volume strategy in a certain market sector.
The strategy of restrictive specialization, fortifying kind	It considers activity restricting upon competencies and not by market sectors.
The cleaning strategy	The elements of low added value in relation to the offered price are gradually expelled from the offer, thus identifying responding reactions from the market and the consumers segment.
The limitation strategy	It considers selecting the sector that can support a differentiation and suppressing the disposable elements in

	order to lower the price according to the reference offer.
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In order to measure the conditions of the socio-economic environment we can use the concept of regional competitiveness because it contains a series of relevant indicators in order to generate a correct image of the socio-economic potential of a region and of the influence on the activity of that region's companies. This concept acknowledgement will be made according to the model submitted within the manual of evaluating the regional competitiveness, made for Romania in 2007 by GAE (The Group of Applied Economics) [6]. The analysis matrix of regional competitiveness submitted by this group contains two parts: one of "hard" indicators, based on statistic data available regularly at regional level and a matrix of „soft” indicators, based on information obtained through survey management, at sub-regional and local level. The „hard” matrix starts from the structural indicators of Lisbon Agenda, 125 numbered from which 13 have been selected, weighted in 3 indexes: economic, social and technological, as shown in the table below:

Table 4. “Hard” indicators of regional competitiveness analysis matrix

Economic Index (I <sub>E</sub> )	GDP/inhabitant
	GDP growth rate
	Work productivity
	Net exports
	Gross fixed capital formation in relation to GDP
	Net income per inhabitant capita
Social Index (I <sub>S</sub> )	The dispersion of regional employment rates
	Employment (total)
	Employment – women
	Medium life expectancy index
Technology Index (I <sub>T</sub> )	Research & development expenses as % of GDP
	The employment in high technology sectors
	Tertiary education with advanced specialization in research

The calculating formula of the regional competitiveness index – IC is a weighted average of three indexes, economic, social and technologic. At their turn, each of these indexes are calculated as a weighted average of the variables selected among each group of concern (economic, social and technological) [6]. The values described by the regional competitiveness index have as an average value of reference the 1 value (the national average).

The „soft” matrix described by the GAE group starts from a series of communitarian indicators of regional development, having the purpose of introducing the indicators at local level, relevant for regional competitiveness diagnosis. These 15 indicators have been grouped in five categories referring to:

- development/ poverty fighting by projects
- social cohesion
- communication
- economic competitiveness
- social development

According to GAE, the index of communitarian competitiveness INDCOM is determined as a factorial score of the five indicators by using a factorial analysis with forced withdrawal of a single factor, and the index of regional competitiveness INDREG is calculated as an average of the INDCOM values, weighted by the localities' population [6]. The values described by INDCOM or INDREG have as an average value of reference the 50 value (communitarian average).

The environment trend, both regional, as well as communitarian one will be assessed according to the average measures specific to those two levels of analysis according to the table below:

Table 5. The environment trend matrix

		Level of regional competitiveness (I <sub>c</sub> )		
		Above average	Average	Below average
communitarian competitiveness index	Above average	(+++)	(++)	(-)

	<i>Average</i>	(+)	(-)	(- -)
	<i>Below average</i>	(-)	(- -)	(- - -)

Legend:

- (+ + +) = Extremely favourable trend
- (+ +) = Very favourable trend
- (+) = Favourable trend
- (-) = Less favourable trend
- (- -) = Unfavourable trend
- (- - -) = Very unfavourable trend

The situations below the thick line are correspondent, in the above mentioned strategy's life cycle chart, to the strategies with an environment trend preponderant unfavourable and the ones above the thick line, to the strategies with an environment trend preponderant favourable.

### 3. The analysis of the strategic potential

In order to conceive a certain strategy, as we have already said, the strategic potential of an organisation must submit to the functionality parameters of the given strategy. In other words, an upstream integration strategy can't be conceived if the financial capacity of the organisation doesn't allow the acquisition or the development of certain production structures or if the current contracts with the current suppliers contain exclusivity clauses or they do not offer the possibility to cancel them.

Because of that, we must assess the strategic potential of the organisation before we select, from the area of possible strategies in line with the environment trend, the possible functional ones.

This analysis must give, on one hand, the description of the least requests to apply each strategy, and, on the other hand, it must describe the situation which the company is in.

For example, if it is seen that the environment trend is unfavourable, one of the strategies the company should consider is *the*

*restrictive specialization, fortifying kind*, which occurs when the sector is at maturity level or in decline and the competitive positions tend to weaken, in this case the contraction is subject to competences and not to market segments. In this case, the least requests to apply this strategy are the following:

- the sector is at maturity level or in decline
- competitive position in deficit
- well defined and protectable competences

From the strategic potential view, in order to conceive a certain strategy, the organisation should have the conditions of fulfilling the least requests in a reasonable degree. Thus, such a strategic option is purely theoretical, inapplicable and if used, the consequences are incontrollable.

### 4. Conclusions

The analysis within a strategy conceiving phase helps us position and segment the strategies from perspective of the environment factors that influence them and of the potential that the organization disposes of.

The environment tendencies must be studied through the competitive influences at the regional and community level. These influences are adjusted by the strategic potential of organizations and they can be transposed into sustainable competitive advantages.

This leads to the conclusion that from the strategy conceiving phase, the key success factors of a company success are identified.

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# The Relationship between Ergonomics and Labor Productivity

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## Abstract

*Although ergonomics has proven essential to increasing the productivity in every industry, worldwide, in contemporary organizations where managers do not perceive the ergonomic aspects or organizational design as some of their duties, there can still be effects of not paying it the right respect.*

*Acknowledging the importance of the relationship between ergonomics and human resource management in organizational behavior, this paper aims to briefly analyze the determinants of activity, so that interested parties have a clear view of their importance, to identify elements of the labor process that work well, so that they can be maintained in the future, and those elements which do not function well and which can be improved to the purpose of an improved labour process.*

**Keywords:** ergonomics, determinants of activity, tasks and work requirements, environmental conditions and equipment, social environment

**J.E.L Classification:** J24, M12, M54, O15

## 1. Introduction

Ergonomics is a relatively new science that has evolved and developed with changes occurred in the labour process and with scientific progress, from the initial

conception, adaptation of labor to humans [5] to the contemporary, the optimization of the human-machine-environment relationship [1].

Ergonomics is a component of human resource management, which in turn, is part of the organizational management.

More and more specialists consider that the human resource management orientation to ergonomics is essential for the future of any organization, as managers' efforts to arrange the working environment are reflected in the motivation of workers, their working efficiency, and thus it can increase the productivity in the organization. Therefore, by attracting, developing and maintaining the human resources the organization needs, managers should be increasingly concerned with balancing economic performance, social performance, long-term business success being ensured only if the interests of employees are included in the organization strategy.

The multitude of definitions of ergonomics in the specialised literature have a common point represented by the fact that the main focus of this science is the man. As shown in these definitions, ergonomics studies the human interaction with the means and the working environment (physical and social), in order to increase efficiency and optimize the conditions of health, safety, satisfaction and comfort, which together provide increased organizational performance and reproduction of labor.

The purpose of ergonomics is, therefore, to improve the work process, to change it in order to make it compatible with the functioning of the human.

To implement this purpose, ergonomics uses an analysis of the professional activity of the individual as a whole, by integrating its dimensions: physical, mental and social, which are to be found in different degrees in the worker (the individual is physically positioned in space, they think, communicate, and interact with others, while performing their activity).

## 2. Determinants of activity

The **determinants** of activity are those aspects of a work situation that generate the way the person will perform the work [6].

Identification of determinants of work is an essential stage in the ergonomic approach because it will allow the process elements that work well to be sustained and those that do not work properly to be worked upon, to improve the work process.

Determinants that make up the framework are grouped by some specialists [6] in three categories as follows:

- tasks and work requirements;
- environmental conditions and equipment;
- social environment.

**A.Task analysis** is a major part of ergonomics as an applied discipline, which is supported by the fact that it is also called "the science of work".

The tasks, together with procedures and guidelines established by the organization, underlie all productive activities.

The specialized literature expresses the opinion of foreign authors (Llaneza Javier Álvarez), and Romanian experts agree with this opinion [2], [1], that, in terms ergonomics, **work** has two components:

- **the task**, consisting of the formal and theoretical description of work, which includes requirements, both physical (working position, the handling of loads, etc.) and psychic conditions (cognitive demands, psychological and psychosocial);
- **the activity itself**, which facilitates knowledge of facts and phenomena

through opinions and representations of workers, and which is never pure execution.

Performing the activity will lead to expected results in terms of quantity and quality, as long as the person who has been distributed the work task very well understands what is expected from them. In other words, the clarity and precision of tasks and requirements set by the organization, the conditions and expected results have a direct impact on the quantity and quality of the work the employee must perform, leaving them with a large or small interpretation space, which also depends on the individual characteristics of each worker.

In relation with work task analysis, some experts define the following concepts [3]:

- **external task or pressure of work**, representing the external conditions and requirements present in the working system, and which affect the human body;
- **internal task or tension of work**, consisting of the worker's internal response to exposure to the pressures of work, response influenced by their individual characteristics (size, age, work capacity, skills, etc.).

About the cases where the worker's ability to perform the tasks is exceeded by the requirements for its implementation, a work overload situation, as it is called in the specialized literature [3] distinguishes between:

- **quantitative work overload**, associated with the conditions under which the worker can not increase the pace of work or has too many tasks to deal with, in a relatively short time;
- **qualitative work overload**, relating to the performance of very demanding work, which the worker believes that they can not perform properly.

In addition to the main purpose consisting in understanding the tasks, specialists in the field believe that task analysis has some additional purposes, including: product design, design of security systems or work spaces.

In conclusion, through the work task analysis, ergonomics facilitates the knowledge of work tasks, how they can be achieved, the necessary conditions, and by

trying to bring them closer to the capacity, structure, features and functions of the human body, the science provides prerequisites for effective realization of the human potential.

**B. Conditions and facilities offered by the job** refer to the many determinants of the activity which have a different value, including: organization of work, organization of production, organization of training, physical environment, technical equipment etc.

**Work organization** includes several major activity determinants (the ability to work, the distribution of tasks to different positions, the relations between positions, the composition of work teams, the work program, the method of payment of employees, the job evaluation procedure, the system used to replace the absent workers, etc.), which may also influence the collective dimension of work (support, cooperation, coordination, etc.) or moderate the effect of the determinants involving the technical equipment.

One of the main elements of work organization and ergonomic design is **the ability to work**. This concept refers to the functional potential of the human body, which helps maintain an optimal level of intensity and efficiency of its performance, over a period of time as long as possible, even throughout the work program, in other words, it refers to all possibilities a person has to perform an activity, to a maximum [3].

The working capacity is determined by several factors, which can be grouped into three categories as follows:

- **biophysiological factors** that are intrinsic to the body, determining the internal labor capacity (age, sex, the build and functioning of the body, the content and organization of nutrition, health, etc.)
- **psychological factors** that influence the ability to work through individual personality (skills, temperament, motivation, etc.)
- **social, economic and technological factors** acting from the outside and reflecting the conditions in which the possibilities of the body are exploited (education level and training, ergonomic work organization, working and resting

conditions, physical work environment, etc.).

Among the biological factors, **the content and organization of food** has a special place, as it ensures the vital energy needed for the vital processes and for the professional activities.

**Food organization** is the number of meals and snacks throughout the day, their distribution and the hygiene prerequisites.

**Personal hygiene** includes, among other factors, the necessary factors for changing the body's position during the meal, to ensure proper rest and blood circulation.

**Health** is defined by the absence of disease, along with the welfare of the body as a whole (physically, mentally and socially).

Dynamic work capacity requires **organizing the work and the weekly rest** on a scientific basis so as to avoid accumulation of fatigue caused by incomplete restoration of daily functioning of the body's potential.

**Organization of production of goods or services** influences the organization as a whole, because the choice of manufacturing philosophy (timeliness, total quality, etc.) or organization characteristics (size, sector working experience, mission, type of goods, products or services, such as the production process - craft or in-line, labor costs, market position against the competition, etc.) made under an insufficient knowledge of the actual work can have negative consequences on both the production process, and the health and safety of employees.

Support determinants of the production process are also to be found in this category, including: maintenance, quality service, logistical and technical support, circulation of information.

**Organizing the training and learning conditions** also refers to a number of determinants of great importance. Although these determinants are included in the previous category, that of the determinants of support of production activities, some experts [7] prefer to deal with them separately to highlight their potential and the significance of any negative effects they may have on the organization, as, in practice, the importance of these determinants is often underestimated.

Business people spend most of their time outside their homes, at work. As the workplace becomes a second home, the way it is arranged is very important, as it can induce a state of comfort to the employee, if appropriate, or, on the contrary, causing fatigue and, consequently, a reduced ability to work, if improperly designed and fitted. Given these issues, the problem of **optimizing the working conditions**, so that they have a positive effect on employees, appears as extremely important.

**The physical environment** includes the spaces in which the work is carried out on the one hand, and the physical environment of the workspace, on the other.

**The space** available to an organization includes the space that is destined for performing the jobs, with their associated characteristics, and areas designated for specific uses, more or less definite, (such as, for example, storage areas for materials, raw materials, products in production or finished products, equipment) or alleys for foot passengers or vehicles. The existence of these areas within the organization generally facilitates the work in workstations (proximity to storage facilities the process by reducing unnecessary trips of employees), but they can also generate some drawbacks (traffic lanes too close to the workstations may present a risk to health and safety, there may be visual barriers, which may influence the way the employees work and the way they are monitored).

**The physical work environment** refers to the audio, visual and thermal, the air quality and the presence of physical stressors, chemical or biological, in the workplace. Their effects on health and human condition are known at present, as they have been the subject of numerous studies, but the impact of workers' exposure to combinations of these stressors is not very clearly established.

Some authors have grouped environmental factors, depending on their nature and their influence on the human body, in [4]:

- **physical environment factors**, including: lighting, noise, vibration, clean air, microclimate (temperature, humidity, air velocity, radiation calories) etc.;

- **mental environment factors** such as: color, functional music, variation - monotony, consideration - disconsideration, collaboration - non-collaboration, interest - disinterest, etc.

The ambient **noise** is a physical factor that is often responsible for the onset of fatigue and decreased activity results because its presence not only affects the auditory organ, but also many nerve centers or even the entire body causing biological and physiological changes that are reflected finally, in the work efficiency.

The seriousness of the action of these factors on the body is different. Thus, depending on the time necessary to restore the hearing after the annulment of the case, one can speak of a **phenomenon of adaptation** (when the interval is relatively short, at least 15 seconds and a maximum of 3 minutes) or **auditory fatigue** (the auditory analyzer fully recovers in more than 3 minutes).

But the presence of noise does not only affect the hearing exclusively, but the whole human body, its harmful effects (of a physiological, nervous and mental nature) can be extended to the general ability of the worker and the results of the work performed. Therefore, to prevent and control the effects of the noise, there must be taken several steps in this direction, as early as the stage of labor resources design.

Removing the harmful effects of noise and improving the body is an effective way of maintaining the health of employees and increasing their work efficiency.

The main purpose of **lighting** is to ensure adequate visibility at work, without overworking the eyesight. This factor has a physical environment importance since it may cause visual comfort at work, the degree of eyestrain of the employees, and thus, the efficiency of their activity.

The most suitable light sources at work are **natural light**, because it does not tire the eyes (which are best adapted to it), and it has a greater diffusion of light, it is hygienic and, last, but not least, more economical. However, natural lighting presents some disadvantages, namely: it is neither permanent nor constant, presenting

large variations throughout the day, and the luminous flux distribution possibilities are limited. The use of natural light can be determined by the size and position of the windows or by using external or internal blinds.

If it is not possible to ensure adequate natural light at a proper intensity, as well as in the case of workplaces without daylight, they have to use **artificial lighting**. Artificial light should be as close as possible to natural light, in terms of intensity, color and caloric radiation.

Lighting must be uniform so as not to produce a contrast between the workplace and the environment. Illumination uniformity is achieved by the number of luminaires and their location.

According to the specialized literature, the importance of visually protecting the human body is supported by the fact that approximately 90% of all information is gathered by humans through eyesight, which explains the special requirements.

Following the studies performed on this issue, it has been agreed that lighting influences at the same time: the health of the visual organ, the comfort at work and the health of the employees, the effectiveness of the work performed. On the other hand, reasonable lighting of the premises and working places may have an effect on preventing accidents at work, improving the working conditions and the quality of results, maintaining the work capacity and increasing the labor productivity.

As it has been demonstrated by research conducted to date, the work performed in poor lighting conditions has harmful effects, both on the visual organ and the whole body. Intense and prolonged straining of the organ of vision, especially in poor lighting conditions, can result in the following successive phenomena:

- **eye fatigue**, which is installed after unilateral and intense overworking of the eye, and it can be manifested by pain or eye burns, shedding, headache, diplopia (double vision), decreased ability to adapt to light, reduced speed of perception, reducing contrast sensitivity, decreased visual acuity;

- **nervous exhaustion**, which is generated by an activity that requires intense straining of visual perception, but not of the retina or the optic apparatus. The main symptoms of nervous exhaustion are: a decrease in the accuracy and speed of movement, a reduced capacity of visual perception, reduced reactions, the occurrence of the state of malaise, headache, dizziness, insomnia, etc.

Because lighting adversely affects the quantity and quality of the work performed, and the frequency of errors and accidents, job organization must use ergonomic principles, taking into account the specific work, the possibilities of the worker and the economic requirements.

Organizations must also bear in mind the fact that an excessive level of illumination is not necessarily effective, and assessing the efficiency of a lighting level is based on several factors including: the size of the object or its details, the contrast between the object and the background, the immediate environment of the reflectivity, the time required to perform the visual task etc.

**Cromatic ambiance** is a psychological environment factor influencing the degree of fatigue of the human body and the results of quantitative and qualitative work.

Studying the color functionality (their effects manifested directly and indirectly on the human and the results of their work), and their psychological and physiological influences, it was found experimentally that the various shades of colors produce different psychological reactions in humans, for which reason, they were divided into three main groups as follows:

- warm colors and cold colors;
- stimulating (or irritating) colors and soothing colors;
- light color and heavy colors.

**Warm colors** are orange, red and yellow, or those achieved by a combination of them. They give the feeling of closeness and they are used in very spacious rooms to create the impression of comfort. **Cold colors** such as blue, green and violet, have the ability to calm or comfort.

The ergonomic design of jobs, seeking to preserve the health of employees and their

normal working capacity, involves ensuring favorable **microclimate conditions**.

The microclimate conditions in which the work is performed comprise all the physical factors (temperature, humidity, air movement and radiant temperature) which exert their influence on the body, as stimulators of the body's thermoregulatory function.

The normal **temperature** is between the following limits: 18-24°C in summer and 17-22°C in winter, with maximum variations of 2-3°C on the horizontal and 1.5 to 20°C on the vertical, presenting up to 2-3°C differences for central heating and 4-6°C for local heating within 24 hours.

**Humidity** is given by the amount of water vapors in the atmosphere. In a pleasant microclimate, humidity values must be between 40 and 50%.

**Air currents** occur due to different volumes of air traffic in the area, caused by uneven heating and thus different density; it is measured in m / sec.

**Calorific radiations** are electromagnetic waves of propagation of small particles (quanta), which is, actually, heat in motion.

The microclimate conditions are assessed in relation to the quantity and quality of the **inspired air**. The most common causes of damaging the quality of the inhaled air: the presence of odors, fumes, dust, gas, lack of oxygen and the great carbon dioxide concentration.

Design and organization of ergonomic workplaces must also ensure **hygiene measures** designed to protect the employees.

Construction of a workstation should also consider the technical equipment necessary (raw materials, tools, safety equipment, machinery and other technical devices), which have a direct impact on the activity.

**C. The social environment** will be appreciated by the following two aspects:

- **The social structures and the organizational culture**, which refer to the process of consultation and decision making within the organization.
- **The various actors that workers interact with in their professional activity**, which are the people working in the same organization, or within another

service, co-workers, supervisors, unions, customers and people using the services offered by the institution.

### 3. Conclusions

The job requirements, the conditions and facilities provided by the workplace and the social environment are part of the work process that can be the direct cause of the workers' condition, and facilitators of performing their activities.

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# The Entrepreneur, Mobility and Flexibility Support of Small-Sized Companies

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## Abstract

*In a market economy, the entrepreneur is seen as one of the most important vectors. He is actually the person who initiates or takes over a business, but at the same time takes upon himself some risks that most ordinary people would not do it, and sometimes by applying fundamental knowledge in a completely original manner to ensure business success, we can say that it keeps the economical organism dynamic and alive. In practice, careful analysis and lucid assessment of their own skills, abilities and availability of financial resources compared to the requirements to start a business envisaged enable potential entrepreneurs to assess their chances of success in starting and developing business that does not exceed a medium size. This paper takes into account based on the literature, several aspects of the above-mentioned circumscribed theme.*

**Keywords:** *business opportunities, customers, SMEs, business decisions, profitability*

## 1. Conceptual elements of the entrepreneur

According to the literature, entrepreneurs are people with practical spirit, always looking for new opportunities for business combinations, being methodical and meticulous anticipation all actions (Sasu, 1998). They are described as promoters of changes that they consider common.

Typically, entrepreneurs do not make the changes themselves, but they analyse them and use this as an opportunity (Chivu et al., 2001). Some results of our entrepreneurial research indicates two categories of entrepreneurs (Rasca, 1998): specialists entrepreneurs (marginal) and dynamic entrepreneurs.

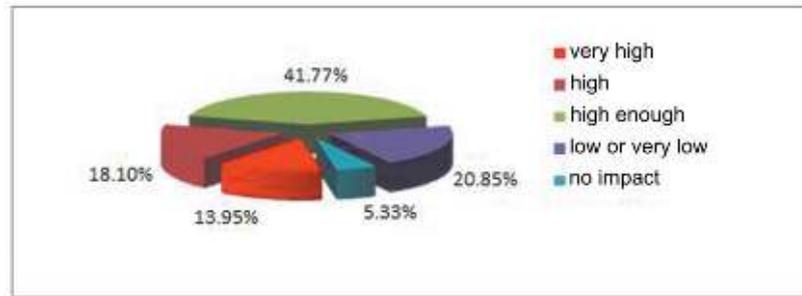
The first category generally has technical studies and what is called special „technical skills”, but their leadership skills and communication are lacking or less developed.

They exhibit the following characteristics during the decision-making process: they are paternalistic (they lead their business as it was their own family); are reluctant to delegate authority; they use few (one or two) capital resources to start a company; they identify marketing strategy with the quality and price of the products and the company’s reputation; they are in charge of sales, and also they count on a limited time horizon.

Dynamic entrepreneurs are those who supplement their technical education with the economic and/ or legal education (Peterson & Smith, 1987). They avoid paternalism, delegate authority, use different marketing strategies and varied sales methods, they use more than two resources of business capital and they set future long-term development plans.

Whichever category they fall, you should note the impact of the crisis phenomenon that manifests itself today on the entrepreneur. The following graphical representation takes into account this aspect, having as a study case Romania (Fig. 1).

Fig. 1 The psychological impact of the crisis on entrepreneurs



Source: White Paper on SMEs (2010)

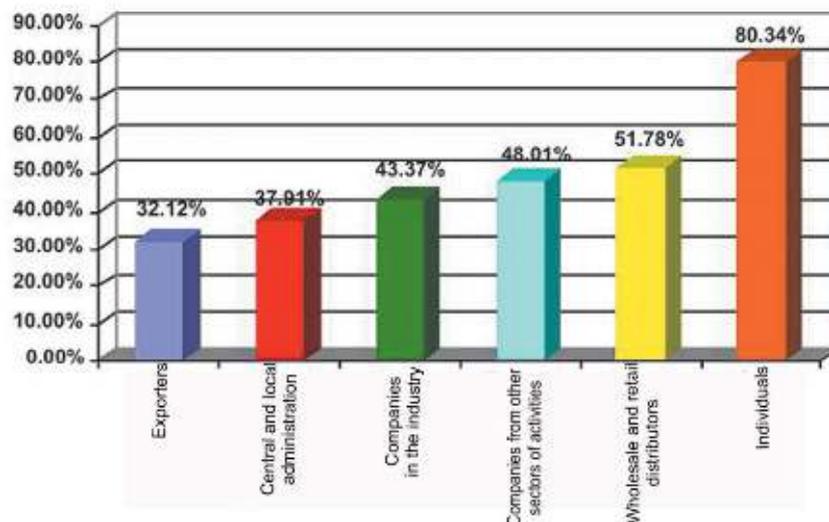
## 2. Business opportunities and orientation towards small-sized companies

Entrepreneurs, to ensure business continuity, they should always catch business opportunities; those opportunities that are sustainable attractive, appeared at the right time, and to make products, services or transactions that are high rated (the extent possible) by clients.

Referring to business success, the opportunity must meet a number of conditions (Sasu, 1998). Among these, arises the possibility of starting a company having a full coverage from the client, whose potential and which report based on risk - profit fit the purpose and values of the entrepreneur.

Here, for example, it is shown the structure of SME`s in Romania according to the nature of the customer (Fig. 2).

Fig. 2 Structure of SMEs in Romania according to the nature of customers



Source: White Paper on SMEs (2010)

Development potential refers to the market share that can be won as a result of the incomes size that can be obtained, as the growth rate and also the period in which business can be exploited.

Estimated profit of the launched business on it, to justify the time and capital to be invested, being higher that their opportunity costs. This depends on the capital required, followed by time to break even, the risks to be assumed and the existence of alternative

use of time and capital required. Another condition regards the possibility of maintaining the profitability of the business.

In time, profitability may decrease or disappear, due to internal factors (management errors that can create various problems within the organization, such as unjustified costs or staff turnover), or external (the emergence of new competition, of substitutes products, changing technology, necessities and desires of consumers,

relations with suppliers and/ or customers etc.).

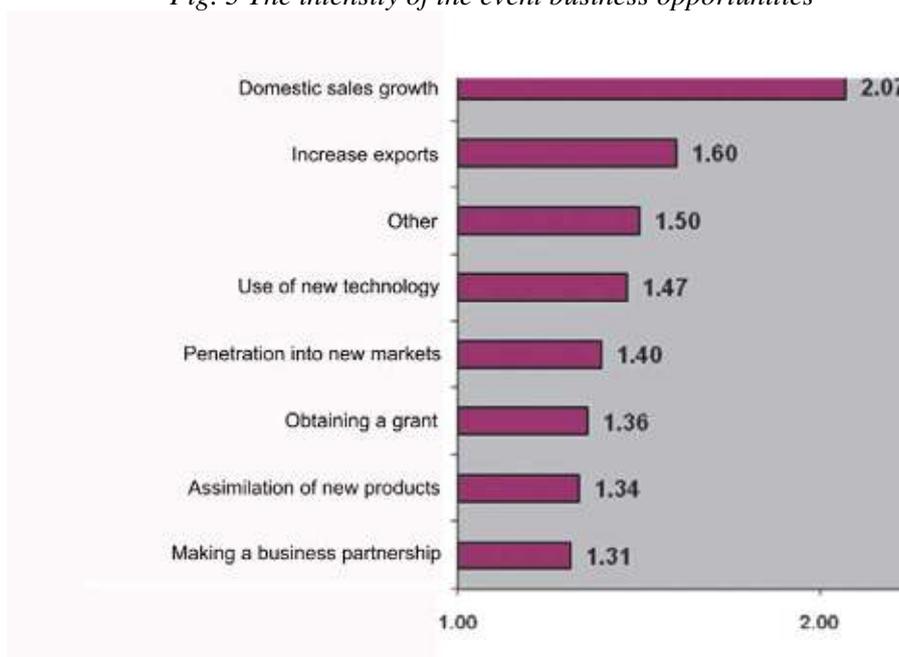
Last but not least is necessary to have the possibility of development, diversification and integration of business on it. Given the high degree of business risk and uncertainty, the entrepreneur should have great flexibility so that he can choose from several options

when it comes to resources and technologies, establish collaborations and strategy.

Then, products and/ or services that are performed must be really needed by consumers, in terms of price, reliability, quality.

We give the event a complete picture of available business opportunities for Romanian entrepreneurs (Fig. 3).

Fig. 3 The intensity of the event business opportunities



Source: White Paper on SMEs (2010)

### 2.1. Creating small-sized enterprises (SMEs) due to the action of a variety of factors influence increased

SMEs have an important role in the process of improving the current economic situation.

For Romania, as a developing country, the creation and rapid expansion of SMEs is required as a priority for action. Thereby, we bring a number of reasons, such as (Russu, 1996):

- by their ability to adapt quickly to market conditions, SMEs are true, advanced pawns of economic transformation;
- developing a strong sector of SMEs. is closely linked to strengthening the economic base of political pluralism;
- known difficulties of privatization and restructuring of public companies make SMEs to be seen more and more as resources to facilitate these processes;

- only a strong decentralization of economy allows its effective exploitation of available resources.

The chances of SMEs creation and rapid expansion are conditioned by their environment of existence and action (Rasca, 1998). Macroeconomic context, enterprise reform, privatization and economic restructuring policy define this environment, the characteristics of which we refer here (Russu, 1996).

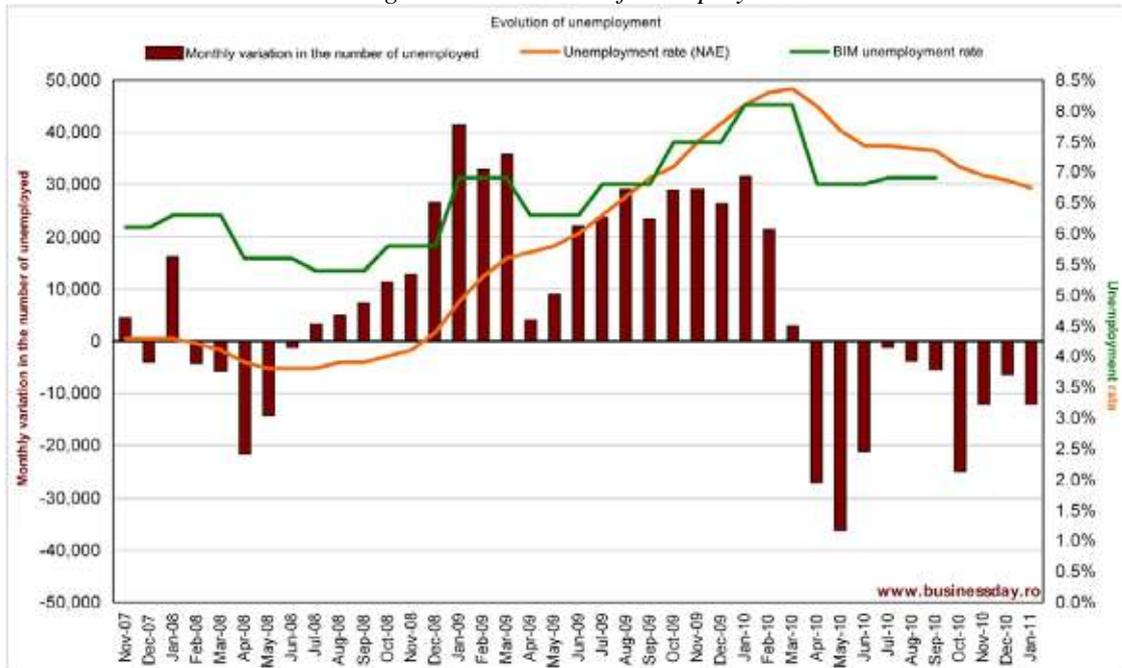
First, we state the existence of a government orientation towards a market economy, which has created quite rapidly a legal and institutional basis, indispensable in the process of initiating market mechanisms; this framework requires further refinements and additions to allow market mechanisms to play their regulatory part.

Having gone through a prolonged and deep recession, with multiple causes, the economy begins to be characterized by a

certain macroeconomic stabilization, a gross domestic product growth, a reduced inflation rate, and recovery of productive activity. A high level of unemployment (Fig. 4), we think that is likely to encourage the creation and development of small-sized companies,

knowing their special role on the number of job expansion in the context of public sector constrain.

Fig. 4 The evolution of unemployment



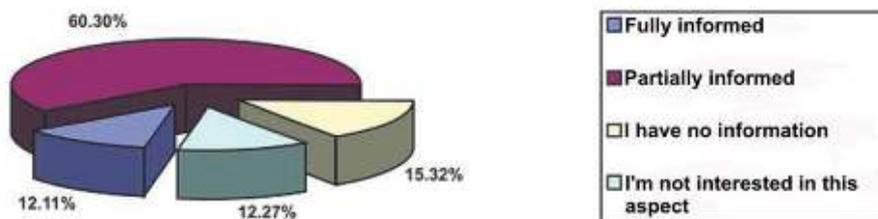
Source: Business Day, Economics and Finance, 25 Feb. 2011

The legal framework for the creation and operation of SMEs, both with exclusively domestic capital and foreign ones, we can say that it was created and it is well individualized; however, many inadequate and bureaucratic practices still persist

hindering and distorting action law (Roman, 2005).

Recently added here and motivational aspects or some European requirement in the matter (Burciu et al., 2007). Their knowledge by entrepreneurs is particularly important (Fig. 5).

Fig. 5 The information from the SMEs on European regulations posed by EU accession

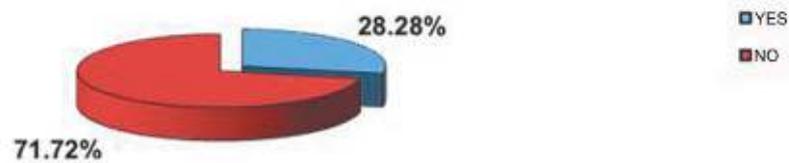


Source: White Paper on SMEs (2010)

That level of information on SMEs in European regulations posed by EU accession and is related to the situation in which the

SMEs on their intention to access funds from the Community budget (Fig. 6).

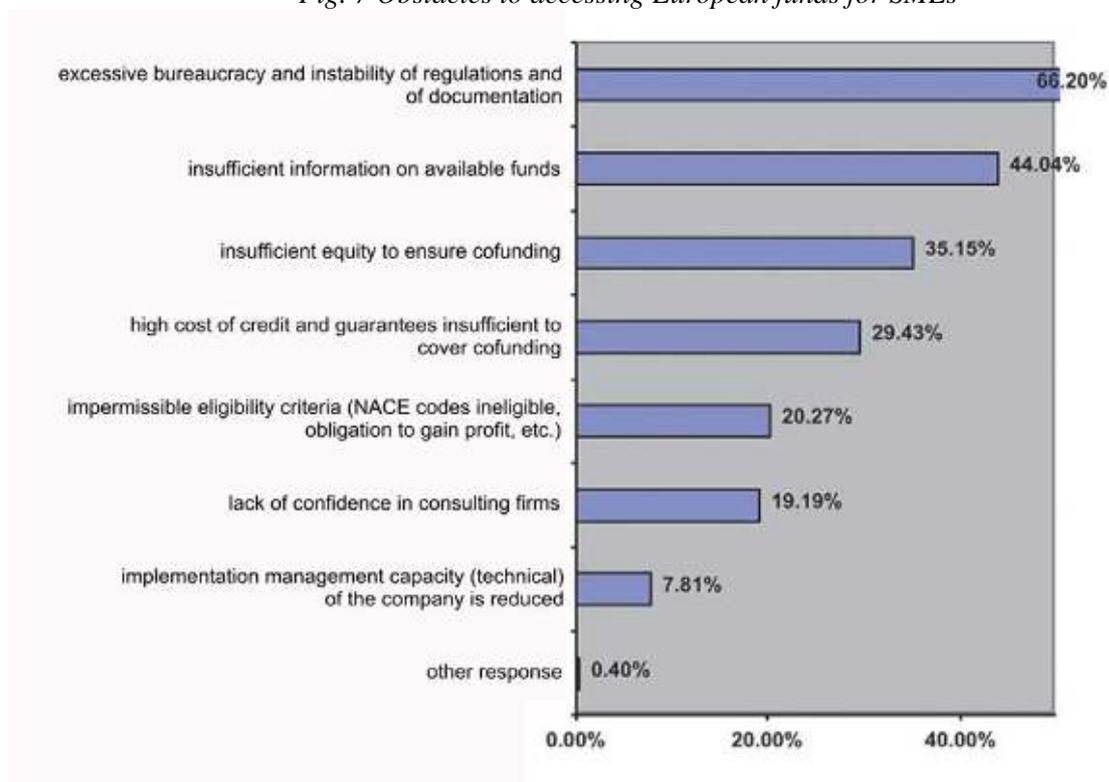
Fig. 6 Statement of intent SMEs access EU funds



Source: White Paper on SMEs (2010)

Recent studies have highlighted several obstacles on accessing European funds by SMEs (Fig. 7).

Fig. 7 Obstacles to accessing European funds for SMEs



Source: White Paper on SMEs (2010)

However, in essence, it should be noted that the main features of the framework to create and operate small outlines the idea that there are many favourable conditions for accelerated development sector.

## 2.2. Strengths and drawbacks related to the initiation of business by small-sized firms

Careful analysis of their qualities, skills and availability funding compared to the start

a business requirements envisaged enable potential entrepreneurs to assess his chances of success in future work. Depending on the outcome of the assessment, he will decide whether to engage in that business (Sasu, 1998).

This decision will be facilitated if business discussions with other potential small business entrepreneurs in the area considered for future business and the company intends to implant the business, these discussions will build better about the fact they hold in

really necessary characteristics to become a good entrepreneur-owner of a successful small business and the difficulties that the company expected to start in early stages of operation.

Option to create a small-sized company involves knowing the advantages and disadvantages involved in (Resnik, 1988), normally this would be implemented in practice only if the strengths exceeding inconvenience (Chivu et al., 2001).

The range includes the following strengths (Sasu, 1998):

- Satisfaction of doing something in their own way. Many entrepreneurs believe that the best way to enter the business is to start from zero as emerging business, increase satisfaction and reasons as an original idea became fact.
- Avoiding a bad reputation. Not all businesses are being sold have a good reputation. In some cases either company or employers have an unhealthy relationship. Starting a business avoid this delicate issue.
- Using new ideas unconditional. When a business has a truly unique idea, you may not be able to use an existing business because it is harder to convert an existing business in a desired project.

Obviously, in this plan there are some drawbacks. Here are just a few of them:

- Saturation. Quite often, a competitor entering a market without an influx of new consumers. Experienced entrepreneurs know the approximate number of local market consumers is aware that their share of the market will be protected if the number of competitors will be minimal. Elimination of new competitors in these markets requires a group effort.
- High cost of new equipment. Starting a business than taking over an existing one, requires normally higher costs due to price equipment. Obsolete equipment are sometimes available, but the entrepreneur should carefully consider possible alternatives. Even if out-dated equipment, the cost can it exceed those of similar equipment that would get by buying an existing business.

In the same context is not neglected any difficulty gaining a reputation. For many entrepreneurs, an important obstacle is to overcome consumer inertia. The name creates a certain confidence of consumers, and some of them hesitate to get in touch with new entrepreneurs.

### 3. Conclusions

Entrepreneurs are people with legal, always looking for new opportunities for business combinations, as methodical and meticulous anticipation and all actions. Most often, they first identify the need and then combine labour, materials and capital needed to meet this need.

A common orientation of these is the initiation and development of business by small-sized companies, even if long periods of time, SMEs have been considered a low and even, as some authors of the economic literature, unsustainable - of large enterprises.

Currently, this type of companies stated scale of increasingly large as competitive entities, able to adapt easily and productive social systems subject to rapid change processes.

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## Social Aspects of Working Groups

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### Abstract

*Identify and research components of human society and the relationships they are a major concern for both sociology and social psychology, political science or anthropology. Using a widely accepted concept, global society is composed of a set of social formations, understood as networks of individuals who share cultural and subcultural models from which to develop processes relative uniformity, distribution status, roles and functions and space selective targeting against general problems of society the main types of social formations are groups, communities and organizations. Groups are social formations in which individuals interact directly based on rules accepted and recognized as members of a distinct entity within a specific time and place. Communities based on the same recognition of rules and principles, but do not involve direct interaction between members (any ethnic, or believers of a particular rite, for example). Party organizations are deliberately set up to achieve a particular purpose, using explicit decision and control strategies.*

**Keywords:** organization, social groups, communication, role and status

**J.E.L Clasification.:** D01 , D21, D74

### 1. Introduction

Psychosocial groups is one of the main themes of social psychology. Qualitative differentiation of groups derived from the members who compose them, that the types of interactions that develop between them. From this point of view, we make a distinction between conceptual and methodological primary groups (small groups with a relatively small number of members),

side groups (consisting of several primary groups) and tertiary groups (sets). At each of these levels of structure groups show a specific psychosocial phenomenology, which requires treating them as distinct forms of social reality, but being a close interdependence. In this chapter we consider issues of social small groups first integrative level where there is dynamic interaction between phenomenology psychosocial and psychoindividual. [1]

Groups are dynamic systems which provide the first level of integration within the overall social system in which institutions and organizations will be higher levels of psychosocial life structure. It is generally accepted that social small groups (primary groups or small groups - in the terminology of other authors) has the following essential characteristics: [7]

- A small number of members, which enables direct interpersonal perception and mutual basis for developing a complex emotional interactions, information, influence or act. The upper limit is estimated at approx. 20 to 30 members, beyond which direct interactions such as "face to face" are not possible.

- direct intimate emotional relations, manifested in the form of sympathy, antipathy or indifference sociometric, this type of interaction is taking place background processes and psychosocial phenomena group. A close interdependence of members, born in the context of joint and making a sense of group solidarity and cohesion.

- Differentiation of roles between group members in this regard, the group appears as a distribution of roles, so that its constituent functions can be performed properly. The existence of common goals and values, relational system prerequisites for development of group members.

Although these features have a high degree of relevance small groups intimate

nature, consider that in this form they can not form the basis of operational definitions. The reasons are multiple. Not all features are necessarily present to the same group, given their great typological diversity and quality distinct phases that groups go through the process of their creation. On the other hand, some of these features are not explicit, in turn requiring complex steps operationalization. Therefore, based on critical analysis of different conceptions of social systems of these specific psychosocial propose another way of defining operational small groups, from structuring role that pregnancy has on their organization as dynamic systems and psychological function consciousness of belonging to the group, in correlation with transforming sense of "I" in the sense of "us".

Small groups is interactional dynamic systems, consisting of a relatively small number of members (2-30), which possesses the following features:

(a) participate directly and consistently to achieve common tasks imposed or adopted by consensus;

(b) directly interact throughout achieve pregnancy, based on values and patterns of behavior, acting and attitude required and / or adopted by the group;

(c) have a consciousness of belonging to the group and recognize each other as members of it (have internalized a same social identity, permanent or temporary, formal or informal);

(d) develop stable relations between its members aleatory , put directly on the type of work they perform in common, namely the type of task undertaken.

As a synthesis of the above, we interpret small groups the interactional dynamic systems based on self-development and adaptation to the environment. Hence some essential features can configure exactly the concept that the circumscribing area of social reality. thus:

a) between system elements (group members) is developing direct relationships, aleatory and relatively stable, amounting to psychosocial group structures (structures, socioaffective, communication, influencing, motivational, normative axiological;

b) further development of its structures, all (microclustered) acquires attributes and functions mere sum of qualities irreducible components;

c) groups are teleological vector systems, the common goals of members having a structural role for life and group work;

d) the complexity of its structures, groups psychosocial mechanisms of self develops internal and external mechanisms that ensure the cohesion, stability and efficiency of joint activities against a continuous learning and development;

e) small groups subsystems are in global social system, which makes the development of coordination and subordination relations with other structural and functional social subsystems (individuals, groups, organizations, institutions);

f) the same as sub-groups complex relations with the external environment, the substantial nature relations, energy, information and psychosocial;

g) due to their dynamic, groups go through developmental stages and processes of training, development, active manifestation and dissolution profiles of these steps being the group's history ';

h) specific psychosocial processes small groups involves a complex interaction of factors, axiological, cognitive, emotional and motivational, sociocultural influences on the fund created by the external environment;

i) probabilistic laws work in groups with different degrees of generality (valid for all groups or only for certain groups, such as sub-components and specific laws).

## **2. Group dynamics and psychosocial functions**

At the most representative structural-functional theories of social groups, Parsons, Bales and Shils [6] emphasizes two main dimensions of any social structure: a) dynamics and b) the duties of the Controlling system. In the most general sense, the term means all the dynamic forces acting on the group as a result of interaction and organization in time of different types of psychosocial processes: socioaffective, motivational, cognitive-evaluative, communication, influence and achieve pregnancy.

In a particular acceptance, having originated in the work of K. Lewin, the term means all psychosocial methods by which the group can be used as a tool for formative intervention on individuals and social

organizations (Gergen, K., et al., 1992 , Maisonneuve, J., 1989) [8]. Although seemingly distinct, the two meanings are closely linked: psychosocial mechanisms and specific knowledge small group allow their use for exerting control over individuals, groups or organizations (for therapeutic purposes or to optimize some aspects of activity within these formations , for example).

Correlated with dynamic problems are formulated and designed to fulfill the role of internal and external groups. Thus, the global social system, groups meet multiple and complex functions, as derived from triple their immediate natural environment and there individual key link between individual and social, basal part of the various types of structures and social formations. Consequently, small group functions will manifest the following directions:

(A) the task in terms of efficiency to meet the criteria grouped and social optimality, the main task with the role of factor association for the group.

(B) psychological satisfaction of needs of group members and solving psychological problems they face in intra-or extra-level group;

(C) providing and maintaining cohesion, coherence and group limits the system, the fund achieve its constituent tasks, which are also the essential conditions of its existence;

(D) regulating relations between the group and other groups, organizations and social institutions, and between them and people covered their formal or informal.

Whatever its nature, the group that bases its existence on psychosocial system capacity to meet the different psychological necessities of its members.

Basic needs integration, affirmation or social recognition, the needs for affection, communication and protection, the descent or addiction - all these configurations specific motivational people may be satisfied in different ways, to an extent which depends on structural and functional qualities group as a system. Group dynamics will be closely linked to individual motivational dynamics of vectors and those resulting in a relational context, interpersonal, intragroup and intergroup and system capacity to meet the needs and aspirations of its members, the conditions offered by the normative and

axiological sociocultural space, respectively.

Group is an interactive environment in which the harmonization of needs not only between individuals of the social imperatives members, but also create new needs, representations and attitudes, which may relate to other members of the group as a thumbnail image of the company or different segments of society global. This phenomenon of "remodeling group psychological context" is achieved by adjustments, adjustments or restructuring the cognitive level, affective, motivational, behavioral, relational and behavioral, the fund created by the ability to influence group membership, but also the pressure , aspiration or comparison.

To achieve satisfaction of needs of its members, the group must meet two essential conditions, which are also the conditions of its beings: the task and maintaining cohesion and limits the are identified. As shown, the task is a key constituent group, whether it is fixed from the outside, as if a formal or adopted by consensus, as in informal groups.

In these situations, the task provides a rationale for the group, even if sometimes a pretext for carrying out functions related implicit needs of its members, which can not be satisfied only by a group interactional context.

As will be shown on the task performs a triple function:

1) polarize and orient the efforts and actions of group members;

2) intra-and intergroup relations structure;

3) connected life and work of the group coordinates global social system, the values, rules and general objectives of socio-cultural group to which it belongs.

Consequently, the nature of the task will profoundly affect the development of interpersonal relationships, especially in terms of leadership and group structure as a system oriented towards a specific purpose.

Correlative nature of the task performance will directly influence psychosocial group processes, is a synthetic indicator of overall system functionality. Serving constituents (the task at a high level of performance) is strongly conditioned by maintaining cosivity enabling coordination and joint efforts focus on the substance of the possible elements of dysfunctional. The group achieved a constant pressure for conformity, facilitates the action of centripetal factors against the spin and try

to increase their attractiveness for its members so as to maintain within the unit and functionality.

Parallel to achieve these basic functions, the group has the ability to mediate and regulate the relations of its members with other groups, organizations, institutions, playing both as a "relay" and that of a "social buffer".

### **3. Structures and processes of group psychosocial**

Small groups social self is as dynamic systems from the development of a set of definite relations between members, due to the conduct of joint activities. The timing of these relations define the group psychosocial processes (diachronic aspect of interpersonal relationships) and how to set up relations at a time defined psychosocial structures (synchronic aspect of interpersonal relationships). The two issues are dialectical and complementary nature, the processes leading to configuration structures, and these, in turn, is the group conducting psychosocial processes. How to show the observational level interactions between psychosocial processes and structures is phenomenology group, the third key dimension of the dynamics of social groups.

Theoretical and experimental investigations indicate that there are four main types of structure (processes) psychosocial group: socioaffective structure (preferential processes), structure of communication (communication processes), structure of power (influence processes) and business structure (processes to achieve pregnancy). To these we add two more categories, although seemingly secondary importance are the training and development group as a social system: motivational-attitudinal structure and structure-axiological participation. Of these, communication structures, influence and activity can have both a formal character, as determined by the constitutive rules of institutional groups, and an informal, spontaneously generated in the context of interaction members in any category of groups. Other types of structures (socioaffective, motivational and participatory-axiological) are mainly an informal, with events in any type of group, although some aspects of formal structures

may influence how to set and expressions. [11]

One of the most important factors is the group dynamics socioaffective relationship that develops between members, since the first moments of their meeting. Emotional structures of the group, or 'sociometric matrix' - the terminology of Moreno, are at the background against which it will develop and manifest all the other structures. However, affective relations as a factor for integration dinamogen life group members and their individual development. From this point of view the group can be considered not only as a general system of relations, but also a framework that ensures the development of emotional, cognitive and relational members, as a condition of his own maturation, social functioning and survival. Affectivity group is as a background that is inserted all other forms of emotional experiences. [12]

Social microclustered provide conditions for complex structuring of affective relations of its members, structure which is based on two main plans, each turn involving two relatively distinct forms of manifestation:

1) the intra-group plan, take emotional processes such as preferential interpersonal relationships and feelings to that of the group: as a whole, between the two forms of affection are closely inter-intra, finding his first term in the sociometric matrix group and the second in the cohesion, psychosocial climate and performance. These types of structures socioaffective were the subject of numerous experimental research, as one of the main themes of small groups

2) the plan extragrupal, emotional processes are structured as compared to other groups who are in relationships and connectedness, and in relation to the social environment in which they operate, the environment consists of organizations and institutions which affect the general social conditions the group. Problems with these types of structures most often addressed in research on the psycho-sociology and psychology of crowds organizations.

Socioaffective structure of the group is how to configure the preference relations of the members at a time, relationships can take the form of attraction, rejection or indifference sociometric. These relationships are of propensities, with a conditioning complex, unable to be identified only by simplifying

the relations of sympathy, antipathy or indifference, developed in the context of interpersonal relationships extragrupale (Moreno, J.-L., 1970).

Factors which determine sociometric choices, trying to identify factors involved in structuring relations within groups socioafective proved particularly difficult, because many existing conditionality in this process and the complexity of relations between different categories of stakeholders: primary or secondary determination or conditioning, individual, group or sociocultural, structural or functional, etc. synchronous or diachronic.

One of the most interesting theoretical openings on this issue is provided which considers sociometric choice as fundamentally conditioned by axiological content of interpersonal relations. From this perspective, any "meeting" has a default evaluator social and valued, values the key individual, group and culture that determines the appearance of "elective affinities". Grid axiological underlying sociometric choices is "coloring" very personal, in fact synthesizing psihoindividuali many factors, psychosocial and sociocultural.

Some research shows a strong relationship between sociometric choices and membership of a particular effort to strengthen and empower the group. This correlation is explained by the significance of the group as a whole has for each of its members in pursuance of the differentiated function of satisfying his needs, individual and social value for members to create a climate event indispensable figures in this context, every effort strengthen the group is in line with an important series of individual and collective motivational factors, which facilitates the formation of preferential positive relationship to those who contribute to meeting the respective vectors motivational default.

A wide range of factors which determine the formation and structure of preferential relations within groups, the following are considered most significant: social intelligence, interpersonal communication skills, charisma, prestige intra-and extra-group, altruism and self-help available competence and involvement in solving problems facing the group, status recognized formally and informally.

Depending on the nature and composition of the group, type of load to be carried out and general socio-cultural context in which working group, the configuration factors that mediate preferential relationships may vary considerably, but each time could be identified a factor that may be considered "purely emotional", taking in that area and ineffable mystery that characterizes the formation of elective affinities. In fact, each of these factors produce certain "emotional echoes" of a sociometric choice whose integration results.

Sociometric technique allows the analysis quantified two dimensions of group structures: a) socioafective size, which is the distribution of potential group members form emotional choices, sociometric rejection and indifference; b) evaluative-cognitive dimension, which expresses the "visibility" interpersonal preferences of third parties (transparency) and members' ability to perceive the real nature of interpersonal preferences of the group they belong to (Grama, D., 1974, Golu, P., 1974)

### **3.1 Structure authority**

Group members are different and as having the ability to influence collective activity and behavior of other members. Formal hierarchy or authority structure expresses informed members of the group depending on the capacity, which is conditioned by a complex series of psychoindividual factors and situational psychosocial. [3]

The structure of formal authority (or institutional power) corresponds to the organizational institution that belongs to the group, responsibilities of various positions exercised varying degrees of competence, experience and authority by those who occupy them. Mention distinction being made in this case between power and authority: the power of expressing a person's access and control means determining the behavior of subordinates, while recognizing the authority reflects the ascendancy of a person in a community, recognizes the particular qualities personal values the social position of consensus over which aspirations.

The most important matter of exercising power and authority in groups refers to the relationship between formal and informal

structures thereof. These reports can be convergence, divergence, complementarity, competition or conflict, with varying degrees of intensity and shades in the form of manifestation.

### 3.2. Structure of the task

The task is the main factor guiding and structuring group work and against which performance is assessed. The task is defined a set of objective requirements, conditions and models developed and validated actionable social, externally imposed or adopted by consent. The load structure will mean all the functional relations between group members, relations imposed by the proper conduct of business to achieve that goal. Typical configuration of functional relations shall designate the types of loads: additive, complementary, convergent, conjunctive, disjunctive, compensatory. In addition to typological dimension, your task is characterized by: overall structure, which expresses the existence of patterns, explicit information and strategies to achieve practical, way of consolidation with the tasks of other groups, complexity, duration, etc. full realization. [13]

Type of task, overall structure and mode of consolidation in tasks other groups are the main factors that will regulate the interaction of group members. Thereby, the other structures (communication, and influence socioaffective) will require continuous reporting task structure, compatibility and harmonization of these structures is the surest way to improve group performance, positive climate and interpersonal relationships.

As a result of the above, psychosocial group structures can be represented by graphs which can be associated with the corresponding matrices. This opens a formal logical analysis of group structure, aimed at optimizing certain structural and functional parameters: performance, psychosocial climate, cohesion, leadership, degree of conflict, interpersonal, intergroup relations, etc.

### 4. Conclusions

To this end was the concept of congruence of group structures, indicator expressing the degree of functional compatibility between

two or more structures psychosocial group: task structure, communication, influence and socioaffective. The concept was developed on mathematical notion of distance and proved extremely relevant theoretically and practically useful in designing, controlling and correcting small groups social dynamics, particularly the industrial, military and "project" . The group has a higher index matching its functional structures with both its performance is better, more stable psychosocial climate, the general trend of such a group being positive. Conversely, a low congruence indicates active or latent failure in the compatibility of group structures. Group performance will be low, the overall trend is worsening psychosocial climate and the further deterioration of interpersonal relationships

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## Current Concerns to Ensure Sustainable Performance of Romanian SMEs

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### Abstract

*The results of the research made by authors highlights the importance that is given to ensuring sustainable performance of the SMEs in the economic, social and environmental point of view. This work has been prepared as part of project POSDRU/88/1.5./S/55287 “Doctoral thesis in economy at European knowledge standards (DOESEC)”, co-financed by the European Social Fund through Sectorial Operational Programme Human Resources Development 2007-2013 and coordinated by The Bucharest Academy of Economic Studies in partnership with Timisoara West University.*

**Keywords:** Sustainability, SMEs performance, sustainable performance

**J.E.L. Classification:** M2

### 1. Introduction

The purpose of this paper is to analyze the Romania SMEs' concerns regarding the assurance of a sustainable performance out of the three perspectives: economic, social and ecological, in order to develop a sustainable behaviour of SMEs. The article is based on a literature's review regarding sustainable development. Further, the paper proposes the concept of performance measurement in order to encourage the sustainable development of SMEs and to suggest the performance assessment approach.

### 2. The role of SMEs

Small and medium enterprises (SMEs) are assumed to play a key role in social and economic development in Romania.

SMEs play a central role in growth, competitiveness, innovation and employment, because of their flexibility and ability to innovate [1]

In the European Union, about 23 million SMEs provide around 75 million jobs and account for 99% of the total number of enterprises. SMEs will continue to play a key role in economic growth, competitiveness, innovation and employment, owing not only to their flexibility, but also to their ability to innovate [2].

Given the current economic context marked by globalization of phenomena, the need has increasingly arisen for deep changes in terms of SMEs performance, so that they can improve their competitiveness and respond to the growing demands of all stakeholders: customers, shareholders, staff, suppliers, partners and the society as a whole. A successful organization must have the ability to continuously monitor external environment, so that it may identify opportunities, changes, trends and risks. It should also be able to detect, attract and allocate the resources needed [3].

At the same time, the organization must have the ability to actively learn, change and innovate [4].

Sustainability is a measure which describes the potential of an organization to maintain or improve its competitive position in the eyes of its customers and shareholders while having the ability to act and react

within a changing competitive environment [5].

Sustainable development is the development that meets the needs of the present without compromising the ability of future generations to meet their own needs [6].

The definition of sustainable development provided by the Brundtland Report renders the interpretation of sustainability subjective, for it does not specify whose needs will be met nor how sustainable development will be achieved; as a result this has led to a plethora of definitions of sustainability which are inherently different [7]

Elkington [8] who uses the triple-P perspective, considers an organization sustainable if a certain minimum performance is attained in the three so-called “p-area’s”. The three P’s stand for people, planet, and profit. The main point is that the “bottom line” of an organization is not only an economic-financial one; an organization is responsible to its social and ecological environment as well. From this perspective, an organization needs to find a balance between economic goals (profit) and goals with regard to the social (people) and ecological (planet) environment. (figure 1)

Figure 1 The Triple-P concept of sustainability



Source 1 Elkington J., *Cannibals with Forks; The Triple Bottom Line of 21st Century*, Business. Capstone, Oxford, 1997

Dyllick and Hockerts transpose the definition, by means of the stakeholder concept, to the organizational level. They define corporate sustainability as “meeting the needs of a firm’s direct and indirect stakeholders (such as shareholders,

employees, clients, pressure groups, communities), without compromising its ability to meet the needs for future stakeholders as well” [9].

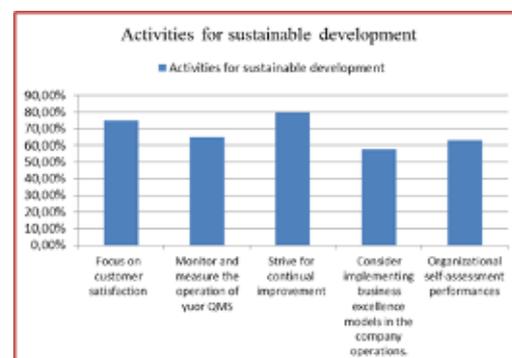
### 3. The sustainable development of Romania's SMEs

This research is based on the sustainable development model defined by Elkington.

#### 3.1. Economic perspective of sustainable development

Nowadays, we can talk about an increasingly high orientation of quality management systems’ models promoted by the international standards ISO 9000 towards the re-organization processes in terms of satisfying customer requirements, and other relevant stakeholders in order to ensure sustainable business development[10]. The literature widely discusses the impact of implementing the model defined by the ISO 9000 on business performance [11], [12] taking into account the particularities of SMEs [13], [14]. It points out that “the success of an organization is based both on meeting current and future needs and expectations of current, potential customers and final users and the consideration of other stakeholders” [15], [16]. Thus, according to ISO 9004:2009, sustainable success of an organization can be ensured by developing its capacity to meet the needs and expectations of its customers and other stakeholders, on long terms and in a balanced manner.

Figure 2 Activities for sustainable development



Source 2: authors processing, 2012

According to a previous research of the

authors, we can say that there are concerns regarding the sustainable development of SMEs [17]. The research highlighted that, in order to support sustainable development, organizations need to concentrate on Focus on customer satisfaction (75), Monitor and measure the operation of your QMS (65), Strive for continual improvement (80%), Consider implementing business excellence models in the company operations (58%) and Organizational self-assessment performances (63%).

### 3.2. Social Perspective

The latest literature tradition to have impacted our understanding of corporate social responsibility is that of sustainable development. It was the Brundtland Commission [18] that for the first time systematically emphasized the link between poverty, environmental degradation, and economic development. Its definition of sustainable development, as meeting the needs of the present, without compromising the ability of future generations to meet theirs, extends the responsibility of firms both inter-and intragenerationally. Thus firms are expected to also consider traditionally unrepresented stakeholders such as the environment and as well as future generations. Although many CSR authors have taken up the notion of a “triple bottom line” [8] there remain important tensions between the CSR and the sustainable development debate [9].

It's very important that social responsibility is promoted by all types of business in all sectors, from SMEs to the multinational. For SMEs, the concept is essential because they have the greatest contribution to business results and on employment. Many SMEs act socially responsible in particular the local community, but broadening the scope of “Good Practice” can contribute to social responsibility in the enterprise. A number of socially responsible companies aware of environment issues and says that such guidance may lead to increased efficiency and profit. Economic effects of social responsibility can be divided into direct and indirect effects. Positive direct effects resulting for example in a better working environment leading to increased employee

motivation and productivity and a more efficient use of natural resources. Indirect effects resulting from increasing interest of consumers and investors correlated with better market opportunities. In response, the criticism of business activity it harms its reputation leading to damage to property values (name brands and images).

For deepening and broadening effects of enterprise social responsibility on their performance is necessary for companies, authorities and universities, through efforts converged to create a program for research and technological development.

### 3.3. Environment perspective

Worldwide, we can state that the environment is a priority for all industries [19]. According to the Industrial Policy in the perspective of post-Lisbon strategy, Romania has set as main target the achievement of overall strategic goals of sustainable industrial development strategies according to environmental and climate change and energy, in order to increase the competitiveness and the performance of those industries which may have a competitive advantage to counter the economic crisis.

In correlation with the other policies and strategies of the national economy and the European Economic Recovery Plan, Romania's industrial policy has as main objectives:

- competitiveness and market access;
- improving the general framework conditions, specific research and eco-development for the active participation in the new European Research Area;
- consolidation of the environmental potential of industry ;
- sustainable use of resources;
- development of industrial and public-private partnership;
- modernizing the labor market.

To achieve this objectives, there have been defined some policy instruments presented further in this paper.

In order to identify the maturity level of Romania's SMEs for implementing an environmental integrated approach, the authors have conducted a comparative study,

analysing the guidelines for the environmental integrated approach [20] and the tools defined by Romania’s Industry Policy. The results of the comparative study are presented in Table XX.

*Table 1 Comparative study between the guidelines for an environmental integrated approach and Romania's industrial policy instruments*

Guidelines for an environmental integrated approach	Romania's industrial policy instruments
Research and Development	<ul style="list-style-type: none"> <li>- Equipping and/or arranging for testing and calibration laboratories and their accreditation, if applicable;</li> <li>- Performance of experimental models, prototypes, assimilation of new technologies that operators performed on the basis of Romanian R &amp; D units;</li> <li>- Performing benchmarking analysis for manufacturing activity in order to achieve the plans of restructuring - development - viability, whose implementation will be monitored</li> </ul>
Research on Alternative Fuels	<ul style="list-style-type: none"> <li>- Certification of products and/or getting environmental label products</li> </ul>
Policies to Encourage Alternative Fuels	<ul style="list-style-type: none"> <li>- Implementation and certification of quality management systems and / or environmental management systems;</li> <li>- Implementation and certification of security management and health, social accountability management systems and food hygiene and / or information security management systems;</li> <li>- Encourage development of competitive clusters (clusters / poles of competitiveness, growth poles, urban development poles, etc.), in accordance with the European industrial policy initiatives.</li> </ul>
Fuels	- No policy defined

Infrastructure Development	
Incentives for Fleet Renewal	<ul style="list-style-type: none"> <li>- Organizing and arranging exhibitions inside economic operators, presentation stands and promotional products industry;</li> <li>- Registering and protecting external market marks, Romanian industrial designs.</li> </ul>
Congestion Mitigation	- No policy defined
Consumer Eco-driving	- No policy defined

Source 3: authors processing, 2012

As we can observe in Table 1, several directions defined by the guidelines for an environmental integrated approach are not yet defined at national level. The comparative studies allow the definition and implementation of government policies and programs to support Fuels Infrastructure Development, Congestion Mitigation and Consumer Eco-driving concept. Using the existing policy instruments, Romania will be able to align to the requirements of the environmental integrated approach but this fact will be possible only in the medium and long considering the lead-time of the research and development activities. In the industry areas, it typically requires 5-7 years to design, test, build, obtain government certification and introduce complex automated production tools. Any policy that is implemented without allowing sufficient time can adversely affect manufacturers, their suppliers, their employees and consumers.

#### 4. Conclusions

Considering the analysis results, we can conclude that in Romania there are concerns about the orientation of SMEs' activities to sustainable development. The findings can be considered a starting point for future researches aiming identifying the best ways for sustainable development of Romania's SMEs, of the three perspectives.

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# Improving Customer Churn Models as one of Customer Relationship Management Business Solutions for the Telecommunication Industry

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## Abstract

*Nowadays, when companies are dealing with severe global competition, they are making serious investments in Customer Relationship Management (CRM) strategies. One of the cornerstones in CRM is customer churn prediction, the practice of determining a mathematical relation between customer characteristics and the likelihood to end the business contract with the company. This paper focuses on how to better support marketing decision makers in identifying risky customers in telecom industry by using Predictive Models.*

*Based on historical data regarding the customer base for a telecom company, we proposed a Predictive Model using Logistic Regression technique and evaluate its efficiency as compared to the random selection. In the future, we will focus on extending our study by integrating more business considerations and mining models in order to adjust the churn models or redesign marketing activities for the telecom industry.*

**Keywords:** predictive models, data mining, churn, time series econometrics

**J.E.L. Classification:** C25, C26, C32, C53, C81

## 1. Introduction

Competition in the telecommunications industry is very aggressive, since on each national market there are at least four carriers struggling to maintain their market share by offering very similar and very attractive products and services. This is the main reason why, in order to maintain their

profitability, telecommunications operators are very concerned in controlling *churn* – generally defined as the loss of subscribers who switch from one carrier to another (Gopal, Meher, 2008) – and, based on predictive data mining techniques, developing new efficient CRM strategies to retain customers .

Keeping in mind the fierce competition on the market, the focus of telecommunication companies has therefore shifted from building a large customer base into maintaining and strengthening the previous developed base, in witch case it is valuable to identify in advance those customers who are likely to switch to a competitor in the near future, the so called churned customers.

Statistics have showed that is 5 to 6 times more profitable to keep existing customers than to attract new ones (LeBoeuf, 2000). This is why, churn prevention can be regarded as a popular way of reducing the company’s costs, while increasing the profitability, which is the basic key for survival on the market, especially for listed companies.

This paper is organized as follows: in Section 2 we will present the concept of CRM and its close interference with churn, especially in telecom, while making a literature review on this subject, Section 3 will present the methodology insisting on logistic regression technique and its application in building a predictive churn model, Section 4 presents the predictive model build based on a data base from a Romanian telecommunication company, and, finally, Section 5 provides the conclusions.

## 2. Customer Relationship Management and telecom churn management

Since is an established fact that the building of long term relationships with customers provides multiple benefits to businesses (Dwyer et al., 1987) and since it has been acknowledged that old customers are more profitable in the long term, because new customers are attracted by promotional offers and tend to switch to another provider at the moment they receive a better discount (Gopal, Meher, 2008), and having to deal with this present necessity of better “Customer Relationship Management”, “(CRM) is a healthy and promising newcomer which has appeared on the business radar”(Greenberg, 2002).

Despite its large recognition as an important business strategy and the fact that the term gives the definition by itself: the management of relationship with customers, there is no widely accepted definition of CRM.

According to some authors (Lin, Xu 2009), CRM comprises a set of processes and enabling systems supporting a business strategy to build long term, profitable relationships with specific customers.

Kincaid (2003) defines CRM as a enterprise approach to understanding and influencing customer behavior through meaningful communications in order to improve customer acquisition, customer retention, customer loyalty and customer profitability.

Parvatiyar (2001) defines CRM as the strategic use of information, processes, technology, and people to manage the customer relationship with the company across the whole customer life cycle.

The same idea is considered by Swift 2001; Kim et al., (2003) – in their opinion CRM consists of four dimensions: Customer Identification, Customer Attraction, Customer Retention and Customer Development.

The above given definitions have shown that in some way, CRM strategies are nowadays more focused on retention, and CRM is more and more becoming a process of retaining customers, with the help of business intelligence and data mining, to maximize the customer value to the organization.

So, in the business world (and we are referring especially to the telecommunication sector), CRM consists of all the activities that can transform a regular customer into a loyal

one by exceeding its requirements.

If referring to the application of CRM strategies into the telecommunication sector, in order to upgrade regular loyalty and retention campaigns, we must specify that a current particularity of the telecommunications market is modelling the attrition risk (or the churn risk, where *churner* is a common term used both in academia and practice to denote the customers with propensity to leave for competing companies). According to some marketing studies (Berson et al., 2000), the average churn rate for mobile operators is approximately 2% per month, which means a loss of 25% of its customer base within a year.

For a customer, cancellation costs are relatively small, given the fierce competition in the market which consists into providing similar services (in terms of price and quality) and offering discounts on handsets and various other accessories.

Nowadays, price is no longer a differentiator, since many telecom providers tend to equal each other's prices. The main differentiator have become the additionally services.

In the present the customer is “serviced”, not only “sold” (Cool, 1996).

Therefore, for almost all mobile phone companies, the biggest challenge is, at the present, switching from reactive to proactive retention, in other words retaining customers before they take the decision to end their contract and identifying those customers with a high churn risk (Slăvescu, 2011).

In order to maintain market share and profitability, telecom companies have used various approaches or management/marketing strategies to retain customers and prevent serious churn problems.

At present, most of the strategies are based on data warehousing - maintaining and managing historical and very detailed data obtained from many computing and point-of-contact devices – and data mining techniques that enriches and transforms data into meaningful information for business decision makers.

In this spirit, a common churn management process involves constructing a churn prediction model using past churn data, and determining key variables influencing churn. The churn model is then used to

identify and classify a list of customers with potentially high risk of churn (potential churners) from existing customer data, to perform the appropriate retention activities (Berson et al., 2000; Au et al., 2003; Chu et al., 2007; Coussement et al., 2008; Ngai et al., 2009).

The efficiency of a company's combined CRM and churn management strategy is measured in terms of effectively decrease of the churn rate (or increase of the retention rate), and not only by whether it can locate a list of potential churners. In our study we will concentrate in building a model in order to identify customers with a high churn risk, the development of a model that can generate the increase of the retention rate, being on our list of future research interest.

### 3. The methodology: data mining techniques and logistic regression

Data mining is an integrated technique that involves analysis, filtering, extraction, and statistical analysis for large amounts of data; it has numerous applications in addressing business problems (Chu et al., 2007; Coussement et al., 2008; Lariviere et al., 2004; Lejeune, 2001; Luo et al., 2007; Ngai et al., 2009). Data mining can be used for analyzing the production process, investigating the marketing efficiency, studying the management effectiveness, or measuring the evolution of the company's stock exchange value (Panait, 2011).

Previous studies utilized various data mining technologies to assist telecom companies in resolving churn problems (Kim et al., 2004; Hung et al. 2006; Xia et al., 2008; Tsai et al., 2010).

Generally, churn is estimated using predictive models that are built based on a significant sample from the database, containing both churners and non-churners at a selected moment (i.e April 2010) and their historical data (at least last 3 months of information regarding their financial situation, their call detail records, their personal details- age, gender, address, etc).

Then, by using an appropriate software predictive tool (we have used Chordiant, but we can also use SPSS, UNIQA, etc.) the model is created by automatically applying a set of algorithms over the selected data set.

There are several categories of prediction models in statistics and data mining that can be applied to churn prediction problems. Past research shows that Decision Tree, Neural Network, Logistic Regression are well suited to this type of problem. For our model we have decided to use Logistic regression.

Logistic regression is a technique in which unknown values of a discrete variable are predicted based on known values of one or more continuous and/or discrete variables. A logistic regression model is distinguished from a linear regression model because the outcome variable in the logistic regression is binary or dichotomous.

If we consider a collection of  $n$  independent variables which will be denoted by the vector:  $x_n = (x_1, x_2, x_3, \dots, x_n)$ , and the conditional probability that dependent variable is present be denoted be  $P(Y=1|x) = y(x)$ .

Then the multiple logistic regression model is given by the equation:  $f(x) = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \dots + \beta_n x_n$ , in which case the dependent variable is given by:  $y(x) = e^{f(x)} / (1 + e^{f(x)})$ .

In our case, the dependent variable is the churn prediction, and it can take the values: “churn” or “not churn” and the independent variables are the fields contained in our database that we have considered relevant for modeling churn. In this study,  $x_n$  =historical attribute variables (i.e. age, tenure, etc.),  $y(x)$  = the probability of churn.

The model performance is measured by the hit and the lift rates. The hit rate is the ratio of the number of correctly classified targets to the number of classified targets. In other words, this is the ratio of true positives to the total number of hits identified.

Hit ratio (H%) =  $A/(A+B)$ , where A is the number of subscribers predicted to churn in the predictive time window who actually churned, B is the number of subscribers predicted to churn but did not. (Hung et al., 2006)

The lift rate is the ratio of hit rate (H%) to the overall monthly churn rate.

For instance, after building the model, we can rank order all customers by their churn score, and define hit ratio (H%) as the hit ratio of the “10% Customers with top churn score”.

If the overall monthly churn rate = 2.5% and hit ratio (10% most risky churners)

= 25%, then  $LIFT(10\%)=25/2.5\%=10$

The lift curve is a measure of productivity for modeling: with random sampling of the entire customer base we would yield 2,5% churners; focusing instead on the 10% top-churn-risk-score customers we would yield 10% churners (Hung et al., 2006).

#### 4. The churn model and the results

In our study we have used data from a mobile telecommunication company, taking a sample of 51691 cases – mobile postpaid customers, where a postpaid customer is a client having a contractual setting for a specific period of time (12 or 24 months) with the carrier – containing both customers that have churned in april 2010 (churners) and customers who have remained loyal in the same month (non-churners) and their historical data for a period of 6 months before the “churn moment” (October 2009 to march 2010). All chosen customers have had tenure of at least 9 months.

We have used 80% (41353 cases) of the entire data set for the training set, which is the data set used to build the model, 10% of the original data set for the test sample, which is the data set used to identify and correct wrong predictions of the model during the building phase, and 10% for the validation set, used to measure the performance of the model against the real outcome.

The training set contains 47.78% churners (19752) and 52.22% non-churners (21601).

There were 13 independent variables included in the model, that have been considered by our Chordiant application as statistically relevant in influencing the churn rate: average number of calls to the Call Centre in the past 6 months, number of visits in the representative stores of the carrier in the last 3 months, average invoice in Euro in the past 3 months, average invoice for voice services only in the past 3 months, average on net call duration (in minutes) for the last 4 months, number of months before expiring the contractual period, etc., each having a specific performance measured by the correlation coefficient (CoC). (See Figure 1)

Figure. 1 The list and performance of the independent variables

The model incorporates the following predictors:	
Field	Performance
AVG_NO_ENQUIRIES_IN_PAST_6M	60.62
RETAIL_VISITS_3M	52.13
A3_TOTAL_NET_REV	55.87
NO_MONS_SINCE_LAST_SMS	56.26
SUM_MO_VOI_OTHER_SERV_MIN	56.94
SDV_MO_VOI_NAT_CALL_CENTER_MIN	54.86
RTS_MO_VOI_MIN	64.75
SDV_MO_VOI_NAT_CALL_CENTER_CNT	54.34
MONTHS_TO_OOC	54.98
A4_MO_VOI_MIN	56.73
A4_MO_VOI_NAT_OTHER_MIN	61.09
A3_AVERAGE_R_VOICE	52.86
A3_AVG_REVENUE_OFFNET_VOICE	52.12

Source: Snapshot from the application

The correlation coefficient (CoC) is a measure of how well trends in the predicted values follow trends in past actual values. It is a measure of how well the predicted values from a forecast model "fit" with the real-life data. In our case it measure the relative influence of each predictor to the outcome variable. We can observe in Figure 1, that the most “predictive” variable is the number of visits in the representative stores of the carrier in the past 3 months.

The performance of the model is given, in our case by the CoC, which is 76.001%, and the lift ratio, as defined in the previous section. The lift ratio for this model is 35,7% (see Figure 2), meaning that if targeting top 10% of the customers with the highest churn score, we can identify and retain 35,7% of them, compared with a 2,5% medium retention rate obtained if randomly selecting the customers.

Figure. 2 The ten deciles of top-churns and the model lift for each

Interval	churned		loyal		Lift
	Count	Percentage	Count	Percentage	
Wide of scheme	0	0%	0	0%	0
[0.003245, 0.019647>	646	2.62%	33442	10.38%	27
[0.019647, 0.025205>	772	3.13%	33919	10.53%	31
[0.025205, 0.029215>	799	3.24%	33845	10.51%	32
[0.029215, 0.034333>	1012	4.1%	33979	10.55%	41
[0.034333, 0.042442>	1121	4.54%	33576	10.43%	45
[0.042442, 0.05266>	1651	6.69%	34068	10.58%	65
[0.05266, 0.067689>	1962	7.95%	30415	9.44%	85
[0.067689, 0.098453>	2761	11.18%	32413	10.06%	110
[0.098453, 0.167329>	5010	20.3%	30162	9.37%	200
[0.167329, 0.815802]	8951	36.26%	26241	8.15%	357
	24685	100%	322061	100%	

Source: Snapshot from the application

## 5. Conclusions

Predicting churn customers using CRM strategies and data mining techniques is an important issue for telecom companies in competitive markets of today.

Our study contains important insights in building predictive models and an empirical example based on real data from a telecommunication Romanian operator, which is quite an innovative research for the Romanian market, national scientific literature on this subject being rather scarce.

According to the performance measures generally used in the international studies, it seems our model is significantly better than random, with a lift ratio of 35.7%.

As most studies of the telecom churn problem, we have focused on constructing an effective churn prediction model to locate lists of potentially lost customers in advance. However, identifying potentially lost customers does not mean those potentially lost customers can be retained and that will be the main subject of our future research studies.

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# The Role of Communication in Tourism Development

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## Abstract

*This paper explores an ecotourism website, various discussions organized around sustainable tourism and a declaration on responsible tourism. It is meant to show that communication plays a key role in tourism in the current international economic context. Tourism development represents an economic activity, which can facilitate economic growth and which can fight against unemployment, poverty alleviation or climate changes.*

**Key words:** communication, tourism development, ecotourism, sustainable tourism, responsible tourism;

**J.E.L. classification:** F02

## 1. Introduction

After the 2010-2011 relative recovery from the 2008-2009 economic crisis, the rhythm of the economic growth in the developed countries is expected to be reduced. This fact will probably affect the emerging economies and tourism industry in particular as tourism provides benefits for the economies of developing countries, where most of the sector's new tourism jobs and businesses are being created. This is why responsible tourism is becoming a necessity more than ever and tour operators, travel agents, product owners, industry organizations or governments from many countries are trying to implement it.

Communication in tourism development can be an important tool meant to support effective responsible tourism activities. It is aimed at strengthening relationships and at facilitating stakeholder participation in the design and in the implementation of development policies or projects. It ensures that activities respond to local needs, local

ownership and link sustainable tourism products to markets. The use of the appropriate terminology advance sustainable tourism policies and strategies, develop interpretations of key responsible tourism issues or experiences and can stimulate further discussions in various thematic areas.

## 2. Ecotourism

The term *ecotourism* goes back to the Goofus and Gallant cartoons, which were about two contrasting boys who respond to the same situation in different ways. Goofus invariably chooses a selfish or irresponsible response, while Gallant always responds with kindness and generosity.

The lack of precise, commonly used definition of *ecotourism* has been a cause of misunderstanding as it was confused with *adventure tourism* and *nature tourism*. Many seminars have been conducted for stakeholders about eco-friendly and people-friendly travel. The aim was to link tourism and environmental protection and to explore ecotourism resources. Various ecotourism awards have been created to highlight leaders developing ecotourism in different places around the world and many conventions on biological diversity developed incentives for an improved communication from government officials to managers striving towards ecotourism.

Lao People's Democratic Republic [1], winner of the 2007, 2008 and 2009 Ecotourism Spotlight Awards, has created an ecotourism website in which the vision for ecotourism is expressed. It enlarges about a local socio-economic development and simultaneously about Lao's unique cultural heritage or splendid biodiversity conservation in order to become a world renowned destination specializing in forms of sustainable tourism through partnership and cooperation.

Towards realizing the vision for ecotourism, the government agencies and the

private sector work to realize the strategy and the action plan. Therefore, Laos and international stakeholders cooperate to preserve the richest network of ecosystems on the Indochina Peninsula, to conserve the charismatic species, to minimize the consumption of the irreplaceable resources such as the energy and to protect the forests, the aquatic resources, the heritage sites or the unspoiled diverse ethnic lifestyles and traditions. The principles of Lao's ecotourism refer to the cooperation between the authorities and local people in order to promote responsible business practices for poverty alleviation and for the benefit of the national economies, of the local businesses or of the local residents.

The purpose of this website is also to provide travelers with ideas about the so-called ecotourism attractions. They include green forests, endless mountains, cascading waterfalls, hidden caves, rare wildlife populations and remote villages housing communities of ethnic minorities. World heritage sites include charming and well-preserved old urban settlements, lesser-known archeological places, temple murals, woodcarvings and pottery.

Nature and culture-based tourism activities are encouraged to generate income for local communities. In order to support community-based tourism, several actions are encouraged. Thus, eating local dishes ensures that the travelers' money stay local and provides tourists with an authentic meal and a tremendous cultural experience. On the other hand, purchasing decorative devices supports local artisans and their traditional crafts, while taking a local guide will make the trip more enjoyable and more educational. Looking for local accommodation such as family-run guesthouses, riverside bungalows, star-rated hotels or colonial-era villas, for local restaurants and for local entertainment venues, near historic attractions or away from the tourist areas, in tranquil gardens, will be a genuine experience with Lao culture and people. Visiting national protected areas will help generate income and awareness to support the conservation of threatened wildlife ecosystem. Other ecotourism activities include trekking, kayaking, bird watching and camping.

The travel website contains references to entry-exit points, to bridges, to international border crossings, to the acquisition of a visa by passport holders, to visa extensions or to the establishment of a visa-free tourism zone. Ideas about the climate, about distinct seasons, about the colorful New Year's festival, about the indigenous languages, about upscale shopping establishments, about provincial capitals, about international direct dial, about business hours for government offices and for private businesses are also included. Information regarding basic health precautions such as eating well-cooked food, drinking bottled water, staying hydrated, avoiding being bitten by mosquitoes and wearing protective clothing is priceless for cultural interactions.

The website enlarges upon well-run ecotourism accommodation places, such as tree-top accommodation, which offers access to forest canopy cable networks, boat landing guest houses and tropical design houses, which use local architecture and building materials. Such places are located in or around natural areas and in ecotourism resorts, where the use of chemicals in daily operations is minimized and waste is well-managed. On the other hand, open-air restaurants offer continental and local cuisine. Information on transport such as regular service to various destinations, international carriers with flights to these destinations or ferry rides across the rivers is also important.

Several ecotourism do's and don'ts for a cultural and friendly travel through the country represent an attraction of the website. Therefore, guests find out that Lao people greet each other by pressing their palms together to “Nop,” that using the feet for anything other than walking or playing sport is generally considered rude and that touching someone's head, bathing nude, kissing and hugging in public is very impolite. Lao people appreciate clean and neatly dressed visitors, who must take the shoes off before entering a Lao person's home. In this country, it is respectful to gently crouch down when passing someone who is seated, but it is inappropriate to step over someone in the path. Travelers are encouraged to speak softly and to avoid confrontation. They should object to begging, but they can give gifts to established

organizations or to village elders. Tourists should not touch sacred items or enter sacred places without permission and women should not touch a monk or a monk's robe. Vacationers should not leave litter and should help prevent forest fires. Eating delicious Lao food, refusing to buy wildlife products, as such commerce endangers many species and encouraging local craftsmen, by purchasing new quality handicrafts, help local business and farmers. The use of drugs is illegal while women and children should be protected from sexual abuse and exploitation by reporting suspicious behavior.

### 3. Sustainable Tourism

The role of communication in sustainable tourism e-conference [2] from June 2006, organized by World Bank, World Tourism Organization and supporting institutions opened a healthy dialogue in which new topics were introduced. An improved communication for sustainable development in the tourism industry is highlighted as tour operators and travelers complain about the lack of transparency from the ground. An award for national tourism board websites as a useful and cost-effective tool for communication was proposed in order to illustrate sustainable tourism practices. National tourism portals could be reviewed in order to provide information that prompts greater understanding of the place and motivates a trip.

Investors and travelers should have access to timely information on governmental and non-governmental organizations, trade associations, community groups, local tourism businesses, development banks, environmental agencies or tourism offices, including updates on disasters. The proposal was that they could be rated not only by what they have online, but also by what they can participate in independent ecotourism groups. Dialogues need lively public forums, online and in the natural world. The lack of communication generates risks in project implementation. If the information is public from contract bidding to field research, such initiative leads to a greater chance of success. Information should be reliable and consistent. Ideas should be shared in an interactive manner and conferences, bulletin boards or informal conversations hold the keys to

spreading the content. There is also a trend towards decentralizing communication and allowing people with a common interest to discuss the issues on their own terms. The results are a frank discussion and an exciting proposal for follow-up work. Anyway, investment in travel writing ought to be a priority.

Despite its successful outcomes, ecotourism has also failures. The travelling public was insufficiently targeted in the green travel declarations. Many official ecotourism events are not particularly eco. Although there is a great deal of discussion around certifying destinations, there has been little attention given to the environmental impact of transportation. Financing remains elusive for communities as well as entrepreneurs and there are no clear indications of how ecotourism projects and services will be funded in the future. Travellers are generally ill-informed by government and by tourism board propaganda, while governments continue to regulate ecotourism in a manner that does not provide incentives. Entrepreneurs and environmentalists complain that it takes a long time to teach government officials the basics of ecotourism and that social organizations are uncertain of whether to promote ecotourism as a development or as a conservation strategy. Ecotourism promoters often have difficulties in having their voice heard by national or regional ecotourism advisory councils and ecotourism associations have a poor record of listening to their members. On the other hand, tourism policy is rarely interesting for the traveller.

Many problems come from the complexities of ecotourism regulation, product development and marketing. Participants to various summits questioned whether travel could be considered a sustainable activity because of basic environmental impacts associated with the use of motor vehicles and aircrafts.

Sustainable tourism is not the same as ecotourism. Ecotourism is a form of tourism involving visiting usually protected areas. It is intended to be a low-impact and often small scale alternative to standard mass tourism. Its purpose is to educate the traveler, to provide funds for ecological conservation, to directly help the economic development and the political empowerment of the local

communities or to provide respect for different cultures and for human rights.

#### **4. Responsible Tourism**

The 2002 Cape Town Declaration on Responsible Tourism in Destinations [3] defines responsible tourism as the market trend in which any tourism business maximizes local economic benefit, and simultaneously provides more enjoyable experiences for tourists by means of a greater understanding of environmental integrity and cultural diversity.

Focusing in particular on businesses, responsible tourism refers to destination management strategies and to the implementation of the guiding principles for economic, social and environmental responsibility. It requires regulations, incentives, supportive policy frameworks and adequate funding, on which authorities, business and local community cooperate in destinations. Responsible tourism is regarded as a behavior. It is more than a form of tourism. It represents an approach to engaging with tourism. It emphasizes that all stakeholders are responsible for the kind of tourism they develop or engage in. Different groups will see responsibility in different ways and what is considered responsible may differ depending on originating markets and destinations.

Economic responsibility means reducing social or economic inequalities, reducing poverty and providing economic development to the less developed countries. Investors should have corporate social responsibility, should assess the economic impact on local livelihood and the local people's lack of access to resources or should adopt equitable business practices. If fair prices are paid and charged, the risk is thus minimized and shared. Investors should recruit and employ staff by recognizing the international labor standards, the responsibility and the market advantage that can go with it. By reporting the progress transparently, by achieving responsible tourism targets in emerging tourism destinations, by adopting a responsible approach and by committing to specific responsible practices in originating markets, corporate businesses can assist and provide small tourism-related enterprises with

capacity building or with mentoring and micro-financing support.

Environmental responsibility involves environmental initiative against planet panic, global warming and the earth's crisis. It promotes education and awareness for biological diversity or the sustainable use of the resources. It reduces waste, over-consumption and carbon emissions. Managers should take into account wildlife issues, vulnerable ecosystems and protected areas, should deal with natural diversity and should consider the volume or the type of tourism the environment can support.

Social responsibility makes reference to the access for disadvantaged communities and individuals and combats sexual exploitation of human beings or the erosion of lifestyles, for reasons of social diversity.

Destinations and tourism operations are following responsible tourism as a pathway towards sustainable tourism. Responsible tourism and sustainable tourism have an identical goal, that of sustainable development. The pillars of responsible tourism are therefore the same as those of sustainable tourism, namely environmental integrity, social justice and economic development. The major difference between the two is that, in responsible tourism, individuals, organizations and businesses are asked to take responsibility for their actions and for the impacts of their actions. This shift in emphasis takes into account the insufficient progress towards realizing sustainable tourism. This is partly because everyone expects others to behave in a sustainable manner. The accent on responsibility in responsible tourism means that everyone involved in tourism, namely government, product owners, transport operators, community services, tourists, local communities or industry associations should achieve the goals of responsible tourism.

#### **5. Conclusion**

The world has paid a lot for ignoring the well-known economic risks of the financial system. On the other hand, many other global risks such as economic disequilibriums, climate changes and the information gap may appear. This is why responsible tourism is important for the progress of the world economy. It encourages tourism activities

meant to offer better quality services for visitors to a destination and fights for several global economic causes such as employment creation, foreign currency earnings, education, health or the environment conservation.

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## Globalization, Entrepreneurship and Small Business

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### Abstract

*New product innovation often comes from small business. Most the radical inventions of the last century, such as the computer, come from small companies, not large ones. And this will not change.*

*Globalization will continue to modify and mold the environment of small business and entrepreneurship. The competition from abroad places strong pressure on small business in terms of efficiency, price, quality, cost, control, marketing, expertise, customer satisfaction and innovativeness.*

*Globalization is an unstoppable phenomenon, presenting opportunities to those who are prepared and threats to those who are not.*

**Key words:** small business, globalization, entrepreneurship, innovation.

**J.E.L. classification:** M19

### 1. Globalization and entrepreneurship

For many small business, going global is no longer just an interesting to do – it is essential to the long – term health and performance of the company.

We start with a descriptive overview of the relationship between globalization and entrepreneurship.

Globalization has begun to dismantle the barriers that traditionally segregated local barriers opportunities and local firma from their international counterparts. Local markets are becoming integral parts of broader, global markets. Consequently, internationally oriented entrepreneurs can now view a much broader range of opportunities and competitive modes, unrestricted by national boundaries. In this integrating global environment, entrepreneurs and emerging business face both new opportunities and formidable new challenges.

As a concept, globalization is generally perceived to include a variety of inward and outward aspects of economic activity, including the following:[1]

- the knowledge and flexibility that allows movement across national borders;
- the ability to take advantage of opportunities anywhere in the world;
- the capacity to move capital and source/distribute products/services in other countries;
- a commitment to transnational management of factors of production;
- the capability to market/or adapt a portofolio of products/ services to specific markets successfully;
- the ability to be simultaneously active in a number of independent business and/or be members of strategic alliances in other countries.

In today’s business environment, most of an organization’s activities are becoming global in nature. Firms across the world have recognized that globalization is a reality that creates unlimited opportunities while intensifying competition and threats. The four characteristics of globalization are increasing worldwide interconnections, rapid discontinuous change, and increased number and diversity of participants in business and other activities, and growing complexity.

Growing interconnections brought about by the globalization process require that both managers and organizations expand on traditional repertoires of roles. As national economies, political systems, cultures, technologies, resources, and industries increasingly converge – perhaps to meld, perhaps to take shape in new forms – global management skills and abilities become more important to all organizations. These skills will be diverse.

Traditional knowledge and skills remain important. Yet global managers can better respond to global demands by learning continuously managing diversity, and

developing a global mindset. This encourages managers to think “outside the box” of tradition. For the individual manager, the task is to prepare for projects, jobs and careers in a future where direction is unclear. This requires that many learn to live with ambiguity. For organizational leaders as well, the challenge is to manage tradition and chance. Global firms may mix and match traditional principles with newly developed ones that borrow best practices world wide.

Globalization will continue to modify and mold the environment for small business and entrepreneurship. The competition from abroad places strong pressure on small business in terms of efficiency, price, quality, cost, control, marketing, expertise, customer satisfaction and innovativeness.

The globalization of economy is growing faster and faster at all economy, require business to produce high competitive products and entrepreneurs who are basically small business, have large potential to produce competitive products.

Entrepreneurship is the process by which individuals, teams, or organizations identify and pursue entrepreneurial opportunities without being immediately constrained by the resources they currently control. Entrepreneurial opportunities are conditions in which new goods or services can satisfy a need in the market. Entrepreneurial opportunities came in many forms such as the chance to develop and sell a new product and the chance to sell an existing product in a new market.

International entrepreneurship is a process in which firms creatively discovers and exploit opportunities that are outside their domestic markets in order to develop a competitive advantage.

## **2. Small business created by young entrepreneurs: a solution to the crisis?**

The globalization of the small enterprise will most likely be the most important development in international business as we begin the new millennium. Most the radical inventions of the last century, such as the computer, come from small companies, not large ones. And this will not change

It is widely aged that small enterprises are the backbone of modern market economies, thus play an important role particularly in

developing countries. Some advantage of small business are:[2]

- Flexibility. The small firm can easily adjust to even the most dynamic changes in the market. As they change they even improve their profit pictures.
- Small volumes are all that is needed. Small and efficient entrepreneurship will reach out to remote and scattered markets. But since they are efficient, entrepreneurs can survive easily under such circumstances.
- Understanding their markets well. Small entrepreneurs are almost an extension of the existing third – world markets. They are sensitive to and aware of the new developments in their markets, and they respond well.
- Efficiency. Unlike their global gigantic counterparts, entrepreneurs are efficient and are low – cost operations. That enables them to succeed under trying conditions that prevail in the small markets of the world.
- Speedy decision making. Almost by definition, one of the greatest advantages of entrepreneurial cultures is that these enterprises can make decisions very quickly and implement the action oriented critical decisions almost immediately. The poorer markets of the world have urgent needs, and such speedy actions are very appropriate.
- Innovativeness. As Drucker (1985) posited, entrepreneurs are very good at converting bright ideas into organized business activities. They generate and cultivate innovation in society.

The globalization of economic activity has a dual impact of small business. For some, it provides new opportunities for expansion and growth by taking advantage of international market potential. For the majority, however, growing economic globalization is increasing the competition with foreign enterprises and it is an inward process that brings competitive challenges and threats. For those small business, globalization bring risks that they unlikely survive in their present form, without improving quality, cost competitiveness and management practices.

Entrepreneurs who are basically small businesses, is the most important player in the building of the globalization, and have

large potential to produce competitive products. Because they have power, wish, to do innovation, desire to accept personal responsibility to create an event by their way, and wish to get high achievements.

In Romanian economy, the transformation that started in the 1990s has changed the market economy, caused a transition of national economy into market oriented one. The transformations had a significant impact on a reform in the labor market and it mostly affected the young people. The development of entrepreneurial talent is important to sustain a competitive advantage in a global economy that is catalyzed by innovation.

Becoming owner of a micro or small enterprise could be an alternative for a young person who has an entrepreneurial mindset. Identifying and nurturing entrepreneurial potential among youth can have long term implications for Romanian economic development.

Young people are a great resource for the development of the society but their potential is not fully exploited because of the labor market inefficiency. Youth entrepreneurship varies according to the age.[3]

*Pre – entrepreneurs* (ages between 15 to19): This is the formative stage. These young people are often in transition from the security of the home or education to the workplace.

*Budding entrepreneurs* (ages between 20 to 25): This is the growth age. These young people are likely to have gained some experience, skills and capital to enable them to run their own enterprises. They often follow one of the enterprise pathways: remaining stuck in marginal activities; going out of business; running successful enterprises.

*Emerging entrepreneurs* (ages between 26 to 29): This is the prime stage. With valuable experiences in business, emerging entrepreneurs have a higher level of maturity than the young people in the lower age groups. Hence, they are more likely to run more viable enterprises than younger people.

The reason for the importance of promoting youth entrepreneurship:[4]

- creating employment opportunities for self – employed youth as well as the other young people they employ;
- bringing alienated and marginalized youth back into the economic mainstream and

giving them a sense of meaning and belonging;

- helping address some of the socio – psychological problems and delinquency that arises from joblessness;
- helping youth develop new skills and experiences that can then be applied to other challenges in life;
- promoting innovation and resilience in youth;
- capitalizing on the fact that young entrepreneurs may be particularly responsive to new economic opportunities and trends

This paper analyzes the necessity of applying the contemporary concept of entrepreneurship to the Romanian market, with a special emphasis on the role of the young people. To accomplish the objective of this study, comprehensive desk research was combined with consultation of young people. A questionnaire was designed to analyze the attitudes of young people when starting their own business. The population of this study involved students from the “Vasile Alecsandri” University of Bacau. A total of 120 students were targeted for this study. All the students involved were in their final year of studies.

The results of the survey showed that most of the students (82,46 percent ) would like to start their own business at some time in the future. The most commonly started motivation for starting a business was “to be your own boss”. Some claimed that they disliked “being told what to do” or felt that they were not good at taking orders from others. Participants have perceived that owning their own business would provide them with independence, freedom and flexibility, giving one the freedom to make decisions about their salary, working hours and location, their career and the direction of their business. Being your own boss was seen to allow someone to be self-reliant and in control. Apart from the personal rewards, an equally common reason cited for starting a business was reaping financial rewards. Many believed that owning their own business was the easiest or the most guaranteed or the sole way of making lots of money. A few have said they felt exploited working for others and wished to receive the direct benefits from profits they generate.

Over two thirds of those surveyed (68,4 percent) felt they have the practical skills needed to start a business of their own and most of the rest felt that they could acquire these skills. The perceived importance of “accepting the possibility of loss in order to have a chance of succeeding” was high, although relative to several other characteristics the risk taking was seen as less critical to the success of an entrepreneur. Generally the respondents rated themselves low, relative to entrepreneurs, on their attributes.

In 74,36 percent of cases the most important reason given by students for not starting their own business was the lack of the right idea. The surveyed students indicated that they are mostly deficient in the foreign languages (32,64 percent) considered to be the basics of entrepreneurship skills for small business (26,12 percent) and international transactions (18,64 percent).

The biggest obstacles to starting their own business as indicated by surveyed students are:

- an unstable political and economical situation (46,34 percent)
- long and complicated registration procedures (18,24 percent)
- excessive taxes (12,4 percent).

### 3. Conclusions

In today’s rapidly evolving and globalizing societies and economies, education must foster entrepreneurial cultures and attitudes and provide the necessary tools. This study has shown that students today need courses and programs that lay down a basic framework for understanding the concept of entrepreneurship. Introducing a structure for supporting and encouraging entrepreneurship education and designed to stimulate and facilitate entrepreneurial activities could result in a lower unemployment rate, increased establishment of new companies and fewer failures of existing businesses.

By cultivating the youth entrepreneurship aptitudes, the young people are also taught to be responsible, enterprising individuals who may become future entrepreneurs or entrepreneurial thinkers and will make their contribution to the economic progress and increase of sustainable communities. Young

people can no longer expect to find the traditional “job -for - life” careers but rather “portfolio careers”(contract employment, freelancing, periods of self – employment).

Entrepreneurship education for students must focused on developing student’s skills to start their own ventures, or a more enterprising attitude to different situations:[5]

- developing more creative, innovative approaches to learning, school work and the school community;
- developing in students the self – esteem, confidence and positive attitudes necessary for consideration of entrepreneurship or self – employment as a viable career option;
- developing in students the attitudes, skills and behaviors to succeed in work – force entry and career progression;
- developing in students the positive attitudes, skills and behaviors needed for integration into the community and participation in its development;

Globalization is an unstoppable phenomenon, presenting opportunities to those who are prepared and threats to those who are not. Globalization will continue to modify and mold the environment or small business and entrepreneurship

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# Being Global: How to Manage Human Resource in the 21<sup>st</sup> Century

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## Abstract

*Markets are global and competitive and the numbers of companies doing business abroad increases every day. Today, the success of individuals and organizations are measured by their adaptability to change. So does the need for international Human Resource Management.*

*The world needs a corps of global leaders who can take on the pressing challenges and contribute to an inclusive and sustainable economic system.*

*The new leaders for the new global environment will have the ability to continuously change themselves without changing their values and virtues.*

**Key words:** human resource, global leaders, global teams, global mindset.

**J.E.L. classification:** M19

## 1. Managing the human resource in the 21<sup>st</sup> century

Organizations depend on people. Organizations do what people do. An organization behaves the way its employees behave, the way its managers direct it.

Today we are living in an age of intensive global interdependence, one where the old way of seeing the world as a predictable, independent mechanism no longer fits. Building on the new quantum physics of the twentieth century, a new model must emerge where the whole organizes and even partly defines the parts. Within organizations, the new framework requires that we pay attention to the relationship between people, to the validity of each person’s unique reality and to the multiple creative possibilities that exists at any moment in time.

The importance of people as vital assets is largely overlooked today. Today, managing human resource effectively is more important

than ever. Managing human resource effectively requires understanding all of the human resource policies and practices that make up an organization’s human resource management systems as well as the interconnections that link the parts of that system together. Because managing people effectively is rather complex, it requires cooperation among human resource professionals, line managers, and all other employees.[1]

Dealing with people is probably the most difficult thing we will ever encounter in life. People are very complex creatures. Not a single person thinks, feels, sees, understands and behaves the same way. We all come from different cultural, national, religious, ethnic and political backgrounds. This makes each and every one of us unique with different set of morals, beliefs and values. This complexity and variety also reflects on our everyday work lives. People’s characteristics values and beliefs form attitudes and behaviors that strongly influence their choice of employment.

Management cannot simply set certain policies and procedures in place and then sit back and watch the days go by. Managers need to put in the time and the effort it takes to deal with the complexities of employees. Internally, managers need to respond to a very diverse work force and variety of business models for various different business units. Externally, things can be worse for managers where the complexity, variety and diversity is even higher in customer needs, cultural values, government regulations.

In addition, organizations have to deal with interdependence. The less rigid organizational borders are, the easier it gets for the organization to take advantage of globalization. This also means, that organizations are more and more exposed to the effects of problems around the globe, such as the recent economic crisis.

Today, the success of individuals and organizations are measured by their adaptability to change. Organizations have abandoned the traditional thinking of what work is and how people should work. Employment now means have more than having a job. It is not just something and individuals does, but a combination of shared responsibilities and individual.

Leaders see human resources assets that need to be managed conscientiously and in tune with their organizations' needs. Today's most competitive organizations are working to ensure that – now and a decade from now – they have employees who are eager and able to address competitive challenges. Increasingly, this means attracting and retaining superior talent and stimulating employees to perform at peak levels.[2]

## 2. Global teams

Many managers now believe that improving the teamwork process in their organization is essential for ensuring their organization's success. Using team-based organizational structures, employers hope to achieve outcomes that could not be achieved by individuals working in isolation. But the payoff from teams isn't automatic. To create and orchestrate teams, people need to be selected, appraised, compensated and trained in ways that reflect the unique relationships that develop between employees who work together.

As a result of the increasingly global business environment, many companies are building teams that cross-national borders and/or include members from different countries of origin. Individuals from different racial and ethnic backgrounds will need to work together in a local workplace, a multinational corporation or an international organization.

Global teams are cross – border work group made up of multiskilled, multinational members whose activities span multiple countries. Managers and members of global teams are faced with the challenge of how to access and utilize individual member's strengths, while at the same time minimizing coordination losses from communication problems, language differences, varying work styles, and misunderstandings. The challenge in managing global teams

effectively is to recognize underlying cultural causes of conflict, and to intervene in ways that both get the team back on track and empower its members to deal with future challenges themselves.

The most advantages and competitive use of global teams involves simultaneous contributions in three strategic areas:

- First, global teams help companies address the differentiation challenge, enabling them to be more locally responsive by providing knowledge to meet the needs of different regional markets, consumer preferences and political and legal systems.
- At the same time, teams provide integration benefits, helping organizations achieve global efficiencies by developing regional or worldwide cost advantages and standardizing designs and operations across countries.
- Finally, these teams contribute to continuous organizational learning, knowledge transfer and adaptation on global level.

Typically, teams are of two types: intercultural teams, whose members come from different countries, and meet face to face, and virtual global teams, whose members remain in separate locations around the world and conduct their work electronically.

There are four key design techniques that help create a supportive environment for global teams: clearly specify the task objective and align it with organizational strategic initiatives; make appropriate resources available; select team members who have the skills, abilities and experience to work in a global team, including the team leader if appropriate; and create a sense of urgency.

It is important to establish a clear task objective and to align the objective with organizational initiatives, whether those initiatives are tied to global efficiency, local responsiveness or organizational learning or knowledge creation. If team members do not know how their task fits with overall objectives as well as with their own priorities, it will be more difficult for them to commit and hence, to participate fully in the team's task. The more clearly and specifically managers can define the task, the greater the likelihood that teams with short

life cycles and urgent deadlines meet with success.

Global teams are embedded not just in one, but in many contexts that may possess quite different systems of organizational support, including budgets, work processes, human resource policies and support people, such as facilitators, administrative support, and information technology tools and facilities. Incompatible or insufficient resources are a major source of complexity and frustration for global team collaboration.

Global team members need to be adept at working with task uncertainty, member diversity, and a variety of team situations. Team members too often are selected based only upon professional expertise or job roles alone, or upon their availability to do the technical work. Research indicates that employees tend to be more comfortable and effective in a global teaming situation if they are capable of performing the core tasks for their roles, are self-disciplined and goal-directed, are flexible, collaborative and willing to share and exchange information, and remain open to feedback.

Global team members should be perceptive and receptive to differences in people and culture, ways of thinking, and alternative approaches to processes. They need to be capable of handling the uncertainty. They should also be committed and connected to the business and competent in using technology required for their roles. These skills, while desirable in many work settings in multinational corporations, are particularly crucial to the viability of global teamwork.

Teams can fail when they are unable to cultivate trust among their members or when they cannot break down often – formidable communication barriers. Trust is critical to the success of global business teams in that it encourages cooperation and minimizes unproductive conflict. Each member of a global team brings a unique cognitive lens to the group. If harnessed effectively, the resulting diversity can yield significant synergies and produce a collective wisdom superior to that of any individual. Without mutual trust, however, team members may shy away from revealing their true benefits. The absence of trust is likely to turn a team’s diversity into a liability rather than an asset.

Communication barriers resulting from differences in geography, language and culture also can sabotage global business teams. With members living in different countries, separated by time zones and conflict schedules, arranging team meeting can pose logistical challenges. Undoubtedly, technology (e-mail, teleconferencing, videoconferencing) can enable members to work together despite geographical distance: but technology should be viewed as a complement to, not as a substitute for, team meetings. Face – to face meetings foster familiarity and trust – not easily established virtual meetings. When members cannot see one another’s body language and direct experience one another’s reactions, the emotional dimension critical to a team’s success suffers.

Members of global business teams typically come from diverse cultures and, as a result, may bring different values, norms, assumption and patterns of behavior individualistic and collectivistic cultural norm for decision

### **3. Global leaders for the 21<sup>st</sup> century**

New times demand new kinds of leaders. The global world of the twenty-first century will require new world class leaders: leaders with a unique combination of attributes and personal characteristics. The new leaders for the new global environment will have the ability to continuously change themselves without changing their values and virtues.

Real global leaders are a new breed with identifiable traits. They have a natural curiosity about the world that leads to relationships with people very different from themselves. From these relationships come insights and innovations that span national and cultural boundaries. While driven to enhance their own prosperity, real global leaders also recognize the impacts of their actions on communities and the planet, and the fact that their personal prosperity is interdependent and shared with the prosperity of others.

To be an effectively leader in the twenty–first century one will need to possess the following key attributes:[3]

- an ability to develop and convey a shared vision;
- a service/servant orientation;

- commitment to risk – taking and continuous innovation;
- a global mindset;
- comfort and confidence with technology;
- competence in systems thinking;
- recognition of the importance of ethics and spirituality in the workplace;
- a model of lifelong learning.

A key leadership attribute of twenty-first century leaders will be the ability to see the world and the workplace with a global mindset. Global mindset can be defined as the ability to perceive and decode behaviors and situations in various cultural contexts. Global mindset is thus the capacity to appreciate the differences among cultures and bridge the interfaces between them. Leaders who possess a global mindset are able to view situations from a variety of perspectives, develop trusting relationships with individuals from different contexts and identify promising routes to successful collaboration.

Global mindset is critical for success as a global leader, but its true benefit comes when global leaders act as global entrepreneurs and leverage mindset for value. Global leaders use their global understanding and connections to identify the opportunities among cultures and regions and turn them into new value-creating operations.

Effective leadership mind the twenty-first century will require the ability to be a systems thinker. Systems thinkers have the ability to see connections between issues, events and data points, to see the whole rather than just its parts. Systems thinking requires the ability to frame structural relationship that result in dynamic networks as opposed to strait patterned interactions or relationship predicated on one's position in the hierarchy.[4]

A twenty-first century leader must think in terms of whole systems, seeing the business as part of a wider environment. This new leaders views business opportunities not simply from the perspective of a solo player, but as one player among many, each coevolving with the others. This attitude is sharply different from the conventional idea of competition, in which companies work only with their own resources and do not extend themselves by capitalizing on the capabilities of others. In the global market,

global leaders wants to make use of the other players – for capacity, innovation and capital.

Twenty-first century leaders must be willing to take risks. And not only should they themselves be creative, they should encourage and reward creativity around them. New leaders must be truly open to the wide range of perspectives and possibilities essential to identify trends and to generate choices.

The big problems we face are global. The financial crisis, climate change, poverty and corruption all require leaders who can understand people different than themselves, forge cross-boundary solutions and foster value creation that is broadly shared.

#### 4. Conclusion

International business success is depend upon the leader's understanding of the global landscape and the ability to rapidly adapt to the changes that impact the business environment. Leaders of domestic organizations as well as those of global companies must handle issue of globalization such as competition, mergers and acquisitions, dissolving borders and cultural diversity. Therefore, the great challenge for the new generation of leaders will be to gain direct knowledge and real experience in a wide variety of geographical areas and to build and articulate a clear vision, even as both the workforce and clientele become increasingly diverse.

We frequently talk about *changing society*, but society has always been changing. Today change seems to have become an intrusive concept, possibly because change occurs at a much faster pace than before, and the consequences are much extensive.

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# New Approaches on Management Systems Audit

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## Abstract

*The practice of management systems implementation became a large practice in the latest decade for all type of organizations. The trends moved from the known quality management to many other fields such as the environment, health and safety, food safety, social responsibility and others.*

*Most of the audits of systems developed in compliance with ISO standards were organized and performed guided by ISO 19011 standard [1]. The evolution of practices lead to the revision of this set of guidelines and last year ISO launched a new edition.*

*This paper presents in brief some challenges faced by auditors during the management systems audit and the elements revised in their practice according to latest requirements.*

**Cuvinte cheie:** audit, management system, ISO 19011

**Clasificare J.E.L.:** M19, M42

## 1. Introduction

Defined as a systematic process of objectively collecting and evaluating evidence in order to confirm or not the compliance with defined criteria (i.e. a reference standard such as ISO 9001 for quality management systems), the audit it is a broadly used practice [2].

The need to extend the good management practices and to have a common approach lead to implementation on a large scale of the requirements defined by specific ISO standards or other similar set of rules. The most popular standard proved to be ISO 9001 (more than one million organizations were certificated up to the end of 2009), but other

standards like ISO 14001 became also a good reference for management system implementation [3].

All standards and similar set of rules related to management systems require to plan and perform an internal audit and the need for recognition of the results of implementation confirmed by an independent party lead to the external audits.

The auditing practices are different taking into account the large fields this process is required, but for the management systems the most known set of guidelines is provided by ISO 19011 developed for the audit of quality and environmental management systems [4].

The first edition of ISO 19011 was approved in 2002 and cancels and replaces the other standards addressing the audit of management systems provided by ISO for these fields.

Following the practice to revise periodically the management system standards ISO approved last year a new edition of ISO 19011 providing updates able to answer to actual specific of management system audits.

This new edition extended the set of audit principles, introduced the concept of risk in audit, improved the guidance on audit planning and performing and provided clarifications on auditor competences.

The changes of the auditing guidelines were made based on the feedback provided by third party auditors involved in management systems audits and proved that the actual practices are well established and mature [5].

## 2. Audit principles

The guidelines provided by ISO 19011 are grouped in 7 chapters, the audit process planning and performance being addressed in the 5<sup>th</sup> and 6<sup>th</sup> chapters, following the known Deming approach (plan-do-check-act) [2].

After the presentation of scope, normative references and definition of specific terms the

guidelines includes a number of six principles able to assure that the audit is an effective and reliable tool[1]:

- Ethical conduct;
- Fair presentation;
- Due professional care;
- Independence;
- Evidence-based approach;
- Confidentiality.

Previous edition included first five principles only, but a new one was introduced: “*confidentiality – security of information*”.

Even if a clause of confidentiality is a part of almost all auditing contracts and the good practices imposed to have a clear declaration of confidentiality from the auditors in each audit opening meeting, ISO considered as appropriate to extend the set of auditing principles emphasizing the importance that the auditors will be prudent in the use and protection of information acquired in the course of audit performance [5].

### 3. Audit planning

Preparation and planning the audit activities are the first activities initiated by an organization when decided to perform an audit.

At this stage taking into consideration the audit objectives and criteria the auditing team should establish steps related to development, monitoring and improvement of an appropriate audit programme, as well as the needed resources to achieve the audit goals.

When decide to perform an audit each organization considers the requirements defined by the regulations, stakeholders, reference standard and own management system documents.

The risks associated to specific activities performed by the organization should provide an important input in the audit planning.

The orientation to risk-based audit it is another important change provided by the actual practices in the management systems audit.

During the development of audit programme the lead auditor should prove a proper understanding of using the remote audit in such a way that the results of the audit process will be not negatively affected.

Current market environment increased the focus on the audit efficiency and effectiveness asking from the professionals in the audit field the capability to select and perform with good results remote activities based on available communication facilities.

The extent of the audit programme is given by the specific of the organization taking into consideration the nature of business, size and other relevant issues.

For the use of organizations providing conformity assessment services in the field of quality and environmental management systems, such as certification bodies, International Accreditation Forum established requirements related to the duration of audit duration.

For example both stages of an environmental management system audit performed in a company with 126-175 employees operating in oil and gas extraction, due to high complexity environmental aspects, should be covered within 12 man/days [6].

The latest edition of ISO 19011 intended to show a flexibly in audit planning according to the size, maturity level and complexity of the audited organization.

At the stage of audit planning the responsibilities are assigned to one or more auditors and appropriate resources are allocated.

All the above presented steps must be well established in a documented procedure together with all necessary details related to the performing of audit activities and keeping of appropriate records.

Such records will provide objective evidences for the formulation of audit findings, including the conclusion related to the compliance with the established criteria.

The audit procedure should have annexed the forms to be used for records. Such records may be:

- Audit plan / programme;
- Audit Report;
- Nonconformity report;
- Corrective or preventive action report
- Etc.

The 2011 revision of standard provides a clear guidance on managing audit programme process flow.

#### 4. Audit activities

Actual practices related to management systems audit provided by third party organizations includes two stages and most of the time both are performed on site.

The first audit stage is focused on collecting and analysis of general data about organization, main documentation and results of system processes such as internal audit and management review.

The new edition of audit guidelines increased the role of internal audit in the evidences proving that the management system requirements are effectively followed.

The second audit stage is focused more on specific operational processes and on identifying on site appropriate evidences related to implementation of management system defined requirements.

The management systems developed by most of the organizations already covers more than one standardized field (quality, environment, health and safety, food safety, energy management, information security, risk, ship and marine technology) and that is why auditors should be ready to perform the audit activities according to the level of integration of implemented systems.

The processes addressed by management system integration include:

- Policy and objectives;
- Management representative;
- Control of documents and records;
- Internal audit;
- Control of nonconformities;
- Corrective and preventive actions;
- Management review.

The stages performed on site begin with an opening meeting when the main issues of the audit are discussed by auditing team with the audited representatives.

Based on effective communication the lead auditor clarifies at the opening meeting all specific data related the audited organization.

Following the process flow described by the ISO 19011 standard the auditor collect evidences make comparative analysis with the requirements and establish the level of compliance.

The audit is based on interview, direct observation and document review. When a

deficiency is found adequate corrective action is initiated.

Professional auditors' challenges are given by auditing of processes with particularities such as:

- Statutory and regulatory requirements;
- Effectiveness of internal audit;
- Continual improvement.

New electronic based systems leads to practices like collection of data in electronic format with better results in using time for keeping records and preparing and reporting audit findings.

The actual key elements in performing the audit activities provided by the new guidelines are related to:

- Risk-based approaches;
- E-auditing;
- Integrated auditing.

The audit ends with a meeting when the audit team communicate the conclusion of the audit based on collated results received from the involved auditors.

#### 5. Auditor competencies

The complexity of the audited systems and the increasing of number of integrated management systems generated some changes in the last chapter of ISO 19011 standard where the appropriate competencies for auditors are described.

Annex A provides examples of discipline-specific knowledge and skills of auditors and Annex B includes additional guidance for auditors planning and conducting audits.

It is clear that the selection process for an effective team should focus on auditors with multidisciplinary competencies.

The emphasizing of “auditor attributes” and better description of competence evaluation criteria are another two issues addressed by changes in the auditing guidelines.

The trend to use auditors with competencies related to more than one reference standard is confirmed today by auditors' training providers.

They are organizing very often sessions where the future auditors are trained for integrated systems.

This approach proved to be appropriate in order to provide assistance in better identification of processes cu

multidisciplinary characteristics and use of audit tools effectively covering in the same time the requirements of all reference standards.

## 6. Impact of audit process

The role of management system audits is more that clear for all organizations which decided to implement the requirements of a standard related to this field.

It is maybe the moment to take into account the need of movement from the main goal given by the measurement of compliance level towards consideration audit as an added value process.

The performance of auditors may have as one of the indicators the number of recommendations based on audit findings.

Such recommendations are oriented to transform, when is the case, the management system documentation from a bureaucratic set of procedures and large quantity of records in one realistic and in line with the business needs.

The certification audit team may become useful by [7]:

- Providing information to top management regarding the ability of organization to meet strategic objectives;
- Identifying problems which, if resolved, will enhance the organization's
- Performance;
- Identifying improvement opportunities and possible areas of risk.

Anyhow the provision of recommendations should be realised having in view the important focus on confidentiality.

Should be assured, for example, that a solution developed by a competitor and observed in an previous audit will not be suggested as an improvement solution to the audited organization.

## 7. Conclusions

The new edition of ISO 19011 standard provides updated references in order to provide effective audits for management systems.

Main changes in the auditing standard are related to capability to audit integrated systems in a risk-based approach and taking into consideration all current practices and

opportunities given by communication technologies.

The auditors are required to improve own competencies in order to answer to the new challenges, being able to use new techniques and to follow in the same time the requirements of more that one reference standard.

It is recognized the fact that due to general economic environment a large number of companies decided to not continue certification of own implemented management systems.

This decision is met often in organizations which fished more than two certification periods.

To recover the interest for third party audits the certification bodies should orient the audit process to the added value that may be provided be the auditors, having direct impact in business development.

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## Strategic Quality –the Main Means

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### Abstract

*This paper aims to underline the role and importance of a quite recent issue for managers and marketing responsables, in fact, the strategic quality, analysed at both objective and the client level. The study propose the identification of the main possible vectors of the strategic quality and to structure several ways to manage the issue. The perception of the quality ,in general, could be influenced by the distribution system, type of products or market position and therefore, the strategic quality could be quite different like nature compared with the industrial quality. Strategic quality based on the industrial quality from the fuctional point of view and require specific means to be managed.*

**Keywords:** quality, strategy, client, needs

**JEL Classification:** M10, M11, M19, M21

### Introduction

The strategic feature of the Total Quality represent at the moment a present and permanent concern of the main part of managers, due to its double character: both objective ( the performance point of view) and subjective ( the client point of view). The daily practice still demonstrate the existence of a gap between the requirements of the Total Quality philosophy and the ordinary quality assurance control. That`s why managers should understand the special nature of the strategic quality concept and to learn to apply it in the current activity.

### The strategic quality objectives

It is obviously that the management strategies doesn`t allways take into account the marketing point of view in order to correlate the level of quality performance with the the client needs. The perfect identification of the market requirements could be a loss of time and ressources if the answer in terms of quality will not touch the customer`s needs.

We could assign four main dimensions to the strategic quality:

- The product quality
- The quality of „total product”
- The enterprise quality and
- The chain quality[ 5]

The product quality is to be analysed at two levels: the objective one and at the quality level perceived by the client. This dimension of quality has a cost but also generate measurables savings and position (quite difficult to be measured). Paradoxically, in practice, the objective quality is the most difficult to be appreciate from the client point of view. Therefore, quality represent what the client really expect ,not what answer to the technical demands of the producer or provider. A logically start for a good quality policy base on the deep study of the client expectations.

The quality of „total product”, concept developed by T. Levitt in the `80 th, leads to distinguish four hypostasis in the product definition: [5]

- Generic product-the material product and its commercial environment;
- Expected product-the extension concerning services provided together with the product;
- Expanded product-integration of

additional material components or new services;

- Potential product-translation of the unexpected, additional features or uses.

A careful consideration suggests to reverse the approach of reflection about quality and to pay more attention to the specific factors of the potential and expanded products, in order to lead in practice to an extension of the client service and to give an alternative to the eternal position based on the price or the quality of the generic product. It is very important to perceive that the cost of that additional quality factor is in generally lower than their impact.

At the stage of enterprise quality the contractor has to impose itself (corporate identity) in parallel with its products and that is a very important strategic imperative. At this point, the contractor must answer at a very difficult question: what is the company specific? This point of view requires a survey of consumers in order to establish the real specificity perceived and to develop the enterprise quality.

Every company depends on an assembly of providers upstream and intermediate clients downstream in order to manage its business. The chain quality will depend consequently on the establishment of closed relationships with the different partners. It will be founded on both classical quality procedures and cooperation forms (assistance) in which clients will help the partner to progress in quality. [5]

### **Landmarks and means of the strategic quality**

Strategic quality based on the industrial quality from the functional point of view and require specific means to be managed.

The perception of the quality, in general, could be influenced by the distribution system, type of products or market position and therefore, the strategic quality could be quite different like nature compared with the industrial quality. Marketing studies demonstrate with many examples this point of view. All these shows that the strategic quality is of a very different nature compared with the quality perceived by the producer or provider. That's why it is very important to identify the possible vectors of the strategic

quality. The strategic management of a company usually pay attention to several landmarks to be followed :[6]

- The factors of excellence;
- The factors of total quality perceived by the contractor;
- The total quality and coherence.

The factors of excellence-Peters and Waterman talk about five principles of "chaos management" which make difficult the link with the traditional managerial approach, but anyway, the global quality sign up in the strategic approach. [5]

The factors of total quality perceived by the contractor-H. Lesca [5] proposed a more scientific approach, using eight factors concerning the capacity of the enterprise to improve the total quality:

- staff motivation
- professional competence
- ability to perceive the external environment and to predict future
- reaction speed of the enterprise
- innovation capacity
- effectiveness of communication and information flow
- tasks parcels reduction inside the enterprise
- better cost management

This hypothese was tested and hierarchised in the order indicated above. This approach has the merit of testing the causes likely to have a decisive influence on the ability of enterprise to improve total quality of their service. In conclusion, this analysis remain functional in the measure that it is expected to restrict the area of the quality approach by subjecting the eight types of cases to different types of criteria in order to retain only a course of action.

The total quality and coherence-the strategic quality appears like a result of the enterprise audit translated in the means coherence establishment. Thus, total quality will occur as a result of the enterprise coherence in relation to the environment on both short and long term, through specific methods concerning all activities. There are two factors to be taken into account for this issue:

- The environment audit and
- The organisational answer, focused

currently on just-in time.

The environment audit has a great importance, because, as already showed, quality is not only objective, nor subjective, this global perception could be touched only through a careful observation of:

- the client expectations-which suppose both the level and the transfunctionality of listening the client voice;
- product evolution this marketing issue in fact, could be the engine of strategic innovations and profit source through the cost optimisation, services variety or a better structure of capital.
- competitors behaviour-the benchmarking become the key factor to improve the total quality, due to the systematic audit and the accent on practice and process.
- chain organisations behaviour-the upstream and downstream, the sales forces and the buyers have to be listened in order to a better management of the total quality.

The organisational answer- from the traditional perspective, quality results from a combination of methods used by specialists in functional organizations. In this regard, even the quality assurance preserve earlier features of the control. In the current approaches, the quality function tends to disappear when it is broadcasted inside the enterprise. That's why the effectiveness will depend on the organization manner implemented to manage it.

### **Methods and techniques of the strategic quality**

Strategies focused on quality are considered competitive strategies, because the mission of quality, today, in general, is to face the competition.

The most popular is the continuous improvement strategy. The continuous improvement strategy, a strategy considered an integrative, transfunctional strategy of a company, aims at gradual and continuous improvement of the products and services quality, as well as of the productivity, with the participation of all personnel.

Kaizen concept, the largest Japanese management concept was made famous by Masaaki Imai, President of Cambridge Corporation in Tokyo and the European Institute Kaizen, author of "Kaizen, the key to Japan's Competitive Success".

In his opinion, Kaizen is a concept 'umbrella', which brings together most of the concepts and practices typical of Japanese, such as: Company Wide Quality Control (CWQC), Kanban, quality circles, suggestion systems, improving productivity, etc. Kaizen strategy represents an alternative strategy to innovation. Unlike the latter, which involves improving processes and products in large jumps through technological innovation, Kaizen strategy adopts the principle of graduation, with "small steps". Such improvement does not involve substantial technological changes, as innovation and can achieve conventional know-how.[1]

Other differences between Kaizen and innovation strategy are as follows:

- Innovation strategy is focused mainly on results, while for Kaizen strategy prevails the process orientation;
- Innovation requires investment, sometimes considerable, to achieve the desired result, while the Kaizen strategy can achieve the same result with relatively little effort, constantly made;
- Kaizen strategy is oriented towards the worker, which is considered the main success factor of enterprise. The innovation strategy is instead oriented towards technology and financial issues that are involved in innovation.

The central point of the Kaizen strategy is Company Quality Control (Japanese version of total quality management).

Kaizen strategy is based on a number of methods, techniques and tools: PEVA action plans, quality circles, small working groups, suggestion system, Kanban, Total Productive Maintenance, the method of "3S" and "5S", etc., detailed below:

- Deming Cycle (PEVA)- Deming emphasized the importance of ongoing collaboration between

research and design, production and sales, quality improvement process, as a graphic presentation that bears his name: Deming's circle. This suggests that to improve quality, cycle "plan" - "run" - "check" - "acts" must be constantly repeated. This suggests that to improve quality, cycle "plan" - "run" - "check" - "acts" must be constantly repeated.

PEVA is the sequence of activities for improvement, noting that it is essential to understand and correctly evaluate the consequences before acting.

- Quality circles, coming from the '50s, where are applied the PEVA plans to solve problems-represent the privileged form of applying the Kaizen concept at group level.
- The suggestion system- considered as the simplest technique used in the continuous improvement strategy. It involves collecting improvement suggestions made by staff.
- Method Just-in Time (JIT) is originally a method of coordination of production processes, which ensure the production and delivery of parts (assemblies), only at the right time, established by orders coming to the next work station. It is part of methods to "pull" production, was applied for mass production, which can be divided into small lots.
- Method of "3S" requires coordinated development of three categories of activities which concern the removal of all that is useless at work; ordering useful objects left and preparing them so they can be used anytime' ensuring clean in the entire area affected by the job.
- Method of "5S" involves the development of two more categories of activities concerning the maintenance of a hygienic and pleasant workplace and a strictly respect of work procedures.

## Conclusions

This paper aims to evidence the need to give priority to customers and its relationship

with quality from a strategic perspective in order to demonstrate that the mobilization of all sale forces of the enterprise can ensure the success of this approach.

Today it is recognized that in many companies this approach has evolved from quality centered on product to the quality centered on process. Although the concept of strategic quality became known, advancing to a Although the concept of strategic quality became known, advancing to a strategic formula evolve more slowly. The recognition of both globality and transversality of the quality and the use of the strategic means of the continuous improvement strategy could bring advantages for client and enterprise as well.

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## Agent Theory and Its Impact on Economic Crisis

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### Abstract

*This article wants to design a liaison between the world economic crisis and agency theory, trying to determine if the current crisis is a consequence of the common corporate governance practices. More specifically, it indicates that these practices lead to excessive risk taking, like subprime mortgage securities, because they have no penalty for the manager, or don't damage his wealth in the case of collapse. Simultaneously, golden parachutes and other exit packages incite termination of the employment agreement since they reward failure, and provide little incentive for the executives to perform properly.*

**Keywords:** Agent theory, principal, agent, incentives, financial crisis

**JEL Classification:** M29

### 1. Introduction

There has been found many causes of current global financial crisis, including uncontrolled real estate market, the large volume of subprime mortgages in the United States and even neo liberal philosophy. We are trying to show that one of the main causes of the current crisis is mainly a matter of stimulation. Incentives can be defined simply as anything that causes someone to take a particular action. Encounter different types of incentives and learned to answer the first years of life. As a child, for example, parents promise that if we go to a movie or eat all the vegetables we get a new computer

game only if we manage to get top marks in school. But incentives are often a penalty. If you break the rules of the road, you can be put to prison. If a company is discharging too many pollutants in water, it will be fined for each liter of pollutant discharged over the legal limits set for the company.

Simply, an incentive is a way to determine people to make more and more good things and therefore less bad things. However, incentives can have unexpected consequences. Consider the architectural landscape of Amsterdam. Do you know why homes are unique in this beautiful city? This is because property taxes depended on the width of the facade residence. As a result, owners decided to build very tall and narrow buildings that extend very far back, with narrow and very steep stairs. Since it was impossible to bring furniture in the house using the stairs, houses were provided with hooks in the ceiling and almost as wide windows as the entire house. I am convinced that people who have imposed these fees were originally thinking about how to bring about higher taxes on property, and not how to promote a different architectural style.

Incentives represent the boundary of corporate life, especially when it comes to top managers and their understanding and proper sizing is the key to resolving almost any organizational difficulties. The corporate governance practices, including those related to reward top managers, are debated in these troubled times. The reason for this approach is based on the recommendations coming from what is called "agent theory" [5]. Agent theory has long been the dominant model used to solve problems related to reward top

managers. This means that the principal (shareholders), whose primary objective (and unique) is to maximize the value of the company, delegates this task to a rational agent with risk aversion (manager). The principal creates major clearing contracts to control the opportunism of the managers, opportunism derived from information asymmetries arising between agent and principal.

## 2. Agent theory – a description

Agent theory is an influential approach to study corporate governance in strategic management [3]; [9], [12]; [15]. While some authors tend to be pessimistic about the effects of separation of ownership from control, modern theorists [5] move from the study of capital market failures to their effectiveness [7].

Modern theorists tend to be (too) optimistic about the fact that different governance mechanisms (eg, the market for corporate control, market for managers) have solved the problems agent. In fact, some theorists [5] suggest that the mechanisms of governance have achieved a high degree of refinement, thanks to which organizational theorists would not have to worry about studying the problem of organizational control.

The basic principal-agent model shows that the efforts, if not observed can be achieved through economic incentives. The compensations of the managers must increase by the profit obtained by the company. Since such structure of economic incentives damages insurance, the expected compensation is higher under uncertainty conditions. This, in turn, may lead the principal (shareholders) to not want to induce more effort. Thus, it can tolerate inactivity. Berle and Means [2] found that separation of ownership from control exists in many different degrees and that this separation is almost complete when there is a substantial minority among shareholders. Pratt and Zeckhauser [14] confirms that the problem of separation of ownership and control is only a part of the economic problems which can be classified as principal-agent problems. Indeed, Pratt and Zeckhauser's research topic is that businesses, employees and consumers often face the problem of agent. The two

have a more optimistic view of the seriousness of the agent problem, although recognize that things can improve with the introduction of creativity in governance.

Arrow [1] notes that the agent problem is an important factor of economic life and the principal-agent relationship has a significant effect and a significant economic magnitude. Very important is that the theory tends to predict very complex commissioning functions to align the economic interests of principal and agent. In fact, we don't observe such complex relationships. An obvious explanation for this divergence is that the mathematical problem of principal-agent does not take into account the bounded rationality.

Levinthal [10] describes organizational models that include agent problem, trying to broaden the number of those interested in these models and to stimulate production of new research. He aims to highlight the methods in which strategic management can contribute to organizational knowledge using specific mathematical forms. Moreover, Levinthal uses ideas of Simon [16], March and Simon [11] and Cyert and March to critically analyze models of agent theory from the theory of firm behavior's perspective.

Jensen and Meckling [8] suggests that if a manager has no debts or holds shares in the company he runs, it will not directly responsible for any cost. In this situation, the managers have an incentive to make decisions contrary to the best decisions that maximize shareholder wealth. Of course, shareholders can engage in a wide range of activities to monitor actions and decisions of managers. To move forward, managers can receive penalty bond which will take effect if they violate the interests of shareholders. These continuous conflicts between managers and investors, together with monitoring and rewarding mechanisms designed to reduce these conflicts are very expensive. All these costs are referred to by Jensen and Meckling as agent's costs. Total agent's costs consist of the costs of monitoring agent made primarily in order to regulate and monitor agent's behavior, expenditures made to reassure the principal and residual costs or costs due to unsolved conflicts of interest between agents and principal - this third category is very broad.

In a world of efficient capital markets, managers, trying to gather funds from external sources, bear full responsibility for these costs. Because managers bear the entire responsibility of occurrence of these costs in an attempt to raise capital, they have a strong economic incentive to choose that capital structure that minimizes the total cost of agent.

Jensen and Meckling examine the consequences of dilution of holding 100% of the entrepreneurial firm. However, real economic interest was moved to the modern corporation with many shareholders, but the translation from the theoretical scenario to another scenario isn't described. The two describe the situation definitely doing the exercise:

One of the most serious limitations of this analysis is that we didn't analyze in this paper its applications on a modern company whose managers have very few shares or have not at all. We believe that our approach can be applied to this case, but ... [these issues] remain to be studied in detail (p. 356).

As a critique of the work of two, Williamson [19], commenting that research, notes that "logic that links micro models and composite applications in which they are used is often visible, but rarely used on the whole" (p. 188).

### **3. Different types of corporate governance structures**

Based on this theory, there have been established a number of "best practices", including the independency of the board of directors, separation of chairman and CEO positions, and the use of incentives. But many of the recently bankrupt companies have followed these practices. Let's take the example of investment bank Lehman Brothers. This company has adopted almost all of the governing practices and even created a special section on its website to explain that the bank has very strong corporate governance structure, including setting stimulents guidelines and a code of ethics.

For most companies which went bankrupt during the financial crisis in 2008, most salary packages were composed from variable incentives based on annual performance, both composed of cash, as well

as stock shares. In accordance with the last report presented by Lehman Brothers, the general manager has received 34 million dollars as annual salary, 85% of it being in the form of shares and options. This model is typical in industry. A similar compensation model was used in large financial institutions such as Bank of America, Citigroup, Goldman Sachs, JP Morgan Chase s.o.

One issue of stock options and other similar instruments is that managers rewarded with such instruments gain profit when share price increases, but don't lose value when the stock price falls. Managers can respond to these tools taking higher risks, since their wealth will not suffer if stock prices decline. This is probably the main reason that companies like Lehman Brothers, Fannie Mae or Freddie Mac were involved in risky businesses such as mortgage securities. Managers can have very large gains in situations of high uncertainty, without the risk of losing their money. Moreover, they only need short-term increases in stock prices to exercise options. In fact, managers are not forced to keep stocks more than one day [15]. The growth of stock prices for one day is not a real gain for a business. Rather it attempts to stimulate forgery of financial statements, tax evasion and other fraudulent actions.

But things could be worse. Additional practices are contrary even to shareholders' objectives. This refers to packets for leaving the company, often called "golden parachutes". A golden parachute is a clause in the manager employment contract stating that it will receive certain benefits (usually money and/or shares) if the employment relationship ends (due to acquisition, bankruptcy or other causes). The argument that led to the emergence of this clause is that, thus protects the managers of risks not under their control. Let's consider, for example, the case of former CEO of Hewlett Packard, Carly Fiorina, who received 21 million dollars compensation when she was dismissed in 2005. Then she got 21 million dollars when HP bought their options and pension benefits. Thus, having such ridiculous output packages, the effects are disastrous because, simply put, they reward failure. What incentives should be invented for a manager to achieve performance if he is rewarded for failure? Could these reasons provide managers incentives to drive the

company to extremes if the future does not sound well? As an collateral effect, this practice causes frustration among other employees of the company that don't have such clauses in their employment contracts, leading to lower staff morale and creating a state of injustice. For this reason, banks rescue plan approved by US Government states that "institutions that sell shares to the Treasury... must meet the standards of stimulating the managers that will prohibit the payments of golden parachute type ... Golden parachutes will be completely prohibited for ensuring the managers in this case."

#### 4. Conclusion

The 2008 financial crisis has taught us at least two important lessons in terms of incentives. First, we still have much to learn in terms of risk. Not all risks are equal, and the excess risk may be more dangerous than assuming any risk. Even if it is clear that in business you have to take risks to make a profit, before that crisis it has been taken risks with disastrous consequences. Thus, setting incentive policies that encourage managers to take risks without limit may be fatal to long-term survival of companies. Furthermore, current risk management tools do not fully capture the intrinsic characteristics of risk and uncertainty. They proved to be inadequate, requiring rethinking-or even eliminating, to avoid the chaos that can occur, especially considering the complex nature of modern finance.

In this respect, Nassim Taleb [17] was very clear (and surprisingly prophetic): "Globalization creates a general fragility, reducing volatility and giving the appearance of stability. In other words, creates devastating Black Swans. We have never lived under the threat of a global collapse. Financial institutions have been merged into a smaller number of large banks. Almost all banks are interconnected. Thus, financial ecology is swelling into gigantic, incestuous and bureaucratic banks - when one falls, all fall. The increased concentration among banks seems to have the effect of making financial crisis less likely, but when it happens, are more global in development and hit us very hard. The landscape was transformed from a highly diversified

ecology of small banks, with varied lending policies, to a more homogeneous framework of firms that all resemble one another. Indeed, we now have fewer failures, but when happen... I get chilled at the thought. Government-controlled financial institution Fannie Mae, when I look at its risks, appears sitting on a powder keg, vulnerable to the slightest breeze. But don't worry: their army of scientists calls these events unlikely. "

Second, payment practices offended public opinion leaders and political leaders. The way the current incentives are built requires urgent review, especially for CEO compensation, since they generate billions on short term but destroy value on long term. Current systems do not stimulate managers to perform adequately. Rather, it encourages them to behave so as to obtain a good performance in the immediately horizon in order to get annual bonus and to exercise options. Instead of promoting the actions favourable to companies' owners , these systems give rise to opportunistic behavior.

There is no easy solution to the problem of incentives. Many compensation schemes seem unbeatable on paper, but have different consequences-sometimes harmful- in practice. Incentives design is not an exact science, there are many trials and errors in this discipline. Unfortunately, the dominant theory has failed to provide satisfactory answers to the question of how to align the interests of shareholders, managers and society as a whole. Thus, both practitioners and researchers alike need to join forces and to rethink their compensation practices.

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## Motivation in Insurance Sales

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### Abstract

*Everyone makes a lot of projects over the entire life. Some projects are completed, but others do not. That's because our lives contain unexpected situations, some pleasant, but others undesirable. Also unpleasant situations as accidents, hospitalizations, deaths may generate financial frustrations, along with physical discomfort.*

*Many Romanians see insurance as a product that “is not up their alley” including it in the luxury category. Furthermore, the media shows, sometimes amplify certain cases of doubt in relations between insurance company - customer. Appropriate marketing, allied with the informational technologies can improve the complete relationship between the two entities - the offeror and the consumer.*

**Keywords:** life insurance, insurance marketing, consumer behaviour.

**J.E.L. Classification:** M 31

### 1. Introduction

Life insurance plays a key role in managing risks in modern societies. It can provide income to beneficiaries on an income earner's untimely death or loss of ability to work [1].

Insurance, as savings instruments, implies the deposit of money involved, in reasonable amounts over a long period of time, not for huge gains, but rather for safety. Although they are extremely useful (Maslow speaks of protection at his famous pyramid on level 2), Romanians accept them very hard. Therefore is very important to make the sale of these products by sales experts to have a high success ratio. Full exploitation of every detail will ensure sales success.

### 2. Insurance utility

Regardless of the amounts required by additional life insurance reserves (profit), what is to be appreciated is the protection aspect it offers, in the long run. Due to the element of unpredictability, people are exposed to financial fluctuations that may occur in sensitive moments of life. Thus, loss of a job generates lower standard of living that can lead to physical/psychiatric illness; the loss of a family member involves funeral expenses, and if the deceased was the financial supporter of the family, a rehabilitation is necessary to a new financial situation; serious injury leads to a person incapability to work, resulting in a lowering of the standard of living and leading to the appearance of substantial difficulties. Another unpleasant aspect is being unable to guarantee a future for the children, to ensure their studies or help them successfully launch into adulthood. Insurance has the role of creating a barrier to these fluctuations, in order to reduce, as much as possible, the amplitude of negative income.

The immense destruction that fire [2] has caused to a local shopping center on small business, caused the small business owners to directly or indirectly realize, how good it would have been if they would have gotten insurance for their business. Their last tardy remark how they couldn't have afforded to buy insurance has no foundation when they watched helplessly as what constituted their daily livelihood was destroyed by a huge fire. Certainly, little effort (but still an effort) that they would have made by insuring their business would be offset by the beneficial effects of compensation. That is why, once again, it justifies the claim that people purchase insurance for a future that due to unpredictability generates uncertainty. There is that saying as we are too poor to afford us cheap stuff. As for many years insurance was

seen as a luxury item, which is not exactly true, this “daring” to afford a “small luxury” would have provided a substantial financial reserve.

Bill Quain noted the propensity of people with money to differentiate between these types of debt, noting investments (cash increase) and expenditures (cash decrease) [3]. He said that millionaires delay short gratification for long-term financial security, buying goods that increase their value, such as stock and not items that lose value over time, such as expensive furniture...

Obviously, in the current crisis, not even stock would be a happy solution. According to the Employee Benefit Research Institute and American Savings Education Council, 66% of Americans are unable to make sufficient savings to retire because of current financial responsibility (liability) [4].

Romanian mentality is hard to change, so hard work is needed from professional insurance agents to make better understood the usefulness of these financial products.

The crisis was an obstacle for those undecided to make their insurance because:

- it has decreased the purchasing power, or
- psychological effect affected them too much.

Regarding the current crisis, Alan Greenspan, in his “The Age of Turbulence: Adventures in a New World” argues that financial market turmoil of the world that began in the summer of 2007 was an “accident waiting to happen” [5].

On the other hand, the economic crisis has imposed on insurance business in a negative trend recording results contrary to the development aspirations of the companies in the economic field. Irritating to a crisis is that, as highlighted by Keynes [6], replacing an upward trend with a decreasing trend often occurs suddenly and violently, while replacing a downward trend of an upward trend is marked, usually by sudden curve. This aspect is fully felt, currently.

Insurance companies are responding to particular needs of the consumer, since the customer of an insurance company is not just looking at a payment amount (premium) but also more favorable terms, the guarantee of compensation, promptness in case of an accident. This additional attributes are often more important than basic service and are essential for differentiation of an offer [7].

### **3. A few considerations about marketing in insurance**

Paraphrasing a natural statement [8], that companies need to keep many of the skills and competencies that have ensured their success in the past, and to form completely new concepts and skills, in order to grow and prosper in the new economy, we can say that for the individual involved in sales is necessary to be complementarity between the existing skills and adapt to new requirements of working; explanation is that, although most often the sales person belongs to a company, also often has the status of freelance. To insurance, this status emerges best, if we relate to professionalism that a difficult sale demands, as that of life insurance. So, often, daily experience shows that these professionals are easily recruited by companies dealing even with other types of sales.

It is known that marketing is a whole system of economic activities related to scheduling, pricing, promotion and distribution of products and services designed to satisfy current and potential customers [9]. Public image of insurance companies established mainly through his actions in the field of advertising and public relations is closely linked to the company's marketing mix, including activities necessary to provide an insurance product purchaser [10].

Marketing mix is probably the most famous marketing term [11], consisting of the 4P that: price, placement (distribution), product and promotion (communication), can be regarded as a vector in four dimensions [12]:

Marketing mix = Product x Price x Placement x Promotion

As the amount of these components is more inspired, the marketing efficiency is higher. A comparison, but not very academic one, is mixing the ingredients for a successful culinary preparation, quantity and quality will provide the taste and appearance of that item being prepared.

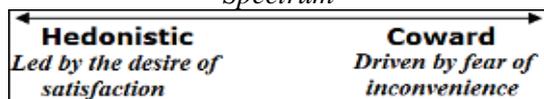
Most marketing efforts of most insurance companies are focused on promoting component. Promoting insurance products is through personal presentations, special promotional activities, advertising and public relations. Promoting insurance is sometimes tricky, since it involves the particularity of

these products which is substantial amounts of money that the individual invests and whose effects may not be seen, as sometimes the insured risk does not happen, such as the non-life products. Moreover, in this area we find the so-called paradox of insurance: that person enjoys losing some money, in that, if the insured risk does not happen, the money paid does not come back in any form to the client; any monies that the customer could benefit from it would be for not so pleasant situations. In this idea, in general, insurance companies take into account that such products, on the anniversary of each year when there was no need for any compensation, grants discounts to premiums paid, which I pointed to, when discussing price strategies. As regarding the life insurance segment in Romania, we can say that pessimism about their life expectancy, if we look at the investment aspect of these products, or overly optimistic about not experiencing or expecting the effects of risk at a personal level, referring to the protection component, we can invoke the “Latin” image of Romanian people: “carpe diem”.

**4. Important issues for sale**

Individual, as a consumer, acts as a carrier of demand for consumer goods and services, to maximize the satisfaction of its needs by using the limited resources at its disposal. In other words, he seeks to maximize economic utility based on the hedonist principle [13]. Usually, it is recommend the emotional attraction in the case of hedonistic products and rational attraction in the case of utility products. Emotional attraction varies from sentimentality to fear (fear of injury or death). Purchase decisions are aimed at obtaining satisfaction or removal of a nuisance [14], something that is shown in the figure 1.

Figure 1. Satisfaction vs. Inconvenience Spectrum



Source: [14]

A problem that requires attention and debate in the insurance industry is the relative effectiveness of different distribution

systems. Two systems dominate the market [15]:

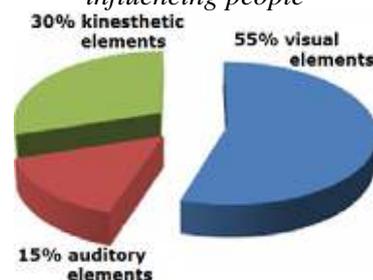
- agencies' own insurance companies, so-called direct sales force, where an agent sells policies for only one insurer;
- Insurance broker - an agent may be representing one or more insurers

Direct selling is often imposed by the characteristics of services provided. As mentioned above, insurance distribution can be made directly by the company or through intermediaries (insurance agents and insurance brokers). If insurers are limited, most times, to the sale of products of an insurance company, brokers are designed to optimize solutions without further limited to a company's products, but choosing a solution as close as possible to the customer's expectations. It can be said that a new company entering the market, most times, was made through intermediaries, so that, when it is found that the company's products sold, to enter e market through direct sales.

Any sale may be divided into four stages: prospecting, interview, presentation and selling. According to relationship marketing concept, we can talk about a fifth step: service. The interview involves, initially, a free discussion – small talk – to make the transfer of trust and enthusiasm of consultant to potential clients and identify needs - vital sales process.

Selling insurance is difficult only by phone although, for example, in 1994 Genertel [16] was created, a company launched in Italy to ensure insurance services through the phone. I personally have made two sales using audio Yahoo Messenger and admit I have to admit I have felt the frustration of not having and eye contact, which, according to research is important, as shown in the figure 2.

Figure 2. The importance of sense in influencing people



Source: [17]

Since we have referred to the telephone approach, it is important to follow only setting a meeting and not a telephone sale. This affirmation is based on some features of negotiations by phone [18]:

- greater confusion - lack the visual feedback,
- greater ease in saying “No” - is less complicated and painless to refuse while on the phone,
- increased speed - telephone negotiations always take less than face to face meetings,
- increased competitiveness - on the phone, people tend to be impersonal and to the point. Therefore, will dominate the other person with the best arguments,
- increased risk - as a faster negotiation and more competitive than a meeting in person, bear in mind that hasty actions are a source of threat for those who undertake them,
- caller advantage - the person who places the phone call is in a privileged position.

During an interaction with a client, using a support of retention of certain important aspects (desirable is that this support is a piece of paper, other means of recording audio and video could create discomfort) increase the chances of achieving a professional discussion. Schiffman [19], obviously taking notes:

- better helps the sale man to retain certain information,
- assures a position of control and authority,
- develop analytical skills, involving three senses: tactile (the hand that writes), hearing (listening to the potential client) and sight (looking to see what you write),
- becomes even for the potential client a support in providing information, helping them to open up easier,
- provides signals for the customer that the agent is fully interested in what he hears.

Schiffman also in one of his complementary works [20] suggests that taking notes helps sales consultant to retain the potential customer needs and to improve presentation. Even claims that having always a pad and pen, these tools helps to build the solid professional relationship. Furthermore, he seems upset by the fact that many sellers fail to use this basic tool - notes.

An unprofessional strategy [21] approach to sales exposes consultants to potential problems, such as:

- long and multiple phone conversation - agents attempt to sell through the phone - which is very difficult,
- lack of interest from potential customer,
- constant objections,
- mistrust,
- denial of subsequent recommendations,
- lack of repeat sales.

In the sales work, very important is to establish a network of knowledge (developing relationship with other people) [22]. This relationship can provide the following advantages:

- bring new customers or leads to new opportunities,
- provides valuable information and resources about potential customers and other useful events to own work,
- help finding the right people to fill key positions, increasing their employment opportunities – many of the old consultants seek to create their own teams to become team manager (unit managers / team leaders),
- helps in solving different problems.

## **5. Ethics in Insurance - motivation vs. Manipulation**

A career in sales is one of the best areas on which we can say that success is linked to performance. Thus, a really good salesman can make more sales with a mediocre product than a mediocre seller with a truly remarkable product [23]. Difficulty producing performant insurance consultants is related to the ignorance of the population of the utility of insurance and distrust in of those who sell it. An insurance agent's image is a poor one not only in Romania. Acclaimed actor and director Woody Allen, through one of his character that you play in “Love and Death”, said rhetorically: “There are some things worse than death. If you've ever spent an evening with year insurance salesman, I'm sure you know what I mean.”

Business Ethics imposed emergence of the concept of marketing ethics [24], which relate to marketing based on integrity, which promotes ethical solutions. It is said that to the people involved in business, what is

illegal is allowed. However, many people wonder whether it is ethical to get people to do something, to buy a product/service, etc. It can give an affirmative answer works, given the fact that everything is done in society (family, friends, business), because people are persuaded to buy, to try to vote, to contribute to a cause or other [25]. Ethics is a very important aspect of sales. This term refers to the analysis of two words (manipulation and motivation) as often these terms are sometimes confused.

Although for some [26], motivation comes from a cynical perspective, handling subtle nuance to this definition, Zig Ziglar sends us to compare kindness with deception [27]. The differences are in the person's intention, motivation and making people act in their own way while manipulation has often resulted in a forced acceptance. Motivation can be defined as the stimulating action to an end, whether the stimulus is consciously or unconsciously [28].

Motivation is ethical and long term, one that is recommended in the sale of insurance, speaking of a long term relationship between agent and client, and the other is immoral and temporary, offering after the momentary advantages, a nasty picture of that agent being in the same field, an extremely high price to be paid. Basically, to handle/manipulate, means to influence someone to act for the benefit of another, especially through fraudulent or unscrupulous methods. One form of manipulation is the lies that can be conventional, half-truths and selective omissions [29], so are not always obvious, but all, as long as they are not whole truth, represent danger.

Many insurance agents are not false in any conventional sense, but the omission of information is just as dangerous if it is to think that perhaps what is omitted can be a very important clause. Also, half-truth can be dangerous thinking about the presentation of the insured's rights, but avoiding the presence of the obligations they have.

The classic example is related to the fact that policyholders are told they can withdraw the money they want but they omit to say that not the full amount and are presented with half truth, avoiding to tell them that the first three years, can not terminate the contract

with the return of money.

## 6. Conclusions

Although there is serious competition on the Romanian insurance market, the great dispute is not between specialized companies, but between them on one hand and consumers on the other. The consumers, most times, are not interested in prospecting what the insurance companies have to offer, in order to locate the most suitable offer to their needs, but put in the balance whether or not to get insurance, to invest in such financial product, or whether to invest in deposits, stocks, bonds etc. This happens most often when mixed life insurance with saving component, allows people to analyze them only from this perspective, making them comparable with other investment products, but neglecting the most important aspect of security: financial protection.

Insurance sales are a daily challenge for those working in this field both in terms of their financial advantages, especially in terms of utility they have on customers.

Using appropriate marketing techniques, improving insurance agents' skills will provide an effective relational process between insurance companies and customers.

## 7. Acknowledgements

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## Managerial Implications of Resistance to Change

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### Abstract

*Change, taking into account the acceleration of globalization, becomes more and more used within organizations, being a central point of concentration of attention for the management but as well for the employees. In order to become truly efficient and to enter within the organization, the reasons of change must be accepted by a sufficient number of actors. Change can involve, in an inherent manner, a risk that not everybody is willing to take.*

**Keywords:** management, resistance, change, organization, manager

**J.E.L. Classification:** M50

### 1. Introduction

The manner in which employees perceive a change is in close connection with the manner in which they react to this one. There are four categories of reactions, even if there can be more variations of these ones. If employees notice that the change is not compatible with their needs and aspirations, they will oppose to this one. In this situation, employees are sure of the fact that this will get worse one the change has been adopted. If employees cannot understand the manner in which the change will influence them, they will present resistance or, in the best case, they will adopt a neutral attitude. Very many people avoid the unknown, the unsafety, in most of the cases due to the fact that they think that a change worsen things.

### 2. Consequences of resistance to change over the personnel of the organization

If the employees notice that a change will be produces no matter the objections that they have, there is the possibility to oppose resistance, but they will accept it with resignation. Even if their first reaction is opposition, once the change is unavoidable, they will not see other solution than to accept it. If the employees notice that this change is in their interest, they will become motivated to accept it. In an evident manner it is critical for employees to feel trustful that the change will be a benefic one. The manager is the one that has the obligation to build an environment in which the employees' attitude will be one of acceptance. One must notice that three from four situations involve a certain degree of resistance. This resistance to change represents a behaviorist/emotional response to real threats or imaginary ones over daily routine. Managers must understand the resistance to change and to learn techniques to overcome them. There are few managers that have not been confronted with resistance from the part of employees, even if the change has been attentively created in order to correspond with the needs of these ones. It is important for the managers to learn to confront themselves with resistance, due to the fact that unsolved efforts for implementation of changes are expensive. These costs refer to a smaller level of employees' loyalty, a small probability to achieve certain objectives of the organization, a loss of money and resources, but also the difficulty to repair the unsuccessful effort.

People oppose resistance to change from many reasons. The resistance to change does not necessarily mean that they will never accept it. In many cases, there exists the possibility to confront with the phenomenon of resistance for the methods of introduction of different changes that have not been favorable ones. The manager, by the implementation of some drastic changes, can create a powerful feeling of insecurity. Maybe the manager has not informed in due time, the employees about change. Sometimes, even if the change is introduced, the resistance phenomena can appear. The manager can use resistance to change as a means to analyze the organization. If the minor changes are rejected, one can observe that there are many types of problems, just like problems that are connected to morale, the level of implication or the level of trust.

Individual behavior or a group that appears as a consequence of organizational change that can take a lot of forms, being different from acceptance to active resistance. The resistance can be as subtle as passive resignation or as evident as deliberate sabotage. Resistance can be as well, immediate and postponed. It is the easiest thing for managers to deal with the phenomena of resistance when this is evident and immediate. For example, a company proposes a change, and the employees' response is concretized by a slowness of the work rhythm or by threatening to start a syndicate movement. Even if these responses can be harmful, their cause is clearly identifiable.

Trust is a characteristic of high performance teams, in which the members of the team believe in integrity, personality and in the capacity of the other members. Managers who trust their employees transform the process of change in an open, honest and participative one. Employees who trust the management are more willing to apply a supplementary effort and to try something different. Disbelief, on the other hand can make that a change that has initially been well conceived, can fail.

When different radical changes are introduced without announcing employees, these one will develop some anxiety concerning implications. Rumors have the role to fill in the hole created from the lack of official announcements, in such a manner

that, employees will develop some negative attitudes against changes. They can develop some behaviors of dysfunctional type – complaining, working slower or impairing the moral of the department. Managers should avoid the creation of situations in which employees are taken by surprise, developing thus a fear for change. They can make this by informing all employees in a corresponding manner.

The calendar of change compared to other events can increase the resistance to change. Weak synchronization can be caused by events within the organization or events from personal life. For example, bringing a young manager from outside the organization, in the same time in which all the equipment and procedures are being updated, can increase the resistance to both modifications. Managers should take into consideration, if possible, other events that take place in the same time with a major change, in order to avoid a bad synchronization.

The approach used in the presentation of a change can increase the resistance to change if people do not like the manner in which this one is presented. An inaccurate approach in the case of a change can be caused by the change of manner in which one communicates or in choosing the communication channel. The transmission of a message or of an e-mail, for example, cannot be as efficient as the personal transmission of the message of change. An approach can as well be considered as inadequate in the case in which the person who transmits the message of change does not agree with this one. Finally, the words used to explain the change can generate inefficient reactions. Announcing the employees that they will not see a salary increase or they will not benefit from certain bonuses, for a certain period of time and that all employees must make an effort to increase productivity, is an example of inaccurate approach due to the fact the employees will conclude that supplementary work will not bring them any benefit. Even so, explaining the necessity of the change, due to the fact that the respective company will not be put in front of certain risks, can generate a more intense cooperation through change.

Despite assays to reduce the resistance to change within an organization, some

reactions to change are unavoidable. Negative reactions can manifest themselves by an open behavior, and resistance to change can also have a passive character. People can have four basic reactions concerning change, and they can feel disadvantaged, disappointed, disoriented and to have the impression that they suffer from a loss of identity. Managers can use some interventions to cope with these reactions [7].

Lack of commitment in the process of change represents a form of psychological receding. The employee seems to lose his interest, initiative and place of work. Employees that come out of this state, continue to fear of change, being in expectation, hoping to something better. Employees who are not involved are present from a physical point of view, but from a mental point of view they are absent. Typical situations of this type involve the following affirmations: “No problem” or “This will not affect me”.

The basic managerial strategy to cope with such persons is to offer them the possibility to express their displeasures. Such employees could be aware of the change from their behavior, and presenting some good intentions of the manager can be a benefic action. Helping them to express their feelings, one can find solutions more easily. Sometimes, people that have initially been passive, become after a certain period of time more sustaining to change, as a consequence of open communication with an emphatic manager.

Another reaction to change is the non identification with the change itself. People react in this way when they feel that their identity has been threatened by change, thus feeling very vulnerable. For many times they deal with a past procedure, due to the fact that in the past, this procedure has created a certain feeling of safety. Employees that feel like loosing their identity they usually present sadness and concern. Managers can help them overpass this stage by encouraging them to explore their feelings and helping them to transfer some positive sentiments in the new situation. One manner to make this happen is to help them identify what they liked in the future situation and to show them how it is possible to have the same positive experience in the new situation.

Disappointment is, as well, a reaction that can be found in the case of change. This one is usually expressed by negativism and fury. Destructive behaviors like sabotage and spreading of rumors can also appear. Typical verbal signs that denote disappointment are “This will never function” and “I am leaving from this company, as soon as I can”. The fury of an employee can be directly expressed only within organizational cultures that can allow this type of behavior. In general, the organization sees these expressions of feelings at the place of work, as being inadequate and unprofessional. Within this type of organizational cultures, fury is expressed and appears under the form of a passive-aggressive behavior, just like gossip and initiation of rumors. One of the biggest dangers of disappointment is the fact that is really contagious. Reaching a compromise with employees who are disappointed can be difficult. So, the first step in managing reactions of this type, is to bring employees, from their state of extreme negativism and emotionally loaded, to a neutral state. Neutralizing the reaction does not mean to reject it, but it means to allow individuals to unload the accumulated fury, so that one will be able to lead a normal discussion. The second part of the strategy in the case of employees which are disappointed is that managers should recognize the legitimacy of their fury.

A final reaction is the one of disorientation. Disoriented employees feel lost and confused and most of the times they are not sure of their feelings. The use energy trying to notice what to do instead of thinking to manner to do things. Disoriented individual ask a lot of questions, becoming thus oriented on details. “Paralysis in analysis” is the concept which is characteristic to disoriented employees. They feel that they have lost the contact with the priorities of the company and could wish to analyze the change in a detailed manner before taking any action. Disoriented employees can ask questions like “What am I going to do now?” or “What should I do first?”.

Disorientation is a common reaction among persons who are used to accomplish some clear objectives, lacked of ambiguity. When change is introduced, this one will create an incertitude and lack of clarity. The

managerial strategy to cope with this reaction is to explain the manner in a manner that will minimize the existing ambiguity. Information about the change must be presented in a frame or vision as a whole, in such a manner that the disoriented individual can see where he is situated, which is his position in the new project. Managers can be capable to diagnose these four reactions to change. No universal strategy can help employees to adapt themselves, due to the fact that each reaction brings some different and significant problems. By recognizing each reaction and by applying a corresponding strategy, it is possible to facilitate the process of transition in case of change.

Specialty literature investigates the role of top management in the establishment and implementation of change, neglecting the fact that initiatives of change belonging to middle managers can have some unexpected consequences, especially over the internal frontiers of the organization [1], [3].

Balogun [4] defines middle managers as being the persons situated in the strategic area of the organization (top managers) and in the operational one. When change is imposed by top managers, middle managers are considered “change agents”. As a consequence, middle managers need to classify expected behaviors with their colleagues, have to monitor the application of change and to establish a system of punishments / awards [6]. Even so, the hierarchical report of these ones against the top management as well as their non involvement in the elaboration of the change project, is transforming them in beneficiaries of the change, just like any other employee of the company [4]. So, for Balogun, the role of the middle manager during the process of change can be taken into consideration, being similar with its role in normal conditions (Table 1).

Table 1 – Activities of the middle management connected to change

	Nature of activities made by middle management	
Persons who will make	Grating some significance	Ensuring the functioning of the

activities, at the suggestion of the middle manager	to change	organization
The middle manager himself	Involving a change of personal order	Ensuring the continuity of daily activity
His collaborators	Sustaining the collaborators in order to have a clear image concerning change	Implementing the change in the respective initiative

Source: Balogun J., 2003, pp. 69-83

This table shows that the traditional role of the middle manager is to know to implement change within a unit, having thus the role of agent of change. Balogun adds two roles which are rarely mentioned in specialty literature: to help other to change, maintaining in the same time the continuity of the activity. So, Balogun demonstrates that, middle managers should take part in personal change. This personal change starts with the acknowledgment of change and with the new responsibilities that this one involves. The acknowledgment decision is facilitated by the communication on the horizontal of middle managers, as well as by the communication on the vertical with the superiors. So, Balogun shows that middle managers have to communicate with their colleagues, to gather information, to ask questions, to share experiences while they try to interpret what is expected from them during the change. These informal changes with their colleagues can as well be accompanied by a formal communication, with the direction team, in the scope of discussing the roles and the responsibilities of these one concerning the change inside the organization.

Balogun [4], as a consequence, insists over the need that the top management be aware about the change that has to be achieved by middle managers over themselves. It is as well important that the direction team proves a real implication of the project change. The incoherence of words and actions of top managers can move the process of change, as it is understood within the middle managers, thus resulting in a deviation between the intentions of the management team and what happens, and in fact on the field [5].

In his reflections over the put into application the imposed modifications, Balogun indentifies behaviors and the thoughts of middle managers as being one the main factors that explain the incapacity to achieve change. Due to the fact that these ones deal with a change in which they decided themselves and due to the fact that they have to negotiate the details with other actors of the organization, especially with their colleagues from other departments, middle managers have to involve themselves in a process of construction of sense, which is not under the control of top managers [1].

Balogun and his colleagues [1] refer to a special category of middle managers, that they call “Boundary-Shaking”. These ones act in a deliberate and aware manner in order to manipulate the organizational context and the persons who work within the organization, by the application of some specific tactics:

Regulation of the control system: to encourage people to support change, middle managers will be able to modify either the control system already existing or the change itself;

Control over the development of change: use of meetings, conferences, individual exchange and other means of formal and informal communication in order to increase and to convince people to accept the change;

Application: manipulation of interaction situations in such a manner that the transmitted message will be an efficient one;

Regrouping information: in order to establish connections between preoccupations and problems of some persons (colleagues, collaborators and top managers);

These results underline the importance of an internal network that has the role to put the organization into move. This fact means

that, if such networks do not exist within an organization, middle managers will create their own network to implement change.

In any change process it is very important to give a special attention to processes of social interaction, due to the fact that these ones can produce some unexpected results, unpredictable, of a nature to modify any planned change. Which are these processes and how do they affect change? Balogun [1] makes the distinction between two types of processes:

Vertical processes between top managers and the “receivers” of change (middle managers and employees);

Lateral processes between middle managers.

They distinguish between, as well their form, being different from verbal form, and formal one (meetings, communications, documents, etc.) or informal (exchange of experience, discussions, etc.) to a nonverbal form (behavior, actions, etc.). So, communication, initially identified as a mean of action between personal changes becomes, in an equal way, a manner to modify the coordinates of initial change. In the lack of top managers, middle managers will accentuate lateral changes (between colleagues) due to the fact that these changes involve people with common experiences.

All these processes will produce some unwanted consequences and will modify the result of the change imposed by the top management. On the other hand, processes represent an opportunity for middle managers to construct their own representation concerning change. This capacity of the middle management to modify the results of change by the means of representation that they create, leads to the revision of a certain number of myths concerning the management of change.

*Table 2 – Ideas over the behavior in case of change, in Balogun's works*

Received ideas or results of previous research	Results of Balogun's research
Change can be controlled and supported by the top management	Top managers can offer a direction of change but they cannot lead it. Actions of the middle management can modify

	the initial intentions of the top management.
Vertical communication of a formal nature allow actors to build a representation concerning the change involved by the top-management	Middle managers build themselves a representation of change during the interaction and informal communication with other persons.
At a certain moment it is important to grant a privilege to written, verbal and formal communication	Communication can take a diversity of forms, including practices that allow the generation of new ideas.
Successive interventions of top management modulate the interpretations of individuals.	Interpretations are divided having in mind the process with a double sense, from the top management to the middle management and backwards
Middle managers apply the plans imagined by top managers	Intermediary managers understand the plans of top management but they try to adapt them to the situation

Source: *Balogun, 2006, p. 29*

### 3. Conclusions

For us, these results lead to the creation of a new perspective over the management: To direct change means to impose, but more the understating of the manner in which the middle managers react to this change this is why, top managers must pay attention, must have some detailed knowledge over the environment and to collaborate with the middle management. In the measure in which top managers cannot control the process of adaptation to change of middle managers, and it is necessary that these ones ascertain the need that their subordinates have and to try to offer a certain liberty by the use of means of formal and informal communication. It is important that top managers remain involved in the process of change and do not have to delegate the application of this one so, after the starting of the process of implementation of change, top managers can take part in the discussions between the middle managers. Through his work, Balogun underlines the necessity that the top managers will not imagine the change

just as a process that has to be imposed and controlled, and especially they have to pay more attention to the interaction between the middle managers, that, if it is not monitored in a corresponding manner, and can generate a new change. For Balogun [3], the management of change connects less to the idea of control, this one being considered firstly as a mean of facilitating the process of elaborating change in order to achieve a common representation of all actors. The management of change is focused over the definition of a frame that establishes the limits of change, within the actors of change that will offer a sense to this one.

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## Internal Audit- More than a Legal Requirement

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### Abstract

*Internal audit is a function who aims to support the management of a company in order to add value. Identifying differences in development priorities and management culture of the department or company as a whole and how they are implemented and followed, internal audit represents for companies a certainty and not only in the respect of a requirement under the Companies Law.*

*Internal audit function is considered to be efficient to the extent that succeeds to help the executive management to reach the assumed targets (objectives) and to give assurance to non-executive management (audit committee or equivalent) on the adequacy and effectiveness of internal control, the process risk management and on compliance with corporate governance best practices.*

*The present paper follows to highlight internal audit's importance in a company, regardless of any legal requirement concerning the compulsoriness of introducing internal audit as a distinct department.*

**Keywords:** internal audit, management, preventing fraud, detection of fraud.

**J.E.L. Classification:** M10, M42

### 1. Introduction

In the past, internal audit represented a sequential number, a routine of compliance audits.

The internal audit was concerned primarily with providing an assurance of compliance with internal and external regulations.

Currently, internal audit is a valuable management consultant.

Internal auditors are focused on

identifying business risk and issuing recommendations in order to improve processes.

Internal auditors face vital issues regarding survival and prosperity of the organization.

The Internal Auditing profession evolved steadily with the progress of management science after World War II. It is conceptually similar in many ways to financial auditing by public accounting firms, quality assurance and banking compliance activities. Much of the theory underlying internal auditing is derived from management consulting and public accounting professions. With the implementation in the United States of the Sarbanes-Oxley Act of 2002, the profession's growth accelerated, as many internal auditors possess the skills required to help companies meet the requirements of the law.

The challenges raised by the economic environment are directly reflected in the auditor's effort to evaluate the impact on the entity's financial position and performance. Understanding the risks to which the entity is exposed to following the economic climate and the methods to manage those risks becomes a key part of the audit engagement contributing to the delivery of quality services, enhancement of business relations based on mutual trust [10].

Risk-based internal audit is defined as the activity that provides assurance on risk identification and management of the structure management. Responsibility of internal audit in risk management is emphasized even in the definition of internal audit.

Internal audit is an independent activity, objective, assurance and consulting, designed to create value and improve an organization's operations. It assists the organization in achieving its objectives by implementing a systematic and disciplined approach in evaluating and improving the effectiveness of risk management, control and governance

processes [2].

Therefore, internal auditing represents a function integrated in the company, when the external auditing represents an independent function whose mission is to certify the accuracy of the accounts, results and financial situations, and more precisely to certify the sincerity and a truthful image of the financial situation and (if we retain the definition of the authorized accountants) to certify the regularization, ingenuity and fair picture of accounts and financial situation.

## 2. Internal audit role in a company

The role of Internal Audit has changed significantly over the past 5 - 10 years, and Best Practice Internal Audit is an important element of good corporate governance, enhancing the effectiveness of management controls, the risk management framework and business processes.

Although internal audit activity has such an important role in a company, at least an ambiguity can be found in its area of definition. It was brought into discussion the concept of total independency of the internal auditor. With this concept it follows to underline the function independency, the lack of pressures over it. But taking into account that internal audit department is subordinated to managers and that in some institutions mainly public institutions internal auditors are entitled with some quests regarding coordination, conceiving some procedures, etc. can we still speak about total independency? The responsibility of control registers ambiguity.

There are many roles that internal audit can fulfill in respect of the risk management process implemented within the organization.

Today, internal audit assumes at least two important roles in respect of the risk management. First, internal audit can act as an advisor helping the organization in respect of risk awareness. This can be done by improving the management understanding of the major risks facing the organization. It should be mention that the risk management process can be used by internal auditors in identifying areas for review. In these ways the internal auditors can focus their activity on the key systems and controls within the organization [3].

Second, internal auditors can act as

trainers in risk management workshops. In this way internal auditors aid line managers understand better organizational risks and controls. This is how internal audit can help the managers to identify various risks [3].

Nevertheless, it should be mention that the internal audit can't assume and be responsible for effectiveness of risk management. That is the responsibility of the top management and operational management. However, assurance on the risk management process can be provided by the internal audit. During the assessment activities, internal audit can also give advice on this field.

Internal auditors play both roles of evaluators and consultants, depending on the circumstances.

Internal auditors need a wider range of skills, advanced technology support (IT systems) and continuing professional development.

An internal audit function should be:

- Independent and objective
- Proactive
- catalyst for change
- Innovative and consultative
- A valuable resource for the organization

To perform their role effectively, internal auditors require organizational independence from management, to enable unrestricted evaluation of management activities and personnel. Although internal auditors are part of company management and paid by the company, the primary customer of internal audit activity is the entity charged with oversight of management's activities. This is typically the Audit Committee, a sub-committee of the Board of Directors.

## 3. Internal audit as management assistant

Main points that delimit the internal audit definition are: management assistance, without judging employees, total independency. The internal auditor will assist managers, in that it allows through their opinions and successive approaches, improvement of decisions that are about to be made. The notion of assisting managers finds itself in a permanent evolution. The actual economic crisis excluded any reference regarding affiliation of internal audit and control which was leading to confusions and has been replaced with a proper word:

consultant. In that, internal auditor assists, recommends, conciliates, but not decide.

An internal audit function could be viewed as a first line defense against inadequate corporate governance and financial reporting. With appropriate support from the Board of Directors' Audit Committee, the internal audit staffs is in the best position to gather intelligence on inappropriate accounting practices, inadequate internal controls, and ineffective corporate governance.

Internal auditors' unique full-time focus on risks and controls is vital to sound governance process and to sound financial reporting. According to statistics from international news and information organization Bloomberg News, in more than half of the 673 largest bankruptcies of public corporations since 1996, external auditors provided no cautions in annual financial statements in the months before bankruptcy. Many of bankruptcies in history, including Enron, Global Crossing Ltd., and Kmart Corp., followed annual reports with clean audit opinions from the external auditors. Although external auditors' independence is protected to some degree, they still face many of the same issues as internal auditors when it comes to undue management influence.

In time of challenges, risk management is an essential preoccupation. Companies must identify the significant risks they confront; to evaluate the potential impacts of those risks and adopt the most efficient measures in case of unpredicted events [10]. Managers must analyze which one of the risks were amplified as a result of the economic environment decrease. At the same time, managers must evaluate all the available information regarding significant risks and make sure that the main premises are correctly tested.

To establish and maintain alignment, effective risk management demands the continuous evaluation of risk identification, control, management and monitoring processes, including the Internal Audit function.

Internal Audit is a key element of an effective enterprise-wide risk management structure. Aligning its mission, strategic focus and core processes with stakeholder objectives and risk management priorities is fundamental to achieving a World Class

internal audit function.

Though the role of a skillful risk management it was clearly shown and extolled, many commissions and institutions analyzed the main causes of the outbreak and spread of the crisis reaching to a common point: a faulty risk management had a determinant contribution in generating the actual crisis. So, one of the negative elements identified in companies strong affected by the economic crisis, was the managers failure in managing risks, in identifying them, mainly because of a high complexity of the services provided and the risky nature of the business. Therefore, revising procedures regarding risk management process, in order to improve its effectiveness, becomes an imperative demand.

High performance internal auditing demands broad perspective and capabilities. Today's leading internal audit organizations are no longer limited to hazard avoidance and compliance. They need to demonstrate a command of risk management, business process improvement and knowledge more characteristic of a consultant than of a classic internal auditor. Furthermore, internal auditors are no longer required to focus solely on financial audits. They increasingly need to be able to provide value adding support to management across all areas of operation

#### **4. Detecting and preventing fraud-one of internal audit main objectives**

The installing of a system in order to prevent fraud remains in the responsibility of the management within the organization and internal audit provides assistance in assessing risks and strategies for corporate control, suggesting the proposals, recommendations and solutions to diminish the threat of fraud, and improve the control strategy.

Fraud consists in any illegal acts characterized by cheating, dissimulation or betrayal of trust without depending directly on the threat of violence. Frauds are to commit by persons or/and entities in the purpose of obtaining money, goods, services; to avoid any payment or loose of services; to assure a personal or commercial advantage.

Internal auditor must gain sufficient and adequate knowledge in order to identify clues

of a fraud. Fraud represents a series of irregularities and illegal actions committed with the intent to deceive.

Frauds can be committed in the benefit of detriment of an entity, by employees or persons outside the entity.

Internal auditors must have sufficient knowledge to identify clues regarding possible fraud, be alert to situations where the internal control system presents insufficiency, appreciate the need to resort to further research and inform the competent authorities.

The management and internal audit play different roles in terms of detecting fraud.

Internal audit role consists in examination and evaluation of activities provided as a service to the company.

In terms of fraud detection, internal audit objective is to help members of the entity to perform efficient providing them with analyzes, evaluations, recommendations, advices and information about the activities examined.

A study by Ernst&Young reveals a worrying increase trend of accounting frauds, despite all forecasts and normative in the field. The study was performed in 30 countries implicating companies from different sectors from multinationals to SME.

Risk factors underlying the accounting fraud were individualized as follows [1]:

- Increasing complexity of organizations;
- Reduced dissemination of internal audit functions;
- acceptance by companies of a certain level of risk, as typical element of the business;
- an internal control system which does not fully meets the economic demands of companies;
- more aggressive accounting policies.

Therefore, the most effective tools that can be used in fraud prevention proved to be only two: management control and functioning of internal audit.

Economic crises that took place on the European scene, have shown that accounting fraud are assigned to deprivation (or absence) of an internal control, formally referred in external normative and internal regulations of companies. But there are close links between fraud, corporate governance and internal audit. The presence of normative (legal basis)

is not enough to make a company efficient. It should be accompanied by an organizational culture based on ethical principles in order to put to the fore its priorities, transparency of information in accounting and internal control and external efficiency [1].

Besides external normative interventions, special attention should be paid to domestic regulatory initiatives from these economic organizations.

The pressure to achieve certain financial targets exercised over managers and the need to comply with contractual clauses for existing funding lead to an increased possibility of developing fraud.

Risk of fraud apparition is amplified by the existence of three conditions: temptation or pressure to commit fraud; opportunities to commit fraud and possibility to cover fraud. Presumption that there is an opportunity to commit fraud lies in the conviction that the system of internal control can be avoided. These kinds of presumptions/convictions are found especially at persons in positions of influence within society or who possess extended knowledge about operations and weaknesses of the implemented controls.

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# A Literature Review of Consumers’ Perception of Nutrition and Health Claims

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## Abstract

*The present development of the market of foods with nutrition and health claims shows some issues with regards to consumers’ understanding and perception. Many items influencing consumer preferences may affect the perception of foods with health-related benefits. In the present study, results of a literature review about factors influencing consumer perception, understanding and use of claims and nutritional labels made on foods are presented. Lastly, some results achieved by the selected papers are analysed and implications are discussed.*

**Key words:** Consumers’ perception, nutrition claims, health claims, labelling, food consumption, food industry;

**J.E.L. classification:** D18, L66, M39

## 1. Introduction

The social and economic welfare and the large availability of foods on the market have increased consumption and the daily caloric intake. Nutrition and medical sciences have tried to steer consumers towards food choices meeting the demands of health and wellbeing. This resulted in increased demand for food products promoting health and nutritional value, and in innovating and developing new products with improved nutritional properties by the food industry. Health has been named as the most significant trend and innovation driver in the global food and drink market [1]. It has to be communicated because health properties are typically attributes that must be conveyed to consumers by information, and their best carriers are claims on the package [2]. Foods

with health-related benefits are generally called functional foods. The latter have many definitions, which vary from the simple “foods that may provide health benefits beyond basic nutrition”, to the complex “food similar in appearance to conventional food that is intended to be consumed as a part of a normal diet, but has been modified to subserve physiological roles beyond the provision of simple nutrient requirements” [3]. Many terms expressing health-related benefits – such as fat-free, enriched, with no added sugar – have appeared on food packages in order to support consumers’ choices [4]. Since 2003, the number of new products in the international food market has grown by about 28% per year, with a broad diversification of the suggested health benefits [5]. The recent development of the market of healthy foods shows some issues with regards to the large commercialisation. Concerns refer to the non-homogeneities in regulations about information made on food defined in order to protect consumers, on one hand, and to consumers’ preferences, on the other. In fact, the application of health claims is currently facing difficulties in some countries because, first of all to the approval system, secondly due to delays or slow the process of issuing new permits. As regards nutrition claims, European regulations, in particular, reveal gaps concerning communication that can further confuse the consumer [6]. Issues concerning consumers’ preferences are more complex because food choices have multiple origins [7], related to health habits and status, nutrition knowledge, food label use, cheaper options, which can differently affect the perception of foods with health-related benefits. Most of the latter are based on cultural features, and purchasing

impulses may be originated by internal convictions, namely personal, or external signals [8]. In fact, food preferences are influenced by sensory and non-sensory factors, which concur to shape consumers' perception [9, 10]. This paper aims at identify and systematise all factors affecting the consumers' perception of nutrition and health claims, as well as the understanding of nutrition information, by developing an extensive literature review of the published empirical analyses. This literature review has detected some evident gaps concerning perception of functional foods in terms of heterogeneity in the attitude and response of consumers. Therefore, findings may help the food industry to enhance the nutrition labelling, and governments to create a coherent framework for the mandatory use of nutrition claims and labelling.

## 2. Methods

The literature review has been developed by using a rigorous protocol for papers selection, which has consisted in searching some keywords in databases. In particular, computer search has taken into considerations EBSCO and Scopus. Keywords have been chosen in order to obtain a large panel of papers. Only one set of primary strings has been applied to databases, without refining the first stage of computer search with secondary keywords. In particular, “consumer perception” has been searched in abstracts by using the Boolean operator AND with “nutrition” OR “health claims”. Furthermore, “consumer understanding” about “nutrition label” has been investigated in databases. Relevance of papers has been assured by limiting results to papers published on Academic Journals. No filter about the date of publication has been applied. The selection protocol has returned about eighty abstracts (81), which have been manually sorted by relevance for the paper objectives. By this way, more than thirty papers (32) have been detected in order to read their complete contents. Lastly, two papers have been discarded because they are literature reviews, while the present study aimed at investigating only empirical work. Text analysis has been related to *objectives*, *methods*, *results* and the *country* of investigation. The latter features have been

summed up in a matrix in order to develop a further quantitative inquiry. The Table 1 shows the above-mentioned matrix without the column of results, which are specifically treated in the following section. In the same Table, the term “NH claims” includes both foods with nutrition and health claims and functional foods. The nutrition label refers to all detailed nutrition information made on foods, different from claims. *Objectives* of the selected articles are mostly classified in “understanding of nutrition label” and “perception of NH claims”, included factors influencing them. In particular, in the present paper the perception is considered as the general attitude of consumers towards foodstuffs with claims, and how this affects consumers' preferences and purchasing behaviour. With regards to *methods* used in the analysed papers, experimental studies include consumers' surveys in which one or more stimuli have been used. Instead, questionnaires refer to simple questions without stimuli administered via direct interviews on points of sales, via Internet, or via phone. At the end, conjoint analysis and projective mapping can be considered as specific experimental methods. Papers are presented in order of publication.

## 3. Results and Discussion

The computer searches have returned papers published starting from 1996. Most of them (30%) have investigated consumers' perception of nutrition and health claims, closely followed by articles about the perceptions of both claims and nutrition labels (23%) and about factors influencing perception and understanding of nutrition and health claims (20%), and, lastly, by studies concerning the understanding of nutrition labelling (17%). Simple experimental studies have been used in more than 56% of papers, while questionnaires in about 27% of studies. With regards to papers included within the two largest groups, experimental studies – simple and both in form of conjoint analysis and projective mapping – have been mostly applied (82%) in order to analyse perception of claims and labelling. These results are in accordance with one of the most authoritative definition of consumers' perception that is the process by which an individual is exposed to stimuli, and ‘selects, organises

and interprets information inputs in order to create a meaningful picture of the world’ [11]. Indeed, only three articles included within these groups have used simple questionnaires without induced stimuli.

Therefore, experimental studies may properly support the investigation of consumers’ perception, by using adapted stimuli.

Table 1. Analysis of the selected papers

Authors	Year of publication	Objectives	Principal methods	Country
Worsley [32]	1996	Understanding of Nutrition Label	Questionnaire	Australia
Burton et al. [36]	1996	Understanding of Nutrition Label	Experimental study	USA
Ford et al. [39]	1996	Perception of NH claims	Experimental study	USA
Mazis et al. [16]	1997	Perception of NH claims and Nutrition label	Experimental study	USA
Andrews et al. [40]	1998	Perception of NH claims	Experimental study	USA
Andrews et al. [37]	2000	Perception of NH claims	Experimental study	USA
Garretson et al. [44]	2000	Perception of NH claims and Nutrition label	Experimental study	USA
Burton et al. [47]	2000	Perception of NH claims and Nutrition label	Experimental study	USA
Bech-Larsen et al. [22]	2003	Factors influencing perception and understanding of NH claims	Conjoint analysis	Denmark, Finland, USA
Kozup et al. [45]	2003	Perception of NH claims and Nutrition label	Experimental study	USA
Burton et al. [48]	2004	Perception of NH claims and Nutrition label	Experimental study	USA
Rimal [46]	2005	Perception of NH claims and Nutrition label	Questionnaire	USA
Wansik et al. [38]	2006	Perception of NH claims	Experimental study	USA
Dean et al. [30]	2007	Factors influencing perception and understanding of NH claims	Questionnaire	Finland, UK, Germany, Italy
van Trijp et al. [31]	2007	Factors influencing perception and understanding of NH claims	Questionnaire	Germany, Italy, UK and US
Jones et al. [35]	2007	Understanding of Nutrition Label	Experimental study	UK
Ares et al. [29]	2008	Perception of NH claims	Questionnaire	Uruguay
Russo France et al. [41]	2009	Perception of iconic representations about health-related benefits	Experimental study	USA
Walker Naylor et al. [43]	2009	Perception of NH claims	Experimental study	USA
Lähteenmäki et al. [2]	2010	Perception of NH claims	Experimental study	Denmark, Finland, Norway, Sweden, Iceland
Ares et al. [9]	2010	Perception of NH claims	Conjoint analysis	Uruguay
Berning et al. [33]	2010	Understanding of Nutrition Label	Experimental study	USA
Moser et al. [34]	2010	Perceptions of simplified nutrition information	Questionnaire	Germany, Belgium
Aschemann-Witzel et al. [42]	2010	Factors influencing perception and understanding of NH claims	Experimental study	Germany
Lynam et al. [27]	2011	Factors influencing perception and understanding of NH claims	Experimental study	Ireland
Kang et al. [28]	2011	Perception of NH claims	Questionnaire	Korea
Aygen [25]	2012	Understanding of Nutrition Label	Questionnaire	Turkey
Carrillo et al. [4]	2012	Perception of NH claims and Nutrition label	Projective mapping	Spain
Carrillo et al. [14]	2012	Perception of NH claims	Projective mapping	Spain
Dean et al. [26]	2012	Factors influencing perception and understanding of NH claims	Conjoint analysis	Finland, UK, Germany, Italy

Concerning results of the selected papers, before verifying if consumers’ perception of claims and labels affects preferences and consumption choices is needed making a distinction between sensory and non-sensory features of products. Literature has highlighted that physical stimuli, such as sensorial features, typically the taste, are important for food acceptance [12, 13]. Instead, non-sensory features – *i.e.* price, brand and health and nutrition claims [14] – may influence consumers’ expectations, which can be subsequently confirmed or disconfirmed by actual properties of the product, after consumption. The higher the

level of expectation about the product, the greater will be the opportunities for this food of being selected [15]. In this regard, it is noted about health and nutrition claims that veracity of the claim plays an important role. If nutrition labelling and information confirm the claim message, it is likely that consumers’ expectations are satisfied [16]. Conversely, consumers will probably develop a negative opinion about products with claims not validated by nutrition information. Besides, by generating expectations about health benefits, nutrition and health claims could influence the hedonic appreciation, and lastly, sensory factors [17].

However, this result is not confirmed by the perception of nutrition label [4]. In particular, the contemporary analysis of nutrition information or labelling, and NH claims seems decreasing the efficacy of the latter in supporting consumers' food choices [39, 18, 40, 37, 44, 47]. In such cases, information about nutrition properties prevail on messages on the front-of-packages, namely the claims, by diminishing the confidence toward the latter if they result biased by the former, as above discussed. Indeed, Carrillo et al. [14] have also highlighted that although NH claims – as non-sensory features – effectively influence the first buy, only sensory characteristics determine loyalty and repeat consumption. Moreover, two papers show that NH claims do not probably influence food choices, because they seem not drive product evaluations or purchase intentions [43], and they can decrease the perceived naturalness [2]. Anyway, most of papers (about 47%) shows that consumers' perception of nutrition and health claims is positive [45, 47, 48, 38, 29, 9, 28, 4], although it is unclear the effect on food intake generated, in particular, by the low-fat and low-calories products [28, 38]. Many authors consider functional foods or foods claiming health proprieties in general as experience and credence goods, which need high search cost of information about their quality and effectiveness [18, 19, 20]. In this regard, a research of BEUC has highlighted that nutrition and health claims can effectively reduce costs of information about functional food because they are direct and simpler to interpret [21]. However, factors affecting consumers' perception of nutrition and health claims pose uncertainties about the real influence and importance of such claims for food choices, and, in particular, for consumption of products with health-related benefits. For instance, country differences in food habits affect perception of nutrition and health claim [22, 23, 30, 31], which in turn is reflected in the legislation – more or less severe [23]. Other studies have pointed out that perception of functional foods is strictly related to the carrier product, namely it is linked to specific categories and their qualities [22, 24, 26, 42]. Gender, age and educational level are socio-demographic features influencing attitude towards NH claims [27, 30]. Lastly, relevance of

healthiness characteristics [26, 40], the scientific proof of the claim [41], as well as the product involvement [42], and the benefit claimed [31] play an important role. To end, the few articles about the understanding of nutrition labelling confirm that their interpretation is affected by socio-demographics. [32, 36]. Furthermore, nutrition label can support purchasing decisions by reducing search costs of healthier foods [33]. However, consumers find information reported on the nutrition label 'difficult to understand', and there is a general 'lack of understanding as to what nutrients are important to examine' [35]. These findings may explain the low rate of reading the nutrition labelling by consumers, shown by the Aygen's research [25].

#### 4. Conclusions

Previous research have highlighted that numerous items like socio-demographic and cultural features, product involvement and perceived relevance, as well as product category affect consumers' perception of nutrition and health claims and labelling. The general opinion about claims is positive, and nutritional information seems to play a crucial role in purchasing decisions and consumption choices. However, consumers gave little understanding of calories, nutrition principles and contents of standards labels. This can result in misleading perceptions of claims, which affect the future development of the market of functional foods, on one hand, and the consumers' full protection, on the other. Therefore future studies should aim at better assessing consumers' understanding of nutrition information and principles, and its relationship with perceptions of health claims and healthy messages on package of foods in general. Findings could effectively support policy makers in planning of proper measures to improve consumers' knowledge and awareness of links between health and diet. In the meanwhile, food industry and market could continue to innovate and differentiate by developing more attractive functional foods in line with consumers' needs, and without prejudicing to its protection and security. Anyway, it could also be useful developing a wider literature review because the present is only a first step of analysis. The authors intend to extend the investigation to other studies in future

research.

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# Increasing the Efficiency of Decision-Making Process with the Help of Econometrics

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## Abstract

*Representing a combination of mathematical methods, economic theory and statistical techniques, econometrics has an important role in fields like management, marketing, accountancy, finance, etc. The large number of practicability fields represents the reason for which, in the last decades, econometrics has known a spectacular development, moving from studying macroeconomic phenomena to microeconomic phenomena. This paper aims to present an econometric analysis of the decision to replace a random wear terminal accomplished with the aim of decision substantiation regarding the IT field. within a company.*

**Keywords:** econometrics, the operating probability, the operating curve, the rate of supply

**J.E.L. Classification:** C01, C60, D80

## 1. Introduction

Although empirical studies in economy have been made since the 17<sup>th</sup> century, the field of econometrics is more recent. The first use of the term “econometrics” is assigned to Pawel Ciompa (controller of the Austro-Hungarian bank in Lvov), who in 1910 published the study “Zarys ekonometry i

teorya buchalteryi” about accountancy and econometrics (the term having then another significance than today) [6]. In 1926, Ragnar Frisch (1895-1973), a Norwegian economist and statistician, has used the term “econometrics” for the first time in the sense that is used today.

In 1930 it is founded, at the initiative of Ragnar Frisch and Irving Fisher, the Society of Econometrics, having as publication the magazine “Econometrics”. In 1933, in the first issue of this magazine, the editor Ragnar Frisch noted the fact that econometrics represents a combination of economic theory with mathematical and statistical methods [8]. Therefore, after it is written in mathematical form, the economic theory is analyzed using statistical methods. If the observed data are consistent with the theory predictions, then the theory is considered to be accurate and accepted. According to Monasch University, “econometrics is a set of quantitative techniques that are useful for making economic decisions”.

Thus, econometrics provides the quantitative basis necessary for the economic policies formulation and simulation having as main purpose providing the economic forecasts provision [2].

## 2. Econometrics analysis

The purpose of this paper is to present an econometrics discussion on a situation to

which the management of the IT department within a company is facing.

Therefore, it is analyzed the case of a company which has 300 terminals. For 10 years, at the beginning of each year, it is registered the number of terminals which are in working order.

If the number of terminals put into operation at the initial moment is denoted by  $n(0)$  and the number of terminals which are in working order at  $t$  moment is denoted by  $n(t)$ ,  $t = \overline{0, T}$ ,  $T = 10$ , of the existing  $n(0)$ , it is issued the calculation and interpretation of the following indicators: the working probability of a terminal after  $t$  years of use, the probability that a terminal to be removed from service after  $t$  years of use and the probability that a terminal to be removed from service in  $[t - 1, t]$  period.

Taking into account the damage probability of a terminal, it is required the determination of the number of terminals which must be purchased in order to perform the activity in optimum conditions and the rate of supply.

From the registrations made, have resulted the following values:

Table 1. The number of working terminals at  $t$  moment

t	$n(t)$
0	300
1	300
2	294
3	270
4	255
5	240
6	210
7	150
8	90
9	30
10	0
>10	0

Source: Data collected by author

Through the time of functioning of a terminal, we understand the time since its implementation (measured in hours) and the considered moment  $t$ .

For a terminal put into operation at 0 moment, the working probability at  $t$  moment is:

$$P_f(T \geq t) = \frac{n(t)}{n(0)}, t = \overline{0, 10}. \quad (1)$$

Using relationship (1), the probability that a terminal to be removed from service after  $t$  years of use is:

$$P(T \leq t) = 1 - P_f(T \geq t) \quad (2)$$

If the company considers that in year  $t$ ,  $t = \overline{2, 10}$  needs a number of working terminals equal to  $n(0)$ , then, at the beginning of the chosen  $t$  year, must be purchase a number of terminals equal to:

$$n(t) = n(0) \cdot P(T \leq t) \quad (3)$$

The probability of removal from service of a terminal in the interval  $[t - 1, t]$  is

$$\begin{aligned} P(t - 1 \leq T \leq t) &= P(T \geq t - 1) - P(T \geq t) \\ &= \frac{n(t - 1)}{n(0)} - \frac{n(t)}{n(0)} = \frac{n(t - 1) - n(t)}{n(0)} \end{aligned} \quad (4)$$

notation

$$= P_s(t)$$

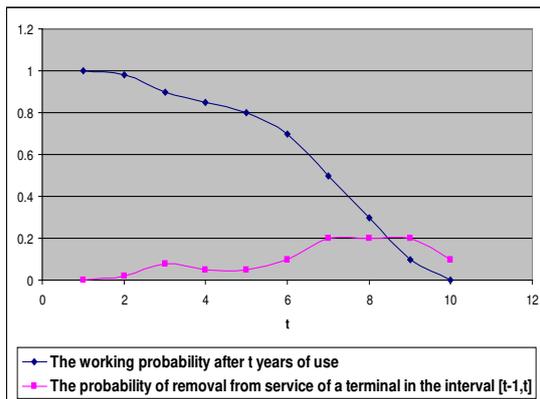
Using data from Table 1, the obtained values following the application of relationships (1)-(4) are shown in Table 2.

Table 2. Features values in (1)-(4) relationships

t	$P_f$	$P(T \leq t)$	$n(0) \cdot P(T \leq t)$	$P_s(t)$
0	1	0	0	-
1	1	0	0	0
2	0.98	0.02	6	0.02
3	0.9	0.1	30	0.08
4	0.85	0.15	45	0.05
5	0.8	0.2	60	0.05
6	0.7	0.3	90	0.1
7	0.5	0.5	150	0.2
8	0.3	0.7	210	0.2
9	0.1	0.9	270	0.2
10	0	1	300	0.1
>10	0	1	300	0

Source: Own calculation

Figure 1.  $P_f$  and  $P_s(t)$  chart values



Source: Created by author

The risk of maintaining a terminal into operation, which reached the  $t$  operating time, is assessed using the damage probability (defined as probability conditioned that a terminal which operated in good conditions until  $t-1$  moment, to have a weakness in  $[t-1, t]$  and denoted by  $P_a(t)$ ).

$$P(t-1 \leq T \leq t) = P(T \geq t-1) \cdot P_a(t) \quad (5)$$

$$\Rightarrow P_a(t) = \frac{P(t-1 \leq T \leq t)}{P(T \geq t-1)} = \frac{n(t-1) - n(t)}{n(t-1)} \quad (6)$$

Table 3. Values of damage probability

t	$P_a(t)$
0	-
1	0
2	0.02
3	0.08
4	0.06
5	0.06
6	0.13
7	0.29
8	0.40
9	0.67
10	1.00
>10	-

Source: Own calculation

If we choose to make the above analysis at the moment of time  $t = 7$  years, we notice that:

- the working probability of a terminal is that of 0.5;
- the probability that a terminal to be removed from service after 7 years of use is that of 0.5;

- the probability of removal from service of a terminal between the 6<sup>th</sup> and the 7<sup>th</sup> year is that of 0.2;

- at the beginning of the 7<sup>th</sup> year will be purchased 150 terminals if it is desired that in the 7<sup>th</sup> year to be 300 operating terminals.

We denote by  $h(t')$  the number of terminals replaced until  $t'$  moment,  $t' = \overline{1, t}$ , and by  $f(t)$  the number of operating terminals at  $t$  moment.

Then, the function denoted by  $g(t')$  representing the number of terminals replaced between  $[t'-1, t']$  will be equal to:

$$g(t') = h(t') - h(t'-1), \quad t' = \overline{1, t} \quad (7)$$

In other words, the  $g(t')$  function defines the supply volume.

With the help of the previous notation, we can write the  $f(t)$  function as being:

$$f(t) = n(0) \cdot P_f(T \geq t) + \sum_{t'=1}^t g(t') \cdot P_f(T \geq t-t') \quad (8)$$

Using relationship (8) and the data in Table 2, we can assert the fact that if in the third year the company has replaced  $294 - 270 = 24$  terminals, then the number of the operating terminals in the 9<sup>th</sup> year will be:

$$f(9) = n(0) \cdot P_f(T \geq 9) + 24 \cdot P_f(T \geq 9-3)$$

$$= 300 \cdot 0.1 + 24 \cdot 0.7 = 46.8 \approx 47 \text{ terminals}$$

Thus, in order to have 300 operating terminals in the 9<sup>th</sup> year must be replaced:

$$g(9) = 300 - 47 = 253 \text{ terminals.}$$

### 3. Conclusions:

Economic decisions are not limited only to those taken by the economists. We can say that any decision affecting the assignment of some limited resources is an economic decision.

The fact that the economic theory's transposition into the real world's economy is greatly influenced by indetermination, leads to the statement that econometrics can not provide perfect patterns for the economy's mechanisms. With all these limitations,

knowing on econometrics help professional economists (not only those working with data), both in increasing their depth of knowledge and understanding of the economy and in developing their capacity of obtaining a perspective on econometric work and make a critical evaluation of it.

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## The Importance of Improving Assessment Criteria for the Increase the Quality of Research Projects Submitted in Competitions

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### Abstract

*The National Strategy for Research, Development and Innovation for the period 2007-2013 is based on the vision of the Romanian society on the role of science, technology and innovation for the development of the knowledge society in Romania, for the economical and social progress [1].*

*The National Plan for Research, Development and Innovation 2007 – 2013, called herein the National Plan II, represents the main instrument used to implement the National Strategy for Research, Development and Innovation.*

*This paper presents a study which aims to analyse the assessment criteria for the research projects submitted in the competitions from 2007, 2008 and 2011 as part of the Partnership Programme and to highlight the importance of improving the assessment criteria for the increase the quality of research projects submitted in competitions.*

**Key words:** assessment criteria, research, NP II, Partnership Programme

**J.E.L. Classification:** I23

### 1. Introduction

The National Strategy for Research, Development and Innovation (RDI) for the

period 2007-2013 is based on the vision of the Romanian society on the role of science, technology and innovation for the development of the knowledge society in Romania, for the economical and social progress [1]. The strategy has the objective to catch up on the gaps in comparison to the level of the European countries and it prepares the RDI system in Romania in order to identify and consolidate, in international partnership and competition, those unique areas in which Romania could excel [1].

In their strife for excellence, the universities, the public institutes of research and development, the other public entities of research play an important role. They are challenged to change into important actors on the knowledge market, attracting and developing human resources of high quality and concentrating on important research facilities.

The involvement on research and the relationship which has become closer and closer to the economical field have turned out to be not only sources of income, but also intrinsic elements in the process of education and training.

In the triangle of knowledge, education-research-innovation, the last element is linked in the closest way to the impact on welfare but at the same time, it is the one which raises most problems as related to complex policies. Innovation, a process with many variables, keeps the collaboration between research and industry at its core.

During the last decade, the developed countries proposed intermediary entities or other forms of interaction and collaboration which could create links between these two sectors, allotting them increasing public financial resources.

The National Plan for Research, Development and Innovation 2007 – 2013, called herein the National Plan II –NP II – represents the main instrument used to implement the National Strategy for Research, Development and Innovation.

NP II aims to accomplish three strategical objectives of the national system of RDI, namely [2]:

1. Create knowledge, respectively obtain certain top scientific and technological results with the purpose of increasing international visibility for the Romanian research followed by a transfer of these results into the social-economical practical activity.

2. Increase competitiveness of the Romanian economy, having an impact on the level of the economical agents and transfer of knowledge in economic practice.

3. Increase social quality, respectively find technical and scientific solutions to support social development and improve its human condition.

The programme *PARTNERSHIPS* estimates original results which refer to the design and accomplishment of original products – prototypes, technologies and innovative services as a result of experimental research with a direct practical purpose and market potential. This kind of programme can achieve, in a logical way, the interface and convergence of fundamental scientific research projects, financed by the *IDEAS* and *HUMAN RESOURCES* programmes, with projects developed in the *INNOVATION* programmes, which finance the undertaking of the prototype products or of the technologies which are expected or accessible on the market, accomplished by the economical agents competent in the nine research fields [3].

The *Collaborative Projects of Applied Research* (CPAR) aim to support and promote applied research in priority areas, inter- and transdisciplinary fields, relevant for the increase in competitiveness in research, development and innovation (RDI) on national level, and in agreement with the

global economy based on knowledge. There are financed different experimental research and technological development projects, undertaken in partnerships and ending up with the design of innovative products, technologies and services targeted to solve and implement solutions to the complex social and economical problems, of national priority and international update [3].

*The objectives aimed by CPAR are the following [3]:*

1. Join the applied research and the technological progress from Romania to the demands of the national and global, social and economical environment, in the accomplishment of original products, advanced technologies and services in nine priority fields, competitive on international level and with a major social and economical impact;

2. Join the applied research to the priorities of the European Research Area (ERA) for technological progress in Romania, increase visibility and prestige on the international market;

3. Stimulate partnerships (research organizations, economical agents, NGOs and/or professional associations and so on), in order to shorten the way from scientific knowledge to technology having a social and economical impact, aligned with the market needs and evolution;

4. Implement the principle “financing follows the scientific and technological performance” in research generating technological innovation, with an impact on the competitiveness of Romanian economy and welfare;

5. Stimulate the investments in the private sector in RDI, in their own activities as well as in collaboration with universities and research institutes, in order to finish and transfer the results to the market.

## **2. Empirical support and methodology**

The study has the purpose of analysing the assessment criteria in the Partnerships Programme for the research projects submitted in the competitions from 2007, 2008 and 2011 and of highlighting the importance of improving the assessment criteria for the increase the quality of the research projects part of competitions in the Partnerships Programme.

## 2.1. Assessment and decision criteria used in the ranking of the research projects

One of the questions which is often asked in the project competitions is the following: Which projects should be supported in order to apply the research rules and programme implementation rules and which should be not?

The assessment and decision criteria and the processes related to them certainly hold a key position in the frame policies which are based exclusively on financing. The assessment criteria create the bond between the project aim, programme objectives and the individual projects. The decision-makers for research policies, the programme managers face the fact that they have to correlate the purposes of the research policies with the programmes objectives and the latter with the assessment and selection criteria of the research projects. This means that the applicants are allowed to assess the projects and the criteria (with the meaning of consulting them in order to elaborate these assessment criteria) without understanding the policies which form the starting point of research strategies and financing programmes. Keeping these aspects in mind, there should be considered a number of practical issues when establishing the criteria: the criteria should be as complete as possible (to cover all the relevant aspects of the programmes); the assessment criteria should be in a small number (so as to take into consideration the project and its performance in the assessment process); the assessment criteria should be independent in order to avoid prejudices, their fraudulent use and false interpretation; the assessment criteria should be easily measured and applied.

There are many possible traps which appear in practical work in the conceiving and elaboration of the assessment criteria. The most frequent ones are the following: too many assessment criteria (often as a result of poor management of the assessment criteria elaboration process); assessment criteria which are not adapted to the objectives of the policy / programme; criteria which are interconnected (thus altered by uncontrollable prejudices); changing the assessment criteria from one call to the other

(often as a result of the learning process, mostly ambivalent, hence the applicants tend to perceive the change in criteria as an additional source of uncertainty).

Experience shows that the assessors tend to use a complex set of criteria, as complex as possible, in the process of project assessment.

## 2.2. Assessment criteria for the Partnerships Programme

For the two competitions from 2007 and 2008 as part of the Partnerships Programme there were submitted projects from the category of *Complex Projects* (CP).

In the competition from 2011 as part of the Partnerships Programme there were submitted Collaborative Projects of Applied Research (CPAR) of two types [3]: *Type I* – The structure of the partnership does not impose the participation of an enterprise. For this type of project, the financing from the state budget could be 100% from the project value. *Type II* – The structure of the partnership imposes the participation of at least one enterprise and the sum of the co-financing should be of at least 7,5% from the project value (project value = financing from the state budget plus its own co-financing) if the participating enterprise/s are small and medium and respectively at least 15% in case one of the partners is a big enterprise, following the provisions of the scheme on state aid.

For the first competition from 2007 the assessment criteria for the research projects in the Partnerships Programme were the following [4]:

1. *Relevance of the project* (max 10 pt): To what extent the project contributes to the development of expertise/skills in the field; The objective is clearly defined?

2. *Scientifically and technically description of the project, incl. the degree of novelty and the possibility of implementation of results* (max 45 pt): The novelty and complexity of the solutions proposed / potential patent; Clarity of the project theme presentation; The degree of correlation with the intended activities; The extent to which results sustain the project objectives and are measurable; How clearly and coherently is presented the scheme of the project (broken down by

activities)?; Highlighting the possibility of transferring the results to potential beneficiaries; The existence of some measures to protect intellectual property; The degree of dissemination of results (int. conferences, fairs, exhibitions).

3. *Project impact* (max 10 pt): The extent to which the project generates clearly social, economic, environmental effects; The extent to which young professionals are attracted to research activities of the project

4. *Project Management. Consortium members* (max 20 pt): Coordinator experience in the field of the project and in management of national / international projects; Partners experience in the field of the project and in national / international projects management; Project coordinator managerial and professional competence; The degree of specialization and complementarity of professional research staff involved in project; Clarity of methods / techniques of management, coordination and communication for the project implementation

5. *Material, financial and human resources* (max 10 pt): The extent to which existing resources ensure that the objectives of the project will be achieved; The extent to which allocation of resources correspond to the implementation plan

6. *Conformity with the Excellence in Research Program* (0 or 5 pt): The project coordinator has a project in implementation / completed within the Excellence in Research Program, Modules I and III and has proposed / participates in FP7? If yes, 5 pt, if not 0 pt.; The project did not participate in Excellence in Research Program, Modules I and / or III - 5 pt is granted by default.

For the second competition from 2008 the assessment criteria for the research projects in the Partnerships Programme were the following [4]:

1. *Relevance of the project* (max 10 pt): To what extent the project contributes to the development of knowledge in the field; The objective is clearly defined and correlated to the output indicator of the Programme

2. *Scientifically and technically description of the project* (max 50 pt): The novelty and

complexity of the solutions proposed; Clarity of the project theme; The degree of correlation with the intended activities; Clarity and coherence of the project implementation plan, broken down by activities; The extent to which results sustain the project objectives and are measurable / potentially patentable; Possibilities of transferring the results to potential beneficiaries; Method of assignation and usage of the research results, in between partners, including the IPR; observation of scientific research ethic issues, if the case; The degree of dissemination of results (int. conferences, fairs, exhibitions)

3. *Project impact* (max 10 pt): The extent to which young professionals are attracted to research activities of the project; The extent to which the project generates well defined social, economic, environmental effects

4. *Project management and consortium members* (max 15 pt): Clarity of methods/techniques of management, coordination and communication proposed for project implementation (project logic diagramme); Coordinator and partners entities expertize in the project field and management of national/ international projects; Project coordinator participation with proposals on FP7 initiative; Project coordinator expertize, including managerial expertize, in other programs / national/international projects; The degree of specialization and complementarity of professional research staff involved in the project

5. *Material and financial resources* (max 10 pt): The extent to which existing resources ensure that the objectives of the project will be achieved; The extent to which the requested resources are correctly adjusted to project activities.

6. *Conformity with the Excellence in Research Program* (0 or 5 pt): Project manager coordinated / coordinates project(s) on CEEX Program, modules I and III and proposed project(s) on FP7; Project manager coordinated / coordinates project(s) on CEEX Program, modules I and III and did not propose projects on FP7 (0 pt) Project

manager did / does not coordinate project(s) on CEEEX Program, modules I and III.

For the competition from 2011 the assessment criteria for the research projects in the Partnerships Programme were the following [3]:

*1. Scientific quality (30%/30%):* Originality (15%/15%) How original and innovative is the research project? To what extent does the proposed research go beyond the current state of the art?; Approach (15%/15%) To what extent are the methods, techniques and investigation tools adequately selected and/or developed, well integrated, well reasoned, and appropriate to the aims of the project? Does the applicant acknowledge potential problem areas and consider alternative approaches?

*2. Implementation (45%/40%):* Human resources (20%/15%) How relevant is the expertise of the key team members as derived from their applied research experience, for the proposed objectives? How well do the skills and experience of the team members complement each other, and how well positioned are they to collaborate productively in view of the project objectives and workplan?; Infrastructure (5%/5%) How appropriate is the infrastructure and equipment which is available or to be acquired, in view of the projected objectives, in the given time frame?; Work plan (15%/15%) How appropriate and well adapted is the work plan for achieving the goals of this project, and how likely is it that the goals be achieved within the proposed timescale and resources?; Budget (5%/5%) How adequate is the budget proposed based on the objectives, the workplan and the existing human resources and infrastructure? Please comment and/or suggest possible corrections.

*3. Socio-economic impact (25%/30%):* Applicative potential (25%/20%) How would you rank the potential of the project objectives to lead to significantly improved quality, performance or efficiency of goods or services? Do the proposed results distinguish enough from products/technologies/services that are already patented or available on the market, internationally? How well positioned is the project to contribute significantly to

solve/improve on a quantifiable social need?; Business case (0%/10%) To what extent is the project well integrated into the business strategy of the enterprise partner, considering its market position and experience? How well positioned is the project to contribute significantly to the business growth of the enterprise partner?

### 3. Results and Controversy

In assessment practice – an assessor works in front of a computer, makes his assessment, fills in all the forms, including all the comments for each criterion and then discusses in the panel with the other assessors and a consensus there should be reached – we notice that such a complex system is difficult to handle. In situations like these, the assessors have the tendency to use their own criteria.

In the calls from 2007 and 2008 there can be noticed a great number of assessment criteria - 21. This great number of criteria could generate overlaps and misunderstandings in the assessment process.

The criteria is usually interconnected, which might lead to prejudices. For example, the creation of new knowledge issues is required in different chapters with their own markers.

In spite of the great number of criteria, there are some faults. The most relevant aspects which is not included in the assessment criteria refers to the organisations which undertake the project. The most relevant question is if that particular project will contribute to the increase in performance for the organisations undertaking it.

There is a tendency that certain aspects from the project proposals be assessed several times: for example, licencing, patents are assessed twice (criteria 2008: g and i), and the novelty of the proposal is assessed three times (criteria 2008: a, c and g). There is also a tendency that some markers be given more importance, diminishing others. There has been proved that the proposals without an economical relevance (without results which could be put into value economically afterwards) could obtain up to 80 % from the maximum assessment score.

Nevertheless, in the case of the call from 2011 there can be noticed a much smaller number of assessment criteria - 14. They

were structured into 3 sets of criteria (unlike the situation from 2007 and 2008 when there were 6 sets of criteria) clear and concise, thus the assessment could be made much better.

In case of the assessment criteria from 2011 the accent lies on originality (15% in comparison to 6%) and on the social and economical impact (30% in comparison to 10%) of the projects, aiming to reach results which will be integrated in economy.

Also, there is given more importance to the assessment of the human resources and to the financial assessment (25% in comparison to 10%).

#### 4. Conclusions

Taking into consideration the aspects studied in the paper, we can draw the following conclusions:

1. The number of assessment criteria from the practical point of view was too large in the case of the calls from 2007 and 2008.
2. In the case of the calls from 2007 and 2008 there were certain aspects which had been assessed several times in the assessment process.
3. A beneficial element for the project assessment was the reduction in the number of assessment criteria for the competition from 2011 (14) in comparison to the competitions from 2007, 2008 respectively (21).
4. Originality (15% in comparison to 6%) and the social-economical aspect (30% in comparison to 10%) of the project have a much greater importance in the call from 2011 in comparison to the ones from 2007 and 2008.
5. The percentage of the human resources and financial aspects of the projects (25% in comparison to 10%) is much greater in the call from 2011 than in the calls from 2007 and 2008.
6. The assessment criteria change too often from one call to the other. This is certainly the result of a learning process and coming from the wish to improve the assessment system. At the same time, all these changes are perceived as a supplementary source of uncertainty.
7. The assessment criteria should be independent in order to avoid

prejudices, the fraudulent use and misinterpretation.

8. The criteria should be as complete as possible (to cover all the relevant aspects of the programme).
9. An assessment criterion which should be introduced is if the project under study will contribute to the increase in performance of the organisations undertaking it.
10. The assessment criteria should be easily measured and managed.
11. There could be introduced thresholds in the assessment criteria, combined with the reduction in the number and share of criteria with a "heavier load".
12. By improving the assessment criteria of the research projects submitted for the competitions as part of the Partnerships Programme there will be obtained an increase in the quality of the research projects, hence a greater social-economical impact of their results.

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# Business Models Based on Corporate Social Responsibility: the Case of Global Pharmaceutical Companies

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## Abstract

*In the past century, the business models were focused on providing a basic product at a low/very low cost, then charging excessive amounts of money for refills or for associated products/services. In the 21<sup>st</sup> century, the business models have to take into account not just the new technologies, but also the social responsibility issue. The aims of our paper are to present in brief the concepts of business model and of corporate social responsibility (CSR), and to highlight the emergence of the business models based on CSR in the global pharmaceutical industry. The methodological approach is based on the literature review.*

**Keywords:** business models, corporate social responsibility, pharmaceutical companies

**J.E.L. Classification:** M14, M19

## 1. Introduction

Over the years, business models have become much more sophisticated as the human society evolved. In the early 20<sup>th</sup> century, the business models were focused on providing a basic product at a low/very low cost, then charging excessive amounts of money for refills or for associated products/services. In the 21<sup>st</sup> century, the business models have to take into account not just the new technologies, but also the social responsibility issue. More and more, business models become sustainable ways of doing business in a highly competitive environment (Nielsen, 2010).

The aims of our paper are to present in brief the concepts of business model and of

corporate social responsibility (CSR), and to highlight the emergence of the business models based on CSR in the global pharmaceutical industry. The methodological approach is based on the literature review.

The paper is structured as follows. The second section outlines in short the theoretical framework related to the concepts of business model and CSR, emphasizing some of the main contributions derived from the literature. The third section of the paper displays a study case regarding business models based on CSR within the global pharmaceutical companies. The paper ends with conclusions.

## 2. Theoretical framework

During the time, the topics of both business model and CSR have led to a variety of publications and researches by academics, consultants, businessmen, and journalists. There are no widely accepted definitions of the two concepts in the literature.

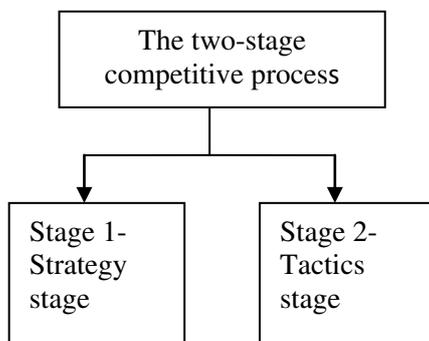
The term “business model” is a relatively young concept. In spite of the fact that the concept appeared in the late 1950s, it became important only towards the end of the 1990s. A business model has been defined in different ways as follows:

- “Business model refers to the logic of the firm, the way it operates, and how it creates value for its stakeholders.” (Baden-Fuller, et al., 2008, p. 1)
- „A company’s business model describes its collaborative portfolio of strategy choices put in place for the handling of the processes and relationships that drive value creation on operational, tactical and executive levels.” (Nielsen, 2005, p. 1)

- “A business model is a conceptual tool containing a set of objects, concepts and their relationships with the objective to express the business logic of a specific firm.” (Osterwalder, et al., 2005, p. 5)
- “Business models describe, as a system, how the pieces of a business fit together.” (Magretta, 2002, p. 6)
- “A business model depicts the content, structure, and governance of transactions designed so as to create value through the exploitation of business opportunities.” (Amit, Zott, 2001, p. 511)

The above mentioned definitions show that there are different understandings of the business model concept. However, several common characteristics of business models can be pointed out. Firstly, business models are strongly linked with the value creation, capture and marketing. Secondly, business models explain how business organizations work and the logic by which they earn money. Thirdly, business models constitute the platform which enables business organizations to select the strategic choices in order to obtain profit. Fourthly, business models are not the same thing as a strategy. According to R. Casadesus- Masanell and J. E. Ricart (2009), the concepts of strategy, business models and tactics can be all integrated within a generic two-stage competitive process framework (Fig. 1). In the first stage, the business organizations choose their business models through they would like to compete against or/and to cooperate with other companies in the marketplace. In the second stage, they make tactical choices that depend on the business models initially chosen.

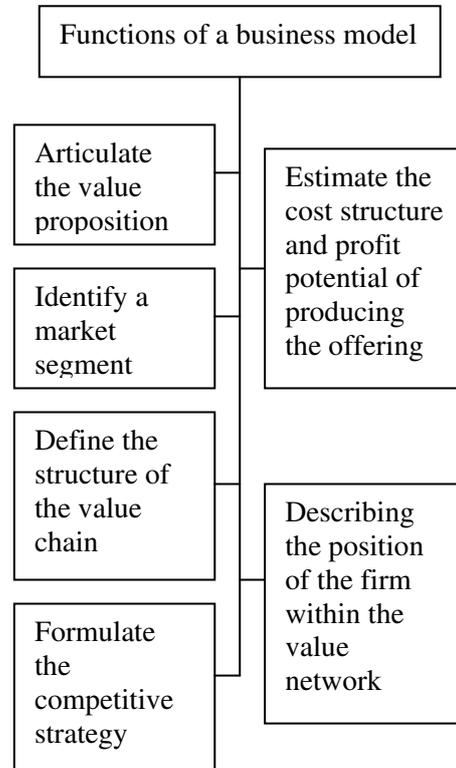
Figure 1. The generic two-stage competitive process framework



Source: adapted from Casadesus- Masanell, Ricart, 2009

There is a multitude of business models in the business world (e.g., multi-level marketing, open source, low-cost). All of them are created on the basis of the functions of business models (Fig. 2).

Figure 2. The functions of a business model



Source: adapted from Chesbrough, Rosenbloom, 2002

In sum, the business model concept is relevant to all companies because it explains what things the business does and how the business makes money doing these things.

On its turn, the term CSR constitutes a multidimensional concept that describes the relationships between business and society. The ancient era of social responsibility appeared very early in the history of humanity. Nevertheless, the First Industrial Revolution brought many economic changes and opened new perspectives on the relationship between wealth and social welfare in the society.

The modern era of social responsibility started in the early 1950s when H. R. Bowen considered CSR as a way of integrating the societal values beyond the interests of corporate shareholders (Toma, et al., 2011). Step by step, CSR has become a concept

debated both by researchers from different fields of study (e.g., sociology, marketing, philosophy, management, law) and by businessmen. There are many definitions of the CSR concept as follows:

- “the way firms integrate social, environmental and economic concerns into their values, culture, decision making, strategy and operations in a transparent and accountable manner, and thereby establish better practices within the firm, create wealth and improve society” (Hohnen, 2007, p. 5);
- “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis” (Commission of the European Communities, 2006, p. 1);
- “the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large” (World Business Council for Sustainable Development, 1998, p. 3).

These definitions reveal several responsibilities of a socially responsible business organization. A. B. Carroll (1991) has identified economic responsibilities (“be profitable”), legal responsibilities (“obey the law”), ethical responsibilities (“do what is right and fair and avoid harm”), and philanthropic responsibilities (“be a good corporate citizen”). Built on the marriage between business and social responsibility, CSR encompasses a wide range of commitments and activities pertaining to environmental stewardship, corporate governance and ethics, human rights, health and safety, community involvement, customer satisfaction, accountability, etc.

In the past decades, CSR has significantly influenced the business models towards a more humane and ethical way of doing business. In this respect, the global pharmaceutical industry provides valuable corporate examples.

### 3. Business models based on CSR in the big pharma

During the last century, the average life expectancy in developed countries increased by approximately 20 years, especially due to

the contributions of the pharmaceutical industry. On the other hand, the industry has been subject to a number of criticisms, revolving around different issues (e.g., profits levels, pricing policies, patient safety, animal testing, environmental concerns).

Since the increasing spread of technological change, the pharmaceutical industry has been characterized by intense competition all over the world (Table 1). In the beginning of the 21<sup>st</sup> century, the big pharma (large globalised pharmaceutical companies) are feeling “pressure from every direction- from regulators setting the rules for drug effectiveness and safety, from managed care organizations and employers pushing back on prescription drug costs and reimbursement, from competitors coming to market with alternatives brands or generics, and from disgruntled shareholders” (Kandybin, Genova, 2012, p. 3).

*Table 1. World’s largest pharmaceutical companies*

No	Company	Sales (\$ bil.)
1.	Pfizer (USA)	67.4
2.	Novartis (Switzerland)	58.6
3.	Merck & Co. (USA)	48
4.	Roche Holding (Switzerland)	45.3
5.	Sanofi (France)	43.2
6.	GlaxoSmithKline (UK)	42.5
7.	Abbott Laboratories (USA)	39.8
8.	AstraZeneca (UK)	32.4
9.	Eli Lilly & Co. (USA)	24.3
10.	Bristol-Myers Squibb (UK)	21.2

Source: Forbes, 2012

In the past, the business models of big pharma had certain unique characteristics as follows (Rasmussen, 2003, p. 1):

- highly structured value chains determined by the regulatory process;
- high cost of product development combined with associated high risks of failure;
- focus on innovation.

Facing with many challenges, the big pharma have pursued new business models, based on CSR. Providing customer solutions coupled with direct accountability for the consequences of decisions made have been an increasingly main source of value and

profits for the today's big pharma. For example, the Roche Holding states that it offers value through targeting treatments to patients that would benefit most.

The leading research-based pharmaceutical company of the world is Pfizer. The American colossus was co-founded in 1849 by C. Pfizer and C. Erhart, two German young entrepreneurs in a red brick building in Brooklyn, New York. By continuously investing in research and development, Pfizer has become one of the most diversified corporations in the global health care industry. The American pharmaceutical heavyweight owns a wide range of biopharmaceutical products. In 2011, its blockbuster drugs were Lipitor, Lyrica, Plevnar 13/Prevenar 13, Enbrel, and Celebrex- each delivered at least 2 USD billion in revenues, and Viagra, Norvasc, Zyxov, Xalatan/Xalacom, Sutent, Geodon/Zeldox, and the Premarin family- each surpassed 1 USD billion in revenues.

According to Forbes Global 2000 Leading Companies, Pfizer is ranked no. 34 in the world, respectively no. 103 in sales, no. 39 in profit, no. 135 in assets, and no. 23 in market value (Forbes, 2012). However, Pfizer is not only the most profitable pharmaceutical company, but also a highly responsible one.

Social responsibility represents a key element of Pfizer's business model (Pfizer, 2012). Some of its objectives related to CSR are:

- to integrate corporate responsibility into Pfizer's core business processes;
- to support US health care system reform;
- to improve public health around the world;
- to reduce its impact on the physical environment, etc.

In order to carry out its commitment to participating actively in and improving the societies and/or communities in which it does businesses, Pfizer has striven to develop and implement many CSR programs in the last decade.

In 2007, Pfizer launched „Mobilize Against Malaria” in Ghana. The program enabled more than 660 chemical sellers in 13 districts to provide better malaria education to over 20,000 people, dispense medicines according to national protocol, refer complicated malaria cases, and pregnant women to nearby health centers (Pfizer,

2009). Also, Pfizer launched “Global Health Partnerships” in 2007. The program supported 29 grantees in 46 countries across five continents addressing emerging challenges in cancer and tobacco control (Pfizer, 2009).

In sum, CSR is fundamental to Pfizer's business model, being highly integrated into all of its components. Moreover, Pfizer has achieved its mission of “Working together for a healthier world” through CSR.

#### 4. Conclusions

In the past decade, the topic of business models has become prominent in the literature. In essence, business models constitute the blueprint of how companies do business.

The big pharma have made tremendous contributions to human well-being. They discovered drugs that solve medical problems to a huge number of people around the world. That is why the business models based on CSR are increasingly implemented in the global pharmaceutical industry.

More and more the big pharma have to restructure their businesses to speed decision-making and increase accountability in order to thrive in today's unpredictable environment.

#### 5. Acknowledgements

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## Strategic Planning for NGOs

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### Abstract

*In a competitive and economic environment, ever changing, the key to success is represented not by the quality of operational planning, but by the clarity of strategic thinking, even it is matter of an NGO. Currently, no one may talk about the environmental stability, the only constant is the permanence of changing.*

**Keywords:** NGOs, strategic planning, changing, strategy, management.

**J.E.L. Classification:** L31

### 1. Introduction

Strategic planning is the main method of organization and unitarian management, by own management, of the assembly of all resources of the company, in order that it can cope with environmental changes and to be competitive. As a form of performance of professional and strategic planning organization should be conceived as a very complex management activity, which is based on studies, calculations, summaries and so on, and combine closely the current planning with perspective planning.

### 2. The planning process

Planning, as the central attribute of management, consists in making the forecast of the trajectory that will follow in the future the respective organization, and has the following main purposes:

- establish the conditions under which the organization will work, these are in fact, the objective frame;
- determine the main objectives of the organization, as well as the necessary means of reaching them;

- define the procedures to be followed for meeting the fixed targets.

Planning process consists of a set stage, correlated between them, which aims elaboration and implementation of plans and objectives of the organization.

In the preparatory phase of the planning process it is to formulate goals and mission of the organization, to establish hypothesis and premises of the organizational environment.

Actual planning phase is focused on the elaboration of short-term, medium and long plans, respecting correlations between them.

In the stage of reserve plans, any organization elaborates a reserve strategy to use in case of environmental changes that do not allow the actions launched according to the original plans.

Implementation phase refers to the start of activity in accordance with elaborated plans. Reviewing phase aims to compare achieved results with the organization's mission, and retaking a new planning process.

All these goals and stages are leading to the underlining of the advantages that entails planning, namely:

- help to clarify the direction of NGOs;
- can have a big impact on motivation of individuals working in respective organization;
- help more efficient use of all resources available to NGOs;
- provides a useful tool to assess progress made by NGOs.

### 3. The importance of strategic planning

As the environment in which the nonprofit organization operates is dynamic and uncertain, as the planning is necessary. In this context, the need to plan arising from consideration of the following *factors*: *a. Complexity NGOs*

In modern society, economic organizations in general, non-profits in particular, have become complex units. This feature is determined not only by size and complexity of operations of NGOs, but also by complicated and numerous interferences that exists between organizational components, by social role that community assigns.

NGO complexity results not only from its dimensions, but also from many other factors, and for that reason the planning is necessary for all kinds of organizations, whether big, medium or small and equally for non-profit organizations.

*b. Changes in the external environment*  
NGO, as economic system, is only part of other larger systems – at regional, national and international level - that is the general environment.

Because the current global environment is dynamic and uncertain, changes occur in an accelerated rate, being difficult to predict and having a strong impact on NGOs. If it is established an appropriate run of future actions, then it helps to maintain in balance the economic system.

*c. Transformation duration of resulting decisions*

In an external environment, more dynamic and more uncertain, if planning is done for larger time horizons, then the goals, that are established, are ampler. Thus, it appears that the time, between the moment when the decision is adopted and the moment when the results are obtained, increases. In this context, managers need to consider everything possible to not affect the achievement of set objectives, and find ways to minimize uncertainty and risks.

Planning becomes a tool that helps managers to cope with change.

#### **4. Stages of strategic planning in NGOs**

John M. Bryson brings to his analysis, significant contributions in improving performance of managers working in the nonprofit sector. He shows that strategic planning is a concept and a new practice in nonprofit and public organizations (only from about 10-15 years).

He divides the cycle of change of strategic planning in NGOs in ten stages, namely:

1. Initiate and agree on strategic planning process.
2. Identify organizational mandates.
3. Clarify organizational mission and values.
4. Assess inner and external environments of the organization to identify strengths, weaknesses, opportunities and threats.
5. Identify strategic issues facing the organization.
6. Formulate strategies to resolve these problems.
7. Review and adopt the plan or strategic plans.
8. Establish an efficient vision of the organization.
9. Develop an efficient implementation process.
10. Reassess strategies and strategic planning process.

Ion Boboc reminds in the work *Management NGOs* same 10 stages, which were initially treated by specialist Bryson in his work *Strategic Planning for Public and Non-profit Organizations*.

In a brief display, these stages are:

1. In the first stage, that can be called also *Initial access* is made an initiation and an agreement on the strategic planning process by involving all stakeholders and negotiating with each other.
2. The second stage, called *Identifying organizational mandates* relates to the needs of that organization, but also to identifying what can make each “managerial player”, according to these needs and the legislation to be known.
3. The third stage, called *Clarifying organizational mission and values (of shareholders)*: clarification of the objectives for which the organization operates, identifying areas of collaboration with other NGOs. A shareholder is defined as “any person, group or organization may request justifiably attention concerning resources or results of an organization or who is affected by these results, examples being citizens, taxpayers, service users, government body, employees, unions, groups of interests, political parties, financial community, companies and various management bodies.
4. Examples of shareholders of a non-profit organization are customers or consumers, taxpayers or auxiliary donors, staff,

executive board, volunteers, other non-profit organizations that provide complementary services or are involved in various projects, as collaborators, banks detaining mortgages of organizations and of providers” (Bryson, 2002).

5. In stage called *Evaluation of inner and external environments of the organization* to identify strengths and weaknesses, opportunities and threats, resources, current strategy and performances.
6. The fifth step, *Identification of strategic problems facing the organization* designed a number of aspects such as focusing on fundamental issues of institutional policy, on what is really important for an NGO, for survival, prosperity and efficiency.
7. Sixth stage called *Formulating strategies to solve these problems* is to ensure the link between rhetoric, choices, actions and consequences, making them consistent and coherent structures at all levels, for all functions and moments.
8. The seventh stage *Review and adoption of the plan or strategic plans* refers to approval and implementation.
9. The eighth stage, *Establish an efficient vision of organization* comprises a set of actions relating to organization description, respectively description of successfully mission, basic strategies, performance criteria, the fundamental decision rules, ethical standards, valid for all.
10. The penultimate stage, *Development of an efficient implementation process* includes detailing of roles and of responsibilities of the Executive Board and managers, specific objectives, expected results and indicators, specific stages of action, programs, requirements of resources and sources, communication process, review, monitoring and correction procedures for determining the responsibilities, setting a budget of the plan.
11. Last stage, *Revaluation of strategies and strategic planning process* is actually the establishing of a prelude of a new round of strategic planning.

## 5. Strategic planning of NGOs – motivations

After this study, organizations engage in strategic planning for various reasons. Those who propose strategic planning attempts typically to persuade their peers with one or more of the following statements:

“We face so many opposing requirements that we need a process to establish our priorities.”

“We must clarify what we do well in order to make that work better and also we must establish what we might do again.”

We have a total quality management program in progress, now we have to "reinvent" and to "reorganize" ourselves. How can we be sure that all this effort is headed in the right direction?"

“We can expect a severe budget deficit next year if we not totally rethink the way we do business.”

“A number of our competitors in the private sector aimed our customers, we must find a way to win the competition.”

“The X problem presse us. We must find a way to solve it, otherwise we will have losses.”

“Our sponsors (or executive board) asked us to prepare a strategic plan.”

“We need to integrate or better coordinate the services we offer to those offered by other organizations.”

“We know that follows a change in management and want to prepare for it.”

“We want to use strategic planning to educate, engage and revitalize the board and staff.”

“Our organization has a shortage of funds, but we must still consider how we can have the greatest impact, we owe it to our shareholders.”

“Everyone deals with strategic planning today, it would be good to do it and we.”

What can be noted after the analysis of these statements is that any reason for which non-profit organizations do strategic planning, results similar benefits, among which it can be mentioned the following:

- promote strategic thinking and action which leads:
- to obtain information more organized for internal, and external environments, but also to the benefits they can get different target groups / various stakeholders, building the future direction of the organization;

- determining the organization's vital activities etc.
- optimization of the decision process due to focus on the most important problems which has results in:
  - making decisions easier for these problems and difficulties of decision factors;
  - strategies are formulated and communicated more easily;
  - making current decisions that depend on future consequences, and setting up a logical basis for decision making process to help coordination of the decisions resulting in different levels;
  - discretion exercised in different areas being under the control of their organization.
- improved performance and increased responsibility which are resulting from the first two benefits listed above.

## 6. Conclusions

Although strategic planning can provide all the benefits mentioned above, this does not mean that the organization will take advantage of it immediately, because planning is a set of concepts, processes and tools that help managers to think and act strategically. It can help organizations formulate and solve the major problems faced.

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## The Role of Foresight on National Economy

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### Abstract

*The Foresight exercises on national level are often reminded in international practice. The most important reason why these studies have gained is the consumption of available natural resources correlated with the technologies used for processing them. Besides this there are added the globalization process and the concept of durable economy, which is often substituted by a new one, the concept of sustainable economy. All these arguments are meant to sustain the necessity of using the national Foresight Exercises, especially for the countries which have an emerging economy.*

**Keywords:** Economic trends, Forecasting, Globalization, Sustainable Development, Foresight

**J.E.L. Clasification:** O 30, O 33, O 39

### 1. Foresight – Definition, Objectives and Functions

One of the first definitions of Foresight's is given by one of its parents, Martin B. R. [7]:

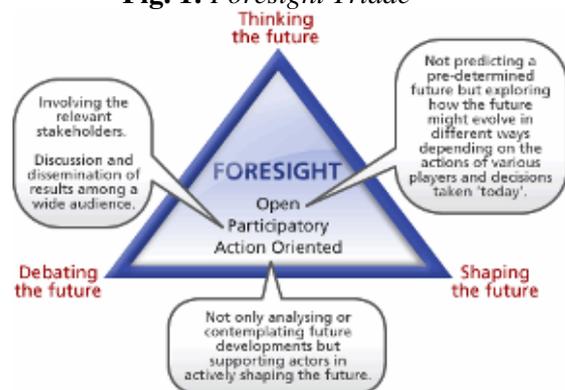
*the foresight is the process involved in systematically attempting to look into the longer-term-future of science, technology, the economy and society with the aim of identifying the area of strategic research and the emerging generic technologies likely to yield the greatest economic and social benefits.*

*Foresight assumes that the future is not predetermined but it can be created or shaped [15]. This entails the assumption that the future can take many forms. Each form represents a possible future which we can access by following a series of more or less correct decisions.*

The Foresight can be described as a mixture of Thinking, Debating and Shaping the Future (Figure 1).

Being aware of the importance of decisions and their succession in time, is the first step in trying to shape the future and to direct it into a desired form, called desirable future.

**Fig. 1: Foresight Triade**



Source: FOR-LEARN, 2005-7

Among the *desirable futures* will be selected a limited number of *possible futures*, called *feasible futures*, from which we will choose the one to be implemented into reality.

What gives the Foresight an action oriented basis (character) is the attempt to coordinate the implementation of decisions?

Foresight exercises can not be conceived without the participation and involvement of representatives, on one hand from the policy- and theory- making, and, on the other hand, from the beneficiaries of these decisions and theories, citizens or businessmen. This gives to Foresight a participative characteristic.

Because the foresight's results are obtained in a joint effort of representatives from different backgrounds, that gives to it mass-media and mediator properties. The mediating function comes from assuming the foresight results' by the participants, and media function is the result of an efficient dissemination in the participants' environment.

Foresight exercises have a multidisciplinary character as it involves

specialists from various fields of expertise, thus giving them a multiple perspective approach to the targeted issue.

Foresight is the term that brings together under its dome a large number of activities, methods and objectives. This forces us to formulate an approach as generally as possible on the Foresight's goals and objectives.

Foresight's goal is to identify, select and implement the developments that may occur in the society, in time, in order to yield the greatest technological, economic and social benefits.

Each of the three components, shown in Figure 1, constitutes three processes that succeed in a well-established order. Each process corresponds to one major objective.

These are the major objectives of foresight:

1. Identification of desirable and possible futures - by exploring the future;

2. Selection of possible and desirable futures, with a major impact on industrial competitiveness, on creating values and quality of life - by debating upon the desirable and possible futures and upon the developments that characterizes them;

3. Active and participatory modeling of the future, giving priority to the developments that have the greatest impact on technology, economy and society, in order to achieve the desirable future.

The *objectives* of a Foresight exercise must be clearly stated, internally consistent and (at least initially) avoid being too specific. This is important to gain widespread support for the exercise early on, although care must be taken not to promise too much to too many players. Ideally, the objectives should be debated by the key players in order to ensure early buy-in to the exercise [15].

The specific objectives of any Foresight exercise are [15]:

1. ***Informing the policy-making*** so that decisions taken by key actors in the commissioning body are more aware of longer-term developments are liable to interact with current policy decisions.[...]

2. ***Building networks*** that bring together people from different sectors and institutions involved with shaping the future [...].

3. ***Developing capabilities*** widely throughout a region or organization and develop a „Foresight culture”[...].

4. ***Building strategic vision and creating a shared sense of commitment to these visions among Foresight participants.***[...].

Three functions of Foresight can be identified [15]:

1. *function of diagnostic* - helps us to identify the stage where we are;

2. *function of forecast/ prediction/ future anticipation*: - helps us to anticipate what might happen;

3. *function of advice/ recommendations*: - helps us decide what to do in certain situations.

## **2. Foresight and the Consumption's Evolution of Available World Natural Resources**

The consumption of available world natural resources (CAWNR) has historically known variations based on technologies performance and size of the population. These culminated with the mankind problems about conservation, rationally use of the resources and the how these are distributed in the entire world.

The evolution of human resources consumption can be described by a logistic curve, as shown in *Figure 2*.

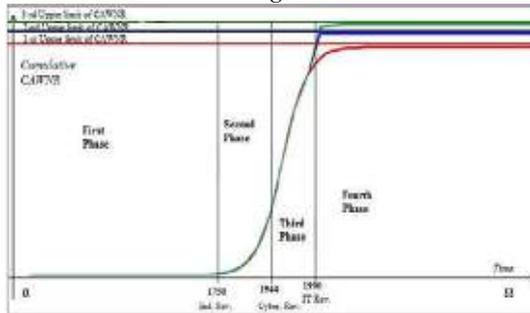
The literature mentions three major technological revolutions which have changes the mankind course and its behavior regarding natural resources: the *Agricultural Revolution* with its origins in the Near East (11.000 BC), the *Industrial Revolution* with its origins in Great Britain (1750) and the *Cybernetic Revolution* with its origins in The United States of America (1944).

Any kind of revolutionary technology which contributes to the exploitation of alternative resources, renegotiate [11] the upper limit of the human resources consumption and has as effect the delay of the depletion of available resources. These technologies represent the solution for mankind, but it's difficult to predict and requires a sustained effort from them.

The Foresight's role is to identify and accelerate the evolution of the emerging components designed to provide innovative solutions for our society. Without this systemic approach based on continuous

contact with reality, the evolution of the innovative technology and the environment which should enclose them will be very slow and will not prevent worldwide collapse in the near future.

**Figure 2:** Cumulative CAWNR evolution and the upper limit negotiated with technologies



Source: Turtorean C. 2011

### 3. Foresight, Consumption Economy and Sustainable Development

The consumption economy is specific for the third phase, shown in Figure 1. This concept, used for half a century and considered to be the solution to ensure economic growth, begins to show its reverse. Many of natural resources were consumed, due to a low processing efficiency, to produce nonperforming goods. In the second part of the phase IV a new approach is present, more responsible towards environment and resources exploitation. The alarm signal was given by the energy crisis 30 years ago. The term of sustainable development is very new in the international practice and it has been imposed on the Environment and Development Conference organized by United States of America in Rio de Janeiro (1992).

The most popular definition is the one given by the World Commission of Environment and Development (WCED) in the report *Our common future* known as Brundtland Report [14]:

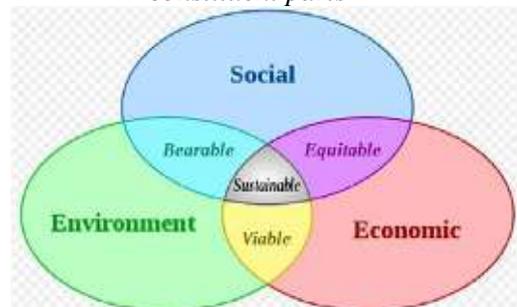
*sustainable development aims to satisfy the present needs without compromising the ability of future generations to satisfy their own needs.*

However, sustainable development alleviates the oscillatory economic growth and tries to impose a healthy and constant rhythm, taking into account the real needs of

society, conserving resources and protecting the environment (Figure 3).

To give more importance to human desires than to all natural and human resources necessary to address their needs means to expose us to risks and not considering the errors that lead and brought the economy in ruins. [...] If, from false reasons, we prefer comfort to the detriment of the nature and of the agriculture-based economy, sooner or later the nature will put the man in the background [12].

**Fig. 3:** Scheme of sustainable development, at the confluence of three constituent parts



Source: <http://en.wikipedia.org/wiki/Sustainability>

In this context, Foresight is an important tool to identify the emergent components capable of ensuring a sustainable development. A better integration of foresight exercises can optimize the economic growth process by stimulating its optimal efficient components and by a political and economical support given to the active participants in economic life.

### 4. Foresight and the Emerging Economies

*An economy can be considered emerging if we register a rapid economic growth but whose evolution is volatile* [16].

Volatility in economic theory means risk and chance, at the same time.

The emergence of an economy, technology or market provides a favorable environment to identify and implement effective solutions. Emergency in an economy is relative and it relates to standard structures (guidelines) indicated by the industrialized countries [3].

For a trained, informed and experienced player, a volatile market may be, in time, a source of winning, while for a non-trained, non-informed and non-experienced player, a

volatile market may be fatal to him, excepting the case when chance, a fourth random component, chooses him as the winner.

The Foresight’s role in an emerging economy is major, as it ensures the acquisition of all three ingredients – training, information and experience. The fourth component, chance, is random and can act as free will.

By ensuring those three components so necessary to obtain performances in emerging economies, foresight become a necessity and it can reduce the negative effects of volatility specific to emerging environments.

To conclude, we can say that Foresight is a very useful tool for the managers who work in unstable environments.

Emerging economies have some features which can be obstacles for the Foresight’s promoters [13]:

*Public administration and governments play an important role in every foresight exercise. The results of Foresight exercises should be included in government actions; otherwise Foresight exercises may not achieve their final goal.[...]*

*Loyalty is an important tool in the hiring process prior to the professional knowledge and expertise [8]. [...]*

*Coordination and cooperation between different ministries and governmental agencies is difficult.[...]*

*The time horizon set by foresight exercises is far beyond the interest of policy makers.[...]*

*Public administration in most emerging countries, including the CEE countries, deals with RDI in terms of restructuring. Furthermore, the ministries in charged with Research, Development and Innovation (RDI) are not so powerful and their position is very fragile in the government.*

As a conclusion, it is difficult to create a coalition between public administration, government and key economic players in order to ensure quality results for the foresight exercises and their effective implementation.

## 5. Foresight and globalization

Jemala M. [6] makes a documented presentation on the evolution of globalization paralleled to the evolution of Foresight. Below we summarize the most important periods, moments and events of the globalization and Foresight evolution presented by him:

**Table 1: Foresight and Globalization**

Globalization		Foresight	
Periods (events)	Phase	Periods (events)	Phase
<b>1490</b> (Chr. Columbus) <b>1913 (WWI)</b>	1 <sup>st</sup> <i>Laissez Faire</i>	-----	Era of Forecasts
<b>1913</b> (WWI) <b>1990</b> (www)	2 <sup>nd</sup>	<b>1914</b> <b>1956</b> (1-st HD)	1 <sup>st</sup>
		<b>1956</b> (1-st HD) <b>Present</b>	
<b>1990</b> (www) <b>present</b>	2 <sup>nd</sup>	<b>1993</b> (P. Processor) <b>Present</b>	2 <sup>nd</sup>
		<b>1998</b> (Black Berry) <b>Present</b>	3 <sup>rd</sup>
		<b>2000</b> (Y2K problem) <b>Present</b>	4 <sup>th</sup>
		<b>2006</b> (You Tube) <b>Present</b>	5 <sup>th</sup>

Source: Jemala M. (2010)

Gheorghiu L. et. al. [5] show some features of the three generations of foresight activities:

- *First Generation: Foresight is here emerging from what are mainly technology forecasting activities, with the analysis driven mainly by the internal dynamics of technology. [...]*

- *Second Generation: Foresight projects seek to grapple with technology and markets simultaneously. [...]*

- *Third Generation: Foresight’s market perspective is enhanced by inclusion of a broader social dimension, involving the concerns and inputs of a broad range of social actors. [...]*

- *Fourth Generation: Foresight programmes have a distributed role in the science and innovation system,*

*rather than being “owned” by a single policy sponsor. [...]*

*- Fifth Generation: A mix of foresight programmes and exercises, also distributed across many sites but in combination with other elements of strategic decision-making. [...]*

*Most foresight programmes at one time have contained elements from more than one generations [...].*

There is no need for countries to gradually go through the five generations of foresight.

The globalization process has a drawback bigger than that of increasing the gap between developed and undeveloped countries and is represented by the stress caused by forcing the human beings to adapt to the speedy changes imposed by globalization [4].

Scholte J.A. [10] defines globalization as the progressive erosion of the relevance of territorial bases for economical, social relations and processes. Thus, globalization is based on 2 components: a technological component which provides the infrastructure for globalization and a political one which ensure smooth circulation of information, goods and people between countries.

Just like to drive at high speeds is necessary a computer assistance for the pilots, in the same way, in order to cope with the shock of change, we must use tools to anticipate what will happen and to allow us to prepare for it. Foresight with his suite of quantitative and qualitative methods can assist society to adapt more easily to the change and to achieve its future goals.

Another drawback of globalization is that the whole process is based on the developed economies which have a leading role and their structure, behavior and efficiency are a model for less developed countries.

Most countries involved in the globalization process will try to converge their own economies to leader economies, thus fixing the main parameters for a desirable future. The same thing happens on technological and social level, this easing the Foresight exercises task of choosing a desirable future.

We can distinguish three categories of Foresight exercises:

1. *Replicated Foresight exercises*-their function is to find ways to reach the level of

the leader economy / society/ technology. Therefore the function of these exercises is to replicate Foresight existing models.

2. *Innovative Foresight exercises*-their function is to create new and desirable futures. Therefore, Foresight function is to create desirable futures pioneering certain areas.

3. *Alternative Foresight exercises* - their function is to control and stabilize the routes to desirable futures already made by a previous replicated or innovative Foresight exercise.

Finally, Foresight is an useful tool for policies in solving the puzzle which helps national economies and technologies to be shaped as needed so that they can integrate in the globalization landscape.

## 6. Conclusions

As the environment becomes more uncertain, the forecast programs lose the efficiency in advantage of the foresight programs.

It is important to use tools that allow us to anticipate things to come, so the shocks of changes should not surprise us! National foresight programs are such a tool for training the nation for future challenges.

## 7. Acknowledgement

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## A Pilot Study on Motivation in Academic Research Testing Validity and Reliability of the Instrument

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### Abstract

*This article is a short presentation of the motivation in academic research. It presents the definition of motivation, some studies in motivation in academic field, scales which measure the professors motivation and a pilot study. The pilot study is conducted to test the validity and reliability of the instrument.*

**Key words:** academic motivation, pilot study, validity, reliability

**J.E.L. classification:** J21, J23, M30.

### 1. Introduction

Motivation, was initially studied by researchers in psychology, and now, is one factor which has sparked the interest of persons from various fields. Marketers turn to studies motivation in several circumstances: when they want to anticipate consumer behavior, when develop or promote a product, when they want to establish strategies for a product or a company etc.

The word "motivation" comes from the Latin word "movere" which means to move, to do [1], [2], [3].

Currently, the concept of motivation has more than 140 definitions, most of those being centered on the mechanism of activation and supporting the effort to achieve certain needs or aims [4]. However, paradoxically, in the early twenty-first century the domain is considered being atheoretical, contestant and poorly predictive [3].

One of the simplest definitions of the concept is the following: motivation can be defined as a force that makes us move, act or do things [1]. Intrinsic motivation refers to engaging in an activity only for the work

itself. Extrinsic motivation refers to engaging in an activity to get a reward separable from the activity itself [5], [6], [7].

### 2. Studies in academic motivation

In literature there are some studies that explored the influence of different variables on motivation to research: money and prestige [8]; motivating factors and demotivating factors [1]; the assessment of work done, good working conditions, pay, assistance in case of personal problems, involvement in decision making, job security, loyalty to employees, free choice of subjects to teach, promote and professional development and teaching field [9]; intellectual challenge, social status, career advancement, professional recognition, contributing to the emergence of new knowledge, personal pleasure, material rewards, participation in professional organizations and the development of processes/ products [10].

### 3. Scales for measuring the motivation of economics professors

The research is part of the job duties of university professors. To investigate teachers' motivation to do research I had identified four adequate scales that measure the motivation at work: WOFO - Work and Family Orientation Questionnaire (Spence & Helmric, 1983 apud. Fairchild et. al. [11], WPI - Work Preference Inventory [12], WTMST - Work Tasks Motivation Scale for Teachers [13], MAWS - Motivation at Work Scale [14].

After analyzing the items of these scales, in accordance with the objectives of the research I chosed WPI scale.

WPI has 30 items. Those items are written in the first person, and respondents are asked to indicate the extent to which each item

describes them (on a four point scale, from 1= never or almost never true about me to 4= always or almost always true about me). For a complete list of items see Amabile et. al. [12]. For translation I used the two-way translation method.

#### 4. The pilot study

The questionnaire was applied to 32 teachers. The sample is one of convenience, non-probabilistic. Using the SPSS 9 software the internal consistency is was tested.

The internal consistency generally range between zero and one, but there are also cases where anomalous results are obtained under zero.

A generally accepted rule is that an  $\alpha$  of 0.6-0.7 indicates an acceptable confidence level, 0.8 or greater indicates a good or very good. High levels (0.95 or higher) are not necessarily desirable because it indicates that the elements may be redundant [15].

However, Nunnally (1967) cited in Glynn and Woodside (2009) states that values of Alpha between 0.5 and 0.6 are acceptable for early stages of research [16].

Table no. 1. shows Alpha coefficient values before and after removal of items. According to Alpha coefficient values , there have been proposed for deletion items:

- Challenge - QI22 "I want my work to give me opportunities to develop my knowledge and skills" - after the elimination coefficient increases from 0.32 to 0.55;
- Compensation - QI32 "As long as I can do what I like, I'm not interested how I get paid" - after the elimination coefficient increases from 0.10 to 0.50;
- Social desirability - QI13 "Sometimes I'm litter" - after the elimination coefficient increases from 0.2 to 0.49.

As shown in table 1. the Alpha coefficient values falls into an acceptable range for a pilot study after purification scale.

Table no. 1. Alpha coefficients

Latent variable	Initial Cronbach Alpha	Cronbach Alpha after eliminating items
Pleasure	0.58	0.58
Challenge	0.32	0.55
Recognition	0.69	0.69
Compensation	0.10	0.50
Social desirability	0.20	0.49

(Source: author's calculations)

Confirmatory Factor analysis was used to check the capacity of each indicator to capture dimensions of latent variables.

This aims, once more, increased confidence and validity of the scale. I checked the adequacy of the measurement model before and after exclusion of items proposed for elimination based on coefficient Alpha.

Analysis was performed in the IBM SPSS AMOS 20. For the purposes of this analysis was necessary to establish the type of scale: the formative or reflective. In the present situation we are talking about reflective models where the indicators reflect the latent variable, ie a change in the latent variable will cause a change in each indicator.

The tests most frequently used for testing the adequacy are GFI (goodness-of-fit index) and RMR (root mean square residual). Experts recommend a GFI value of the coefficient at a level greater than 0.9 and a value of RMR as close to 0 [17].

As shown in table no. 2. for latent variables "pleasure" and "recognition" based on coefficient Alpha I decided not to remove any item. However GFI values recorded excellent values of over 0.9. For the other three latent variables GFI values have increased considerably, reaching a level of 0.915 for variable "compensation" and for variables "challenge" and "social desirability" value close to 0.9 (0.897, 0.854 respectively).

Although for the latent variables "challenge" and "social desirability" the results are not excellent (but have a value close to the value 0.9), scales shall be kept because the problems can occur due to small sample.

Table no.3. Reliable analysis and Confirmatory analysis results

Latent variable	Initial GFI	GFI after eliminating items	InitialRMR	RMR after eliminating items
Pleasure	0.905	0.905	0.89	0.89
Challenge	0.779	0.897	0.167	0.157
Recognition	0.963	0.963	0.078	0.078
Compensation	0.876	0.915	0.055	0.053
Social desirability	0.793	0.854	0.075	0.070

(Source: author's calculations)

A more complete analysis of the adequacy of the model will be made in further work on a larger sample.

## 5. Conclusions

In conclusion, there are many ways to measure teachers' motivation. Choosing between them is a difficult decision. Even after the choice is made, there are many tests to run to ensure the validity of the used instrument. This study presents a summary description of the domain analyzed and some instrument test results.

## 6. Acknowledgment

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# Characteristics of Quality Management in Tourism Services

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## Abstract

*Quality has become a strategic element of organisations' management, as it is at the basis of product and services competitiveness domestically and internationally.*

*Quality must be understood by the superlative of excellence, signifying the maximum possible satisfaction of the customer's needs in a dynamic context.*

*Services represent one of the sectors of modern economy that register significant dynamics.*

*Achieving customer satisfaction is essential to developing or maintaining business. Thus, current trends in quality management lead to integrated solutions for quality insurance.*

*We notice the direction towards adopting the concept of total quality management, in which the emphasis is on the participation of the entire staff to achieving and improving the quality of tourism services.*

*In all tourist service companies we notice the need to align with the EU requirements on quality.*

**Keywords:** tourism, quality, management, certification, competitiveness.

**J.E.L. Classification:** L83.

## 1. Introduction

In the context of the growth of the customers' demands, of the society in general, and of the market globalisation, quality has become an important factor of products and services competitiveness.

At macroeconomic level, the quality of products and services is related to the quality of life, determined by the technological development level. Therefore, the increase of the consumers' demands has led to more and more restrictions, regulations and standards related to people's protection of life and

health, as well as to environmental protection.

In the market economy, the credibility of a product or service, namely tourism, becomes even greater if its supplier also has an implemented and certified quality management system as required by the ISO international standards.

## 2. Vision on quality in tourism services

Services are one of the most dynamic sectors of modern economy, an extensive interface between the individual and the organisation of society. To meet the consumers' needs, services are in constant evolution and diversification.

Knowledge of the structure and essence of the needs met by services are important in defining quality.

The offer of services has certain features given to a large extent by its predominant material character.

The definition of quality should include the fact that environmental issues interferes with the services sector.

In a competitive economy, the quality of consumer services is important for the following reasons:

- increasing customers' requirements;
- showing fierce competition;
- identical attitude of services users with the customer's in general – the need for consideration through offer customisation.

The design of the ISO9004-2 standard states that a service may include two components:

- material;
- immaterial.

The higher the share of the immaterial components is (for example basic service, accommodation), the lower the weight of the material components is (facilities, means of transport, accommodation etc.).

Due to intangibility, the quality of a

service is difficult to assess before the customer's purchase, the delivery and the consumption taking place simultaneously.

What makes it more difficult to assess the quality of services is the approximately 10 times lower number of the quality characteristics as compared to those of a material product [5].

However, the ISO standards highlight two important aspects related to services, namely:

- the quality of services largely depends on the qualifications and motivation of the company's employees;
- unlike the quality of material goods, the quality of services is impossible to check before reaching the customer. Usually the service reaches the customer right in the moment of providing it so that the possible qualitative deviations cannot be corrected.

Moreover, in the field of tourism services, the requirements towards quality register a high level of exigency due to certain features specific to providing the service: [3], [5]

- inseparability of services provision from the provider's human and professional quality;
- continuous adaptation of services provision to the customer's needs and personality;
- increase of the quality level of the tangible components (price, environment, equipment characteristics) accompanying the service provided;
- the price paid by the client when there is a match between his/her expectations and the quality of the services provided, expertise, knowledge, experience, environment, reliability, courtesy, honesty, waiting time, duration of orders and their execution.

The quality of the service depends on the customer's behaviour. The tourist services market can be influenced by the customer's reactions to the quality of the performance, its costs, the conditions and time of the performance, of any intention to change the provider.

Unlike other categories of services, the tourist services consumer's active participation to the service consumption differs depending on the nature and content of the various types of tourism.

The modern businesses have focused their

quality policy on the need for excellence in service.

Currently, the European Union's vision on quality can be highlighted through the following equation: performance + associated service performance = customer satisfaction = confidence.

In tourism services, customer satisfaction includes:

- correct, complete and accurate information;
- a favourable impression at the meeting with the staff of the service provider;
- availability to the customer and prior treatment to customer's requirements;
- a reasonable price and getting the expected result [4].

### **3. Improvement of service quality - the ultimate goal of quality management in a tourism-oriented organisation**

Together with the rapid technological and socio-cultural changes, the methods of insuring the quality of products and services have evolved as well.

Internationally, various approaches have appeared on the place and importance of the quality objective in the evolution of a company's activity.

Thus, the current trends in quality management lead to integrated solutions of quality insurance. We notice the direction towards adopting the concept of total quality management (TQM), whose basic principles are considered the following:

- customer orientation and meeting his/her requirements;
- quality is the first, through preventive activities;
- continuous improvement;
- involvement of the entire staff to achieve and improve quality.

Achieving customer satisfaction is essential for the development or maintenance of the turnover and of the provider's profit.

In this context, every organisation in Romanian tourism should conduct an analysis of the quality of the activities it performs in order to:

- establish the qualitative level of the service provided;
- know the strengths and weaknesses of the organisation;

- formulate decisions to improve the quality of the tourist products offered.

Improving the tourist services quality is closely linked to improving the management of tourism businesses operating on the Romanian market. In the centre of its concerns, quality management should consider the following aspects:

- knowing the customers' expectations;
- teamwork;
- working with partner organisations;
- promoting fair employee motivation;
- knowing the degree of customer satisfaction.

Customer satisfaction must be compatible with the standards and professional ethics specific to the tourist organisation.

In this sense, the human component, the one targeting customer satisfaction, is the focus of quality management. In an organisational approach of the service providing business, relational quality becomes a competitive advantage. In the context of this approach, the entire staff of the organisation (contact staff, operational staff, functioning staff and senior management) must act for the person in the front line, the customer [3].

Continuous improvement is a process of increasing the organisation's efficiency in achieving the policy and objectives in the field of quality [2].

#### **4. Quality management system certification in tourism services**

SR EN ISO9001:2001 standard – “Quality Management Systems. Requirements” represents a means of monitoring and controlling of the quality and benefit levels of an organisation [1].

The need for its application is motivated by the fact that it brings benefits to the organisations that wish to certify the quality management systems through customer orientation, requiring a permanent responsibility of the managers, developing a positive attitude of the staff towards the continuous improvement of the activity.

In all types of accommodation, food and entertainment it is necessary to align to the EU requirements on quality. This alignment involves, among others:

- acquisition and harmonisation of the

existing standards in the field of tourism and ecotourism;

- setting certification bodies of the compliance of tourism products and services in the field of tourism and ecotourism;
- developing inspection bodies in this field;
- design, development and implementation of management systems for the quality of services, tourism and ecotourism products in every tourist location;
- quality management system certification for the quality of the services implemented in every tourist location;
- database development for tourism, services and products quality management systems;
- continuous training of the tourism professionals;
- organising experience exchanges;
- implementation of HACCP requirements in all tourist locations and their certification;
- mutual acknowledgment of the Romanian and foreign certification bodies operating in tourism.

In the European Union the quality management system certification and the certification of persons are not required by law but they may become mandatory through the decision of public authorities.

The businesses and organisations in Romania that have trade relationships with the economic agents from the EU countries are recommended to certify the compliance of their products, services and quality management systems with the EU regulations and with the contracts signed with their partners.

#### **5. Conclusions**

Tourism is an industry in constant expansion, both nationally and internationally. This requires special attention from the economic agents due to the specific features in which it takes place.

The quality of the services and even the quality of the tourist product, overall, represent weaknesses of the field, also highlighted by the business partners.

Applying the concept of service quality implies the existence of an organisational culture and appropriate management

education.

The multitude of components involved in tourism product development and marketing decisively influence the approach method related to competitiveness. Given that the tourist product is addressed to the customer for a longer period of time, any deficiency of one component affects the overall level of competitiveness.

Therefore, it is important to insure a consistency between the components of the service performed, in order for the quality to be finally total.

It is also necessary to adapt the small providers of tourist services, which provide most of the local tourism offer diversity, to the demands of certain customers much better educated related to their rights as consumers.

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## Fast Food Paradox: Freedom and Cultural Imperialism

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### Abstract

*Fast food is often regarded as a form of cultural imperialism. Fast-food products, originating in the U.S.A., are considered by the critics of this phenomenon as responsible for eroding the interest in local food traditions and affecting their continuity. Based on the results of some researches realized at international and national level, the paper highlights the main issues underlying young people preference for fast-food. The consumption of fast food is associated with the idea of independence and fun with friends and also being away from the parents' control. In addition, in food choices, young people are seduced by the sensorial dimension, being less interested in the nutritional benefits. This paper has an educational character for the new generation of consumers, because it presents an analysis of the nutritional profile of fast food products and highlights the imbalances and risks for consumers in case of excessive consumption.*

**Keywords:** fast-food, mcdonaldization, cultural imperialism, new generation of consumers, nutritional value, risks

**J.E.L** classification: O 14, O32, I 31

### 1. Introduction

Fast food is not a recent phenomenon. The emergence and further development of fast-food industry is closely linked to hamburger, a product whose popularity has increased over time, so that it is now an integral part of the offer of any fast food restaurant.

The American style of eating hamburgers was officially registered in the U.S.A. in 1904, during National Fair in Saint Louis, and the first pizza shop was opened a year

later in New York. These moments can be considered decisive for the introduction of fast-food style, although occurred fifty years before the McDonald brothers establish fast food system, marking in this way the official debut of the fast food industry, which expanded from North America throughout the world and became a real phenomenon [16].

McDonald's is today the world largest and most popular fast food chain restaurants, having over 32000 restaurants in approximate 120 countries.

The main determinants of the fast-food industry development are considered to be the change of the lifestyle and the habits of the big cities residents, the increasing of buying power, the emergence of a middle class, the development of the modern trade (emergence of hypermarkets and shopping centers).

The paper presents the dominant themes in the process of mcdonaldization and explains the association between the phenomenon of fast food expansion and cultural imperialism all over the world.

Also, in order to explain the preference of the new generation of consumer for fast food, are analyzed the results of some researches which were conducted to highlight the key factors in food choice of the young people.

Finally, is realized an analysis of the nutritional profile of the fast food products which emphasizes the nutritional imbalances and the consumer health risks in case of an excessive consumption.

### 2. Mcdonaldization and the rise of the American cultural imperialism

McDonald's restaurant is one of the industries whose development had a great influence on the contemporary society, so that today, it talks more and more about the

mcDonaldization of the society. The term "mcDonaldization" is defined as the process by which the principles of fast food restaurant began to increasingly dominate many sectors in American society and the wide world [16].

The assembly band, the Taylorist scientific management and Weberian bureaucracy are the main precursors of the mcDonaldization, which currently affects not only the catering sector, but also other sectors of the society: education, work, health, travel, leisure, diet, politics, family etc.

McDonald's has made its footprint more and more in American society, but also extended its influence beyond, becoming more than a leader, as wanted Ray Kroc, the company founder. McDonald's is exercising now its dominance on the international market of fast food. Thus, the existence of some standardized American networks of fast food in many other countries of the world wide can be considered as one of the most important indicators of mcDonaldization.

In addition, many countries have developed their own versions of the McDonald's restaurant. The success of McDonald's restaurant in Russia, for example, led to the development of an indigenous fast food restaurants named "Ruskoie Bistro", which fits on the lifestyle and local traditions. Another example is India, which has developed a fast food chain, named "Nirula's", offering hamburgers with sheep meat and also another traditional Indian dishes. Thus, the existence of indigenous clones of these systems represents another indicator of the society mcDonaldization.

Ritzer (2003) reveals five dominant themes in the process of mcDonaldization:

- *Maximum efficiency* is the main goal of a fast food restaurant. Efforts in this direction, mainly applied by organizations for their own interest, have resulted in: optimization of various processes, simplifying products and services and the use of customer to perform work that normally would be carried out by the employees.
- *Calculability* is seen in the tendency to transpose in numbers and the production and the services and concentrating on quantity (fast obtaining of large quantities of products) and creating the

illusion of high quality, when in fact quality is poor.

- *Predictability* involves keeping under control of some elements such as: discipline, systematization and standardization, in order to obtain similar products anytime and anywhere. Predictability is provided in various ways: creating predictable environments, realizing predictable interaction with customers, obtaining predictable behavior of the employee, making predictable products and processes and reducing hazards and nuisance. This kind of predictability approach lead inevitably to the transformation of the activities in a series of routine acts, meaning repetitive work, which not involves too much intellectual effort.
- *Control* is achieved by replacing the human being with non-human technology, because man can be a major source of uncertainty, unpredictability and inefficiency. This is true both for those working in the system (employees) and for those served by it (customers). Technology have been developed and applied to increase productivity and reduce costs. Replacing the human being with machines is the control climax over people, who thus can not be unpredictable, because they are not directly involved in the process.

Generally, all mcDonaldized systems have some distinctive features, as follows [16],[17]:

- they provides customer and employee efficiency and predictability;
- they describe themselves through an avalanche of superlatives in supporting their interests (they cultivate the image of an environmental friendly company and they declare its social responsibility);
- affect the habits of the society as a whole by undermining some norms deeply rooted in local cultures (for example, in Japan - undermining the interdiction to eat from standing and to drink from the bottle);
- represent a symbol of cultural imperialism and of the ascendant of American culture on the world.

Critics of fast food are associating the expansion of this phenomenon with cultural imperialism. This is the process by which a

culture, society and nation impose their cultural practices and institutions to another culture, with the aim to erode or even destroy the traditional elements of the other.

Approached from historically perspective, cultural imperialism often supported and also, was supported by other forms of imperialism, such as economic and political imperialism. In the current era, the institutions of colonial occupation by a foreign government are obviously much less frequent than in the late XIX and early XX century. However, the imperialist cultural relations can exist even in the absence of other forms of imperialism, being fueled by the actions of multinational corporations.

The cultures which face with imperialism often feel the erosion of their traditional elements as a deletion of individual identity and a reduction of the distinctiveness. Critics of cultural imperialism and supporters of local cultures have used, over the years, a variety of methods to counter this threat. The example of food products is particularly illustrative. Taking into consideration the importance of foodstuffs in numerous cultures, the efforts to protect them vary from the official government policy to various guerilla actions [9].

Also, there are numerous structural forms of resistance. One of the best known and most important organization, which emerged as a response to the quick spread of fast food culture is SlowFood organization, founded in Italy by Carlo Petrini, which subsequently spread across the world.

Some countries, through the government policy, tried to limit the threatening of cultural imperialism on the traditional foodstuffs. An relevant example was the initiative of the Ministry of Culture from France, which, in 1989, created a separate structure, dedicated to the culinary arts, whose primary goal is to combat the spread of fast food culture, perceived by the French government as a serious threat.

Regarding the fast food consumption, the U.S.A. won the first place. Statistics show an alarming situation, because around 25% of the U.S.A. population are obese (almost 40% of children and adolescents are overweight). This frightening reality can be considered almost an epidemic of obesity, which is probably the consequence of the high popularity of fast food restaurants (over

300000 fast food restaurants in U.S.A.) [10],[19].

In Romania, fast food restaurants have appeared in the '90s and quickly integrated in Romanian landscape, triggering a real phenomenon. Apart from the changing habits and patterns of life style of residents from the Romanian big cities and the increasing of purchasing power, another factor that supported the expansion of fast food has been the development of modern commerce (hypermarkets and malls proved to be opportunities for the expansion of the national and multinational fast food chains). In addition, subsidiaries of famous multinational chains of fast food have appeared in various institutions, train stations or subway stations.

Eating in fast food restaurants became a habit of Romanian contemporary lifestyle, especially among the new generation of consumers, obviously an unhealthy dietary behavior, which, together with the lack of physical activity, is in a perfect accord with the trends of capitalist society [4].

### **3. Fast-food - a symbol of independence among young people**

Fast food style is very popular among teenagers all over the world. Approached in terms of eating behavior, teenage can be considered as a transition from a stage when parents' control prevailed to another, characterized by an absolute personal control over the type of food eaten, their frequency and quantity. Besides, children raised in a single parent families or families with both parents actively involved in work, is "enjoying" a weak monitoring of eating habits.

A study realized by George and McDuffie (2008) [8] highlights the considerable influence that young people have on their food choices. Aimed at identifying decisive factors in guiding the food choice of young people, the study showed that the taste is the characteristic which has the critical role.

This observation is common to many studies (Beasley et al. 2004; Louis et al. 2007; Davis and Carpenter 2009) [2], [5], [11] which demonstrate that in the attempt to change the food behavior, young people are slightly willing to make compromises on taste.

Another study, realized by Popescu et al. (2010) [14] points out that the new generation of consumers tends to generalize the role of sensorial properties and to neglect or even disregard the nutritional profile in the food choice and quality perception. The authors explain this feature of the alimentary behavior of young people by the fact that they have formed the eating habits during the time of the maximum boost in the food industry, being in general accustomed to eat ultraprocessed industrial foodstuffs, which can be characterized by special sensorial properties, but with a nutritional profile often unbalanced. The images of these foodstuffs are stored in the memory of the young generation of consumers. Therefore, the possibility of gaining its knowledge, which implies the comparison between the perceived images of the foodstuff and those from memories, is obviously limited. So, young people prefer foods with artificial taste, because these kind of products compose the prevalent foodstuff offer of today.

Teenagers prefer refined foods, rich in saturated fat and sugar and they are eating fewer healthy foodstuffs. Eating healthy is associated with parents' control and with the idea of "living with parents", while fast-food style is associated with the idea of independence, fun with friends and being away from home [2].

Another explanation of the special attraction of young for fast-food lies in the designing of fast food products in such a way that their consumption is driven directly by hand, without using cutlery, which contributes to a much stronger olfactory stimulation. This, combined with an important mobilization of tactile and visual senses, though it seems to indicate a regression to some childish habits, when contact with food are operating in a more direct way, leads to the conclusion that food fast products simultaneously address to all senses, trying to satisfy in a larger extent [15].

Although fast food products are characterized by high sensorial value, nutritionists point out that they are very unhealthy, exposing first the consumers to a high risks of energy intake and lack of variety.

Fast food products are full of empty

calories, which come mostly from the saturated fat and sugar, giving the feeling of satiety for a while, but not sustaining the effort of the human body throughout the day. This is one reason for that consumer feels the need to eat more and more.

Many of the ingredients composing the typical menus of fast food restaurants contain large amounts of fats, especially saturated fats (French fries, meat, cheese). Nutritionists recommend that up to 30% of daily energy needs to be covered by fat. In general, this limit is exceeded by about 10%, but people who eat fast food usually add to them many other percents. In addition, these products are fried and in this process raw materials incorporate large amounts of harmful fats (trans fats) and other potentially carcinogenic substances resulted from the heating of the fats at the high temperature (acrolein and acrylamide) [18]. Besides, all these dishes are usually heavily salted (salt content of a typical fast food menu is much higher than the daily recommended amount of 1,8 g) and seasoned with spicy sauces. Fat in association with salt make all foodstuffs tasty and palate pleasant and the ubiquitous presence of these components in fast food products explains their universal success.

But, on the other hand, fast food products are poor in vitamins and minerals, because the menus contain only very small portions of fresh fruit and vegetables. In addition, sandwiches, croissants, hotdog, pasta is almost exclusively refined, thus having no dietary fiber and other essential micronutrients (which can be found in whole grains) [18].

Fast-food products contain many of dangerous food additives: coloring, flavoring (one of the most dangerous food flavorings, used widely in fast food, is monosodium glutamate - E 621), synthetic sweeteners (such as saccharin, cyclamat, aspartame, acesulfame K and sucrazit), preservatives, acidity regulators, stabilizers etc.

To support the above statements, we have analyzed the composition and the nutritional value of the Big Mac sandwich, using the information provided on the McDonald's website. Since 1968, Big Mac has become the symbol of McDonald's, being the preferred product of customers. It contains two slices of beef, lettuce, onions, pickles, cheese and Big Mac special sauce. All these

ingredients are arranged in a bread roll with sesame seeds. Food additives included in Big Mac are: the bread roll - Bread improver (E300), the slice of Cheddar cheese - Emulsification salts (E331, E452) and coloring (E160a, E160e), the Big Mac sauce - Stabilizer (E415), the pickled cucumbers - Preservative (E211) and Acidity regulator (E327) [20].

The Big Mac sandwich has 27 g of proteins, 25 g of fats and 40 g of carbohydrates, which resulted in an energy value of 525,8 kcal ( $4.1 \times 27 + 4.1 \times 40 + 9.3 \times 25 = 525,8$  kcal).

Taking into consideration that the average daily energy need of a teenager (who is exercising less) is 2500 kcal, we can observe that just by eating a Big Mac sandwich, his energy need is covered approximately 20%. If Big Mac is consumed along with a large portion of French fries and a soft drink (always present in the fast food menus), the energy value can reach over 1200 kcal, thus covering of almost 50% of the daily recommended need. However, while such a menu can be quantitatively cover the energy requirements recommended by nutritionists for the lunch meal, in terms of nutritional quality it is unbalanced, because it not contain the raw materials (such as vegetables, fruits and whole grains) providing the essential micronutrients (vitamins and minerals) and also fibers.

#### 4. Conclusions

Even fast food is one of the most spectacular innovations in history, a type of food for everybody, regardless of age, sex or culture, the excessive consumption is considered by nutritionists as responsible for obesity, which become the second cause of the mortality all over the world, after smoking [15].

Fast-food products are characterized by high sensorial value, due to the widespread use of food additives, but they have a very unbalanced nutritional profile. Fast food products are not authentic foodstuffs, having a very high intake of empty calories that are unable to support the body's effort. Nutritionists unanimously agreed that fast food products have a poor nutritional quality, because, on one hand, they contain large amounts of fat (especially saturated fat), salt

and sugars and, on the other hand, low amounts of vitamins, minerals and fiber.

Although public interest groups have addressed over time many critics (especially related to consumer confusing about the nutritional quality of products, the marketing focused on children, the providing of "super size" offers which encourages overconsumption), when they appeared in another cultural context, American fast food companies have been welcomed by some members of the local culture, being perceived as a symbol of modernization and progress [6], [7]. Especially young people are attracted to this type of food, because they are more vulnerable to the effects of advertising, considering their parents as old fashioned when trying to guide them to a healthy diet.

The technological development, the economy and speed have contributed to the popularity of fast food industry all over the world. But, their misleading offers are misleading the consumers. Under the pretext of saving money, the consumer is encouraged to take an entire menu (for example: a serving of French fries, a hamburger, a carbonated drink and a dessert), being determined, in fact, to add at a meal at least 200-300 kcal and thus, the hypothesis on obesity is confirmed. Unfortunately, the reason to buy cheap foodstuffs such as fast food products, is bringing over time significant financial harm to consumers, because the savings that he would make it is eroded by subsequent expenditure, caused by the serious health damages (obesity, diabetes, cardiovascular disease, cancer etc.) of the regularly consuming of these products with a very unbalanced nutritional profile.

This mindset can be changed only by correct information, taste education and also by orienting the consumers' demand toward traditional foodstuffs, which are able to provide authenticity and nutritional benefits [13].

#### 5. Acknowledgement

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# The Role of Teams as Organizational Structures in a Global Organizational Context

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## Abstract

*The flexibility that modern companies must show in regard to global market entails the recourse to work teams which are multicultural adapted and aware of their role and place in the overall structure of the organization. The technological changes along with the customer needs diversification require the awareness of the influence of organizational structure on team members as well as the influence of teams on organizational structures and organizational context. The present paper aims to point out the importance of teams in the modern organization from the perspective of organizational context and organizational structure.*

**Key words:** teams, organizational context, organizational structure, self-managed teams, team-based organization

**J.E.L. classification:** L1, L2, M1

## 1. Introduction

Regardless the approach of team work as a particular type of group, the overwhelming majority of authors agree that all work teams are groups, but not all work groups are teams. Team work is a particular type of small group, along with committees, task forces, departments and councils. Team is a group, but the reverse is not true. [1] A group consists of people working together, but one can work without the other. A team is a group of people who can not work, at least not effectively, without the other members of their team, [2] and team members are held together by their interdependence and their need to collaborate in order to achieve common goals.

These distinctions between work groups and organizational teams necessarily require

the approach of teams in organizational context and not just the focus on team tasks and roles of team members. This means a teams approach as a particular type of organizational component, often temporary, with well determined role in the sequence of processes and activities. We say “temporary” because in the global economic environment the only constant is change and this requires a continuous readjustment of organizational structures taking into account the products, markets and customers in accordance with team members work skills.

## 2. The influence of organizational context on team functioning

The organizational context has a significant effect on how the teams perform optimally. [3] Teams can be used to improve the organizations operations, but they are sensitive to the organizational environment and require appropriate conditions to carry out successfully their activities.

The context in which team develops may include the organization overall strategy, its structure of authority, technologies, physical working conditions, management practices, formal rules, the quality of management, organizational rewards and penalties. [4] All of this is reflected in the organizational culture and is materialized in the support that organizational culture provides to the teams.

Thus, the probability of teams to be successful is higher in organizations with a supportive culture that encourages open communication and collaborative effort [5], situation in which the power and responsibility are assigned to teams so that they can control their own actions. This is because although the use of teams can help to change organizational culture, this change can be difficult to initiate when the limits are imposed by the existing culture.

Yet, there are companies for whom team spirit and teams building represent even a part of organizational culture being that a powerful culture encompasses team features, respectively: people work together, have common values and make decisions towards achieving the organization goals and objectives. For example, Microsoft employees are empowered to perform duties while the company encourages team spirit and puts less emphasis on hierarchy. [6]

Then, there must be provided to the team different modalities of organizational support in order to help them to operate more efficiently. Hackman and his colleagues concluded that there are six main areas in which teams need support from the organization: purpose, resources, information, education, feedback and technical assistance. [7]

Thus, teams perform their tasks more efficiently when they have clear objectives and well defined tasks, and must be provided, at the same time, with adequate resources, including financial, staffing and training support. Teams need valid information about their organization in order to underpin better decisions, to coordinate their efforts with other organization members and to plan forthcoming changes. Finally, teams must be provided with technical assistance and assistance related to group processes because they need technical support to solve problems and mediation to deal with interpersonal difficulties.

The building of high performance team requires efforts both from the team and the organization. To improve the way in which its members operate, a team needs feedback regarding their performance and a spur for change. To some extent, the team can evaluate itself, and its members can provide mutual support, but a high performing team requires feedback from the organization and rewards for outstanding performance. Without such feedback team members will not focus on the objectives that the organization has set for the team. [8]

Taking into account the perspectives offered by the organizational analyses, we can say that the William Ouchi's "Z" model is the most appropriate for the successful use of teams in the organizations that working nowadays in a highly turbulent global economic environment. „The manager

specific to “Z” theory aims to achieve equalitarian relationships between employees, replacing the hierarchic line management with self-management, generating a strong engagement, loyalty and motivation among employees.” [9] Then, the organization of type “Z” “is a culture of consensus, a community of equals who cooperate with each other in order to achieve common goals. Rather than rely exclusively on hierarchy and direct control of the behavior, it is based on commitment and trust”. [10] These features will be an essential competitive advantage for the organizations that aim to achieve success in a global market to the extent that they will be found in the relationship between organizations and their teams.

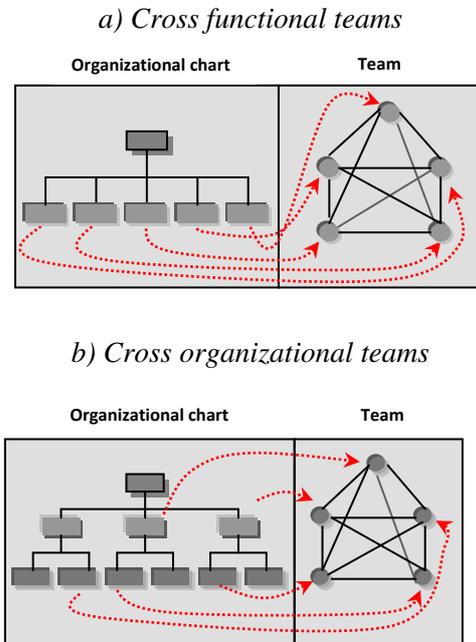
### **3. Type of teams within the organizational chart**

In relation with organizational structure of a company, we emphasize two ways of building teams, frequently found under various names (process improvement teams, autonomous teams, task forces etc.)(figure 1); in this case it is important the mechanism through which employees are selected from different “areas” of organizational chart and the objectives or tasks that must be performed by teams constituted in this manner are less significant: [11]

- a) *cross functional teams*: consists of members who traditionally work in departments located at the same hierarchical level, and this kind of team is called to fulfil a specific task under authority of a formal leader; can be included in such teams also external parties, such as consultants, experts, etc.; teams of this type is characterized by the temporary formation – that means its members will return to the original department – and will be made to resolve unconventional problems etc.
- b) *cross organizational teams*: team members are selected from different hierarchical levels to deal with clearly stated objectives and will work for limited periods of time under the authority of an appointed manager; this team is also found in practice under the name of task force and is build for atypical situations from the organization's life (an accident,

a crisis, a new product or service designed, an advertising campaign etc.).

Figure 1. The organizational chart as a “sum” of “n” teams and ways of building teams for diverse problems



Source: Huczynski, A., Buchanan, D., *Organizational Behaviour. An Introductory Text*, 4<sup>th</sup> edition Prentice Hall, 2001, p.385 apud Burciu, A. (coord), *Introducere în management*, Ed. Economică, București, p.356

The temporary nature of these types of teams induces a major issue concerning their structure since requires by members to constantly adapt to new work situations. In this case, employees' personal skills influence in a large extent the team development as a necessary step between stage of sufficiency and stage of high performance.

A more common type is inter-functional team. Since this kind of team operates in the same department, does not require major changes in the operational program of its members and does not raise special problems related to adaptation and leadership compared with other two types. Also, unlike the previous types, inter-functional team may have a longer existence, depending on the purpose for which they were formed.

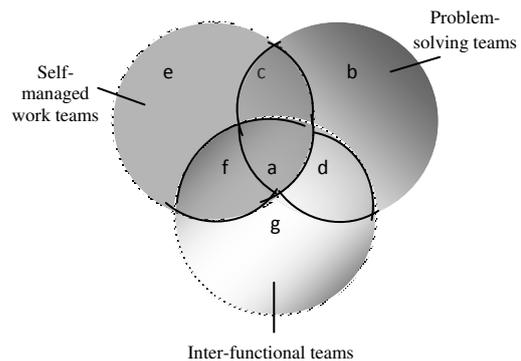
#### 4. Teams as organizational structures

Beyond a simple criterion for classifying the teams, the organizational structure itself can suffer large changes, depending on the complexity of activities and, correlated with this, depending on the need for teams. We consider the Likert's conception of overlapped organizational structures, namely, organizational structures based on overlapping and integrated work groups. The link between these groups is achieved through “linking pin”, that is persons belonging to several groups at once, to their group, but also to the immediately above group on hierarchical scale. The main elements that Likert emphasizes are, on the one hand, the effective communication between group members through “linking pin”, and on the other hand, the interpersonal connections that can be established between members of different groups. [12]

Taking into account the principle of support relations invoked by Likert, we can discuss about organizational structures based on overlapped and integrated teams.

Figure 2 suggests ways of such teams' overlaps, according to basic criteria that differentiate them, and figure 3 seeks to highlight the teams as components of structures such as those proposed by Likert.

Figure 2. Overlapped teams

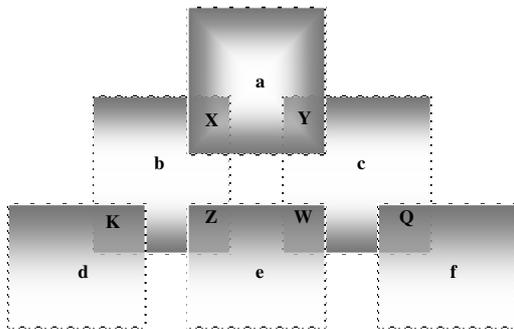


In figure 2, section *a* represent a team which is a problem-solving, self-managed and inter-functional team, while section *b* represent a problem-solving team, which is neither self-managed, or inter-functional; *c* is a problem-solving and self-managed team, but its members belong to different departments (ie it is not an inter-functional team), *d* is an inter-functional and problem-solving team, but is not self-managed and so

on. Also the letters in the figure 2 may represent members of the organization (or members of subsidiaries located in different countries) which belong to various teams in different times and depending of organization’s needs.

In figure 3, the teams overlapping suggest a team-based organization. Although the chain of command is kept the structures formed by teams are more flexible, communication is facilitated by members simultaneously belonging to different teams (X, Y, K, Z, W, Q are “linking pins”), therefore, their degree of efficiency is higher than in the case of traditional organization, characterized by rigidity and mainly downward communication.

Figure 3. Organizational structure based on overlapped and integrated teams

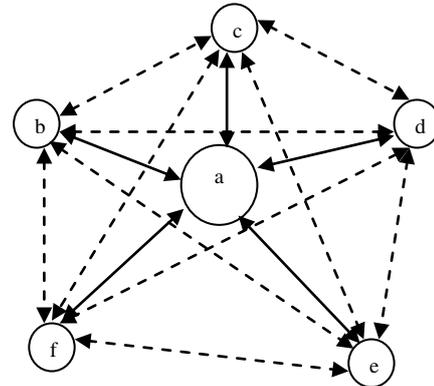


The membership to different teams can be considered an impediment since every team seeks to attract resources and competes with other teams. It may, however, that precisely this double membership to lead to the attempt to find compromise, the aim being the overall efficiency, at organizational level. In fact, even conflict, between certain limits, may cause the evolution and development, according to Lewin's dynamic theory.

We can consider that this way of functioning of the teams within the organization represents a translations into practice of “adhocracy”, which is specific to organizations with a strong force to adapt, changing “on the fly”, organized on flexible complex team, with self-management competencies. (“Adhocracy” describes a structure that naturally opposes bureaucracy. It is characterized by the existence of small groups or project teams which can operate freely in and across the organization. [13])

Furthermore, in the organization which embraces the work in teams we can find collective structures that revolve around a main management group, influencing and being influenced rather than giving and receiving orders. (figure 4)

Figure 4. A team-based organizational structure



The traditional organization is represented as a chart with reporting lines and hierarchical layers, while the team-based organization looks more like a solar system where planets are governed by the force of the largest (the main team management). The role of leaders is to make sure that the employees will work with efficiency and power of the components of that solar system, thinking in terms of the whole, and not just from the perspective of the component that they represent, and also must always put emphasis on integration and cooperation between groups. [14] Figure 4 suggests such an organizational structure: the two-way dashed arrows indicate open communication between all teams and reporting lines, also represented by two-way arrows, show a permanent feedback from the team management *a*.

## 5. Conclusions

The teams approach in the organizational context as organizational structures more or less stable over time would be a concern for modern companies since the old structures, based on strict hierarchical lines, can no longer face the actual challenges of global competition.

This approach is necessary given the advantages that teams bring to their organizations compared with traditional

organization:

- teams are more oriented towards goals than the organization as a whole, and they establish more easily their vision and their purpose;
- teams are more flexible than organizational groups because they can be more easily formed, dissolved, reorganized, resized;
- teams are best suited to solve complex problems that require different views and knowledge;
- teams get better value from the resources of each member;
- teams promotes delegation because they provide the security to control the behavior of its members by their own rules etc.

Capitalizing on these advantages by companies impose giving up “prescriptions” for success and the permanent adjustment of organizational structure to the new market requirements. At the same time, they must ensure the necessary conditions for the teams to accomplish their specific tasks with maximum efficacy and achieve outstanding performance. Finally, managers in the global economy need to know when to resort to self-managed teams and to what extent this is beneficial for both team performance and the overall company success.

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**Section II**  
**Business Economy and Administration**

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**Subsection 2**  
**Finance and Accounting**

## Benefits and Costs of Foreign Banks Entering the Banking Market in Central and South-East Europe

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### Abstract

*Since banking sectors from Central and East-European countries are currently characterized by high levels of presence of foreign banks, in this article we intended to conduct a costs and benefits analysis on their entry in the banking markets of these countries. The study will begin with a comparative analysis on bank privatization policies used in 5 Central and Southeastern Europe countries (Poland, Slovakia, Hungary, Romania and Bulgaria), because they had a great influence in increasing domination of banks with foreign capital. We will also compare the characteristics and structure of the banking sector in each of the five countries and we'll show that in recent years, in every country, there is a growing governance of foreign-owned banks.*

**Key words:** foreign banks, banking intermediation, solvency and profitability of the banking system

**J.E.L. Classification:** G21

### 1. Introduction

Banking sectors in ECSE countries are characterized by very high levels of foreign bank presence. In some countries, the position of foreign capital banks is overwhelming, these banks entering in banking markets from ECSE countries most of the times during or immediately after a crisis and after a reasonable level of stability was restored. Foreign presence (in terms of assets) is held by Austrian, Italian, Belgian,

German and French investors. Greek investors enjoy also a prominent position, especially in South East Europe. The five largest foreign bank owners in ECSE countries are: Unicredito Italiano, KBC Bank, Erste Bank, HVB Group, Raiffeisen, Societe Generale. In the top-5 international banks, classified in 2009 can be mentioned Raiffeisen, Unicredit, Societe Generale, Erste and KBC.

The market entrance of foreign owned banks in ECSE countries was not always that easy. In the early '90, only a few foreign banks have entered the market through establishing of Greenfield institutions. This thing was motivated by two factors: lack of support for foreign banks in ECSE countries and the unattractiveness of these countries before structural reforms. Greenfield banks that were established have developed rapidly and have focused their operations to entities that have followed and exploited opportunities for new local markets. The increasing of foreign banks in ECSE countries has determined as well enlarging the degree of banking market concentration. Some authorities have preferred to recapitalize and to cleanse banks' portfolios, to make them more attractive to foreign investors. On the other hand, in many countries, authorities were skeptical to the foreign investors and have permitted only conditional purchase of institutions, as in Poland. Very often the entry barriers have been relaxed only after the crisis and this was motivated by the need to recapitalization and restorations of normal functioning of the banking system, as it was the case with the Baltic and Balkan countries after the crisis in

Russia, Argentina, after the tequila crisis in Mexico [2]. Foreign banks in Romania,

Slovakia and Bulgaria control more than 80 percent of bank capital.

*Table 1. Market share of foreign banks in ECSE countries (1995-2009)*

Country	1995	1996	1997	1998	1999	2000	2001
Bulgaria	n.a	n.a	34,8	43,4	46,6	48,1	66,7
Poland	19,24	29,79	41,52	49,7	56,0	56,6	61,3
Romania	14,11	12,84	24,46	35	41,75	53,8	60,6
Slovakia	n.a	39,6	39,2	37,3	24,6	28,1	60,0
Hungary	35,6	45,9	61,2	60,4	62,1	64,0	61,0
	2002	2003	2005	2006	2007	2008	2009
Bulgaria	66,6	76,3	80,0	80,1	82,3	86,3	86,6
Poland	63,2	63,3	69,9	66,6	66,6	67,0	62,9
Romania	64,9	66,3	62,2	88,6	87,7	88,2	85,3
Slovakia	85,3	88,9	97,3	98,9	97,0	96,3	94,3
Hungary	58,6	81,9	84,5	81,5	78,4	72,7	70,2

Source: processed by Havrylchuk, O., E., Jurzyk, works quoted, 2006, *CEE Banking Sector Report*, Raiffeisen Zentralbank Osterreich AG, Vienna, 2010, pg. 51, the authors' calculations

## 2. Benefits and costs of entering for foreign capital banks in ECSE banking systems

Benefits and costs of entering for banks with foreign capital on the financial system and national economies are extensively investigated in the literature. The main benefits presented in the literature are: the entrance of banks with foreign capital into the domestic banking sector increases efficiency because increased competition leads to lower costs and increase profits, improving the allocation of credit to the private sector as the credit risk assessment becomes more developed, promoting economic growth; the presence of foreign capital banks helps the developing of a national legal framework for banking supervision that will increase overall transparency; it is expected that foreign-owned banks to provide more stable sources of funding because they have access to external funding sources by parent banks, as domestic financial markets become less vulnerable to internal shocks; banks with foreign capital can reduce costs associated with bank recapitalization and restructuring in post-crisis period.

Major costs associated with foreign bank entry shown in the literature are: if the market share decreases with the entry of domestic banks with foreign banks, domestic banks may have an incentive to take greater risks; because foreign-owned banks generally have superior products and services of local banks, they will gain market share including

profitable sectors of the economy and risky sectors will be financed by local banks; through increased presence of foreign banks, the access to some sectors of the economy may be affected; the presence of foreign capital banks increases the systemic risk through the occurrence of contagion effect; because foreign capital banks have different priorities, their lending model tends to ignore the domestic economic priorities.

Claessens, Demirguc– Kunt and Huizinga (1998) have shown that the presence of foreign banks can help increasing the competition, improving the allocation of loans and access to international capital markets. But there are also costs associated with foreign bank entry, costs that may include increased systemic risk caused by increased competition and risk propensity of banks to maintain or increase market share (Hellmann, Murdock and Stiglitz, 2000) [5]. Claessens, Demirguc– Kunt and Huizinga (1998) examine the effects of foreign banks entering the national banking sectors. The authors show that developing countries foreign banks have higher rates of profitability and higher interest margins than domestic banks, while in developed countries the situation is opposite.

Another conclusion is that the profitability and general administrative expenses of domestic banks decrease after the entry of foreign banks on domestic markets [6].

Demirguc– Kunt and Huizinga (1999) shows similar results. They demonstrate that foreign capital banks generally have higher

profit margins than domestic banks in developing countries [7]. Other studies show that the entrance of foreign banks reduce operational costs and profitability of domestic banks, reducing the risk of a banking crisis and lead to higher economic growth by improving the efficiency of domestic banks. Agenor (2001) points out that since investors are not familiar with the specific problems of countries in which they invest, they tend to withdraw immediately and massively to the first difficulty encountered [8]. This can lead to a profound crisis on domestic financial markets.

Foreign ownership may have a stabilizing effect on the banking markets in ECSE countries for the following reasons: first, one of the advantages of foreign ownership is that foreign-owned banks have lower sensitivity to host country conditions; secondly, banks with capital foreign have better access to international markets, international experience shows that parent-banks serve as lenders-of-last resort if their subsidiaries are facing some problems. Meanwhile, foreign banks can contribute to destabilization of banking markets, as they may be affected by business conditions in their home countries and changes in health or strategies of the parent banks. Finally, there is always a fear that foreign-owned banks attract the best customers, leaving to domestic banks riskier customers, which could also lead to their poor performance [1].

Because ECSE banking sector is characterized by the highest level of presence of foreign banks in the world, many specialists have conducted numerous studies on their profitability compared to domestic banks, their impact on the business sector, but also on the host country lending. A recent study [9] conducted by Olena Havrylchyk (2010) analyzes the impact of the presence of foreign banks in Central and Eastern Europe (CEE) (depending on how their entry), on the rate of input and output companies, their size and their likelihood of survival in the early years, but also the impact of foreign-owned banks over the credit supply to small and medium enterprises (SMEs) and finds that

the acquisition of domestic banks by foreign investors has reduced creation and entry of smaller firms, while the exit rate of firms has increased. At the same time, the entrance of banks with foreign Greenfield capital has stimulated the creation of companies but also of their output.

Although foreign capital banks have contributed to increasing the supply of credit in ECSE economy, not all borrowers have received loans equally. Some studies show that foreign banks granted fewer loans to small companies, being concerned instead of crediting large firms (Degryse, Havrylchyk, Jurzyk & Kozak (2009). Olena Havrylchyk demonstrated by the study realized that SMEs are supported in financial terms by local banks and in a lesser extent by foreign-owned banks, which only increase the competitive pressure to amplify their supply of loans to SMEs.

### 3. Structural evolution and current characteristics of banking sectors in ECSE countries

To highlight the degree of development and structural characteristics of banking systems in ECSE countries, we conducted an analysis evolution of the number of credit institutions, the concentration of banking and banking intermediation, solvency and profitability of the banking system in 2005-2009. Structural developments in the banking sector in ECSE countries during 2005-2009 indicates a decrease in credit institutions in countries such as Bulgaria, Poland and Hungary, but an increase until 2008 of the number of territorial units operating in these countries, except Slovakia (see Table 2). A similar trend can be observed to be manifested throughout the EU and implicitly, euro area-wide. In Romania and Slovakia we observe an increase in credit institutions until 2008, after which their number remains constant in Slovakia in 2009 and in Romania is reduced from 43 to 42 credit institutions.

Table 2. The number of credit and number of local units (agencies) in ECSE countries (2005-2009)

Country	Number of credit institutions					Number of local units (agencies)				
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009
Bulgaria	34	32	29	30	30	5.629	5.569	5.827	6.080	6.038

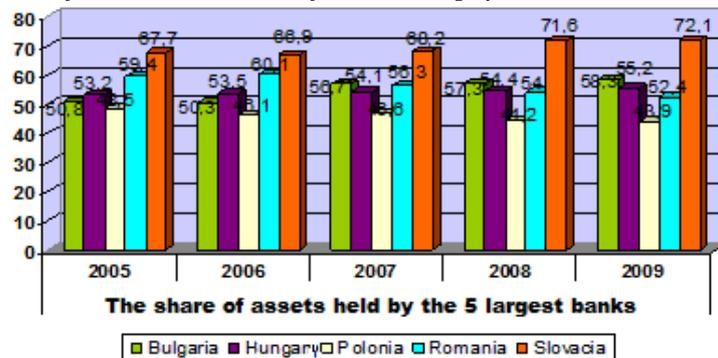
Hungary	214	212	206	197	190	3.125	3.243	3.387	3.515	3.551
Poland	730	723	718	712	710	10.074	10.934	11.607	12.914	13.292
<b>Romania</b>	<b>40</b>	<b>39</b>	<b>42</b>	<b>43</b>	<b>42</b>	<b>3.533</b>	<b>4.470</b>	<b>6.340</b>	<b>7.375</b>	<b>6.425</b>
Slovakia	23	24	26	26	26	1.142	1.175	1.169	1.258	1.230
MU16	6.704	6.535	6.391	6.175	6.458	171.846	183.772	186.252	187.679	179.916
EU27	8.683	8.507	8.354	8.090	8.358	214.925	228.648	233.800	238.021	229.532

Source: EU Banking Structures, September 2010, pp. 35-51 [www.ecb.eu](http://www.ecb.eu).

As what regards the degree of banking concentration, it is observed to be high in most countries. Concentration ratio of top five banks in all countries ECSEE was 50 percent or above this percentage. Only Poland had a concentration level lower than this level. In the period 2005-2009 observed increasing trend of the concentration

measured by Herfindahl concentration index, while the share of assets held by the five largest banks in countries recorded changes ECSEE upward, except for Romania and Poland, countries in which we observe a decrease in 2009.

Figure 1. Evolution of the concentration of the banking system in ECSE countries (2005-2009)



Source: developed by authors based on data from the EU Banking Structures, September 2010, [www.ecb.eu](http://www.ecb.eu)

Another measure that indicates the degree of banking sector development and public confidence in the banking system is the ratio of bank deposits to GDP. Table 3 shows the

evolution of the loans and deposits denominated in euro ECSEE countries during 2005-2009.

Table 3. Evolution of total loans and total deposits in ECSE countries (2005-2009)

Country	Total loans - mil Euro					Total deposits - mil Euro				
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009
Bulgaria	9.415	11.701	19.389	25.571	26.470	11.210	14.875	20.520	22.302	22.859
Hungary	45.980	56.298	65.565	76.473	73.087	38.480	47.129	51.150	55.152	56.326
Poland	77.995	96.470	133.590	158.173	175.453	105.818	121.634	147.294	153.789	171.412
Romania	16.583	27.928	42.056	50.823	49.811	21.623	30.175	37.779	40.248	41.331
Slovakia	14.609	21.518	26.547	30.752	31.109	21.889	19.525	21.831	22.626	21.961

Source: processed by EU Banking Structures, September 2010, pp. 35-51 [www.ecb.eu](http://www.ecb.eu), authors' calculations

The above table reveals both that the credit level in the countries studied and the deposits record an increasing evolution, the growth rate being faster until 2007, after which there was a slowdown in its increase,

mainly due to turmoil and financial instability caused by the financial crisis triggered in 2007.

The soundness of the banking system in ECSE countries is indicated by the ratio of

bank capital adequacy. Evolution of this report shows that over the last six years, there has been an improvement in capital adequacy ratio of banking systems in ECSE countries. Noteworthy in the year 2009 that all banking systems have been considered an indicator of higher solvency level regulated, which means

that the banks were, on average, well-capitalized. The following table shows the capitalization of banks using capital adequacy ECSEE countries during 2005-2010.

*Table 4. Capital\* adequacy ratio in ECSE countries (2005-2009)*

Country	2005	2006	2007	2008	2009	Rate established by law
Slovakia	14,8	13,1	12,8	11,1	12,6	11
Poland	14,6	13,2	12,0	11,1	13,2	8
Bulgaria	15,3	14,5	13,0	14,9	17,0	12
Romania	21,1	18,1	13,8	13,0	14,7	8
Hungary	11,6	10,8	10,0	11,1	12,9	8

\*% of assets weighted with the risk rate

*Source: processed by the authors after Raiffeisen Research 2010, Country Report IMF 2011*

The year of 2009 was characterized by improving solvency, result attributed on one hand, to stagnation in lending (a contribution having the more prudent attitude of banks concerning risk-taking), and on the other hand, to increased capitalization of the banking system as a result of banks efforts to increase capital. From Table 5 it can be seen that the profitability of the banking sector in ECSE countries has improved significantly in

recent years, except the maximum intensity of the crisis – the period of 2007-2008. This was a result of the overall reform of the banking system (eliminating bad loans, privatization of state banks, introduction of modern banking techniques, credit expansion) and the high level of intermediation in these countries.

*Table 5. Banking sector profitability measured by ROE in ECSE countries during 1995-2009*

	2003	2004	2005	2006	2007	2008	2009
Slovakia	27,2	29,0-	17,7	18,7	16,5	14,1	6,5
Polonia	5,4	17,6	20,8	23,1	22,9	21,2	11,2
Bulgaria	18,7	20,2	21,6	24,4	23,8	15,8	9,3
Romania	15,6	17,0	12,6	10,4	9,4	1,7	2,7
Hungary	21,1	26,5	26,6	24,7	20,1	15,2	10,4

*Source: processed after Barisitz, S., Banking in central and eastern Europe 1980-2006, Routledge international studies in money and banking, SUA Canada, 2008, Raiffeisen Research 2010*

#### 4. Conclusions

Banking system in ECSE countries has grown significantly over the past two decades. Although the banking sector has grown significantly in recent years, there are still many challenges to be answered, especially the banking sector of South European countries, because it is less developed than the banking system in CEE countries. Accession to EMU and the possibility of adopting the euro in the future, implementation of new Basel III treaty, strengthening the regulatory and financial performance are some of the challenges for ECSE countries in banking. Growth potential

in the area will allow financial institutions improve their performance and extend their activities. We believe that the main concern of banks for the future is restoring and maintaining public confidence in the banking sector.

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## Peculiarities of Romanian Insolvency System

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### Abstract

*For a company that has financial difficulties it is best to enter an insolvency procedure. This process offers the possibility to assess the viability of the company and to find the proper solution for its situation. This study examines the peculiarities of the insolvency procedure. The stages of this process present a high significance for all stakeholders, giving the fact that they are all involved in it and the effectiveness of the procedure affects the its final relation with the insolvent company.*

*An entity that enters an insolvency procedure can be either reorganized either liquidated. Each of these solutions has its effect on the company, on its partners and on the economy in general.*

**Key words:** insolvency law, bankruptcy

**J.E.L. Classification:** G33, K41

### 1. Introduction

Bankruptcy law has always had a fundamental role in resolving the situation of firms that were having a period with financial difficulties.

Insolvency law establishes a balance between several objectives. Its purpose is to protect the rights of the creditors, the interests of the shareholders and customers, and avoid potential liquidation of viable companies.

Insolvency law facilitates the recovery or the market exit of inefficient firms. We can identify significant differences between national insolvency regimes that are related to the fundamental considerations of policy, structure and content.

*Insolvency proceedings and their effectiveness* have significantly variations from a country to another. Some countries have complex insolvency procedures while

others have just a simple procedure of liquidation [1].

To improve and accelerate the insolvency proceedings, the Council of European Union adopted the Regulation no. 1346/2000 on insolvency proceedings, which establishes common rules in this field. These rules do not provide a substantial harmonization of national insolvency laws because there are many differences between these systems. Thus, it can not facilitate the use in practice of a single insolvency proceeding, which may be applicable throughout the European Union. Council regulations contain rules relating to the transfer of the headquarters of a European Economic Interest Group, a European company and a European Cooperative Society [2]. Thus, issues related to how to reconcile the differences in insolvency systems with permanent economic integration increase their importance.

To develop an environment that manages the internal crisis and it increase the effectiveness of the structural measures at an European Union level, it has to be established the extent to which insolvency laws should be harmonized in the European Union's member states. There are only a limited number of issues that need to and can be harmonized. These are broadly as follows:

- a possible common test of insolvency in the insolvency proceedings;
- formal aspects related to the filing and resolution of claims in the proceedings;
- some aspects of structure and content of a reorganization plan;
- the terminal relationship between contractual rights and insolvency;
- administrator's responsibilities.

In order to determine the orientation of the insolvency legislation it should be taken into consideration the peculiarities of national insolvency proceedings that may be then compared with the same elements of the procedure, but applied in other states. For

this purpose, the procedure can be divided into three main stages [3]:

- The opening of the procedure;
- Control and management of the company during the procedure;
- Reorganization plan and results of the procedure.

## 2. Criteria for filing for insolvency procedures

In Table no. 1 we compared the possibilities for opening an insolvency procedure in some countries from Eastern Europe. In all states the insolvency procedure will open when a companies has no liquidities to pay its debts. Over indebtedness appears when a company has a rate of indebtedness over the limit that is recommended by the experts. The debt of a company, calculated as a report between total debts and total assets, must have a value less than 66% in order to show a good financial position. Only Romania and Hungary do not apply this criterion when filing for an insolvency procedure. Imminent insolvency, on the other hand, was introduced only by the regulations in Romania and Czech Republic.

Table 1. Criteria for filing for insolvency in Eastern Europe

Country	Lack of liquidities	Over indebtedness	Imminent insolvency
Bulgaria	✓	✓	-
Czech Republic	✓	✓	✓
Hungary	✓	-	-
Poland	✓	✓	-
Romania	✓	-	✓
Slovakia	✓	✓	-

Source: Balcerowicz et al., 2003: 12

## 3. Judicial reorganization and bankruptcy procedure in Romania

The first step in an insolvency proceeding is to hand in an application in order to request the opening of the procedure. This application is introduces in court. This application may be filed by the debtor, by a creditor or by any other person or institution

lawfully entitled to introduce this type of application, such as the Romanian National Securities Commission.

A company that finds at certain point that is insolvent or that this state is imminent, must address the court in whose jurisdiction the debtor is located and request to that effect, within 30 days from the date of the detection of this state. By law, the request must be accompanied by conclusive documents. In this case, the debtor may opt for reorganization or for a simplified procedure of bankruptcy. In any case, if the company has gone through a reorganization process in the last five years, this option is no longer valid.

*A creditor has the right to request the opening of a procedure if he has claim against the debtor due for more than 30 days.*

The debtor will be announced concerning the demand introduced and he will either question it, either accepts the state of insolvency, within 10 days since the notification. If the state of insolvency is disputed by the debtor, but then the appeal is dismissed, the debtor will enter directly into the general procedure and will not be entitled to the possibility of judicial reorganization. This procedure can be proposed, however, by creditors that have, together, at least 20% of the credits.

By deciding the opening of the procedure, the court will decide the administrator or liquidator that will manage the entity.

If a general proceeding is opened the court will appoint a judicial administrator and if it is decided to open a simplified procedure the court will appoint a provisional liquidator. The right of administration can be taken from the debtor if the intention of reorganization is not announced when the judicial administrator is named. If not, the debtor will no longer administrate the company when it enters the bankruptcy proceeding. During the observation period, the debtor is allowed to perform its daily activities and can make payments, including to its creditors. These operations will be supervised or conducted by the judicial administrator.

The judicial administrator will then proceed to prepare a report on the causes and circumstances which led to the insolvency of the debtor, which will be completed within 60 days from his assignment. This report provides information about the debtor

through a financial analysis of the economic activity undertaken during last three financial years and then it concludes about the causes and events that caused the insolvency or determined the liquidation. The same report states the persons to which the current state of society would be attributable. The purpose of the report is to specify data regarding a possible reorganization or the causes that makes it not be possible.

When the judicial administrator suggests through this report the entrance of the company in bankruptcy, the judge will provide a decision that will be published in the Bulletin in order convening a meeting of the creditors. Creditors will have this opportunity to listen to the creditors' committee opinion on this situation and to vote the proposal of the judicial administrator. For the approval of his proposal it is needed the vote of creditors holding at least two thirds of the claims. Also, when a creditor or several creditors holding together more than 20% of all claims included in the preliminary table of claims announce the intention to submit a plan of reorganization of the debtor in accordance with the law, the judicial administrator's proposal will not be voted, regardless of the outcome.

If the general meeting of creditors approves the proposal of the judicial administrator, it will be decided that for the debtor the bankruptcy procedure will be applied, so the judge will give a sentence to state this.

Third parties will be notified about the opening of the procedure by the judicial administrator.

Employees are the only creditors that must not file a statement of claim. Their claims will be registered by the judicial administrator in accordance with the accounting records. All other creditors holding claims prior to the opening of the proceeding will make an application for the admission of claims. This application must be submitted before the date fixed in the opening sentence of the procedure. This request must be filed even when claims are not specified by a title and include: the name of the creditor, permanent address, the amount of the claim, foresights related to any preference rights or guarantees and supporting evidence attached.

All claims will be subjected to verification. After verification, the judicial administrator or the liquidator will develop and submit in court a preliminary table of claims, which shall include all claims against the debtor, depending on their type: salary, budget, unsecured, secured, with priorities, conditional or not yet due. For each claim it shall be specifies the name of the creditor, the amount claimed by the creditor and the amount accepted. If there are secured claims, the title which supports the guarantee made must be presented. Other elements presented in this table are the type of the claims and why claims were listed in the table or have been partially removed. The table will be displayed at the tribunal, so that creditors with claims enrolled may attend the meetings of creditors.

Claims of any creditor who has a debt to the firm in insolvency procedure can be compensated.

Any interested person may submit written appeals on claims included in the preliminary table of claims by the judicial administrator or liquidator. After resolving the appeals through the courts, the judicial administrator or the liquidator will have to submit the final table of the claims in court and at its headquarters. The table should make clear the amount registered, the priority of the claim and the situation for each one.

Completing the definitive table has as a consequence the participation at the vote on the reorganization plan or in any distributions of money in case of simplified bankruptcy procedure only for holders of claims included in this table.

The judge will decide the entrance of a company in bankruptcy. This decision is taken when: the debtor has declared its intention to enter the simplified procedure; the debtor has not declared its intention to reorganize or, at the request of the creditor to initiate the procedure, the debtor contested this state and the appeal was dismissed by the judge; none of the subjects entitled to propose a reorganization plan have done that or none of the proposed plans were not accepted and confirmed; the debtor has declared its intention to reorganize, but suggested a plan or proposed plan of reorganization has not been accepted and confirmed; payment obligations and commitments are not fulfilled as stipulated

by the debtor's confirmed plan or activity during its reorganization brings wealth losses to the debtor; the judicial administrator's report proposing, where appropriate, the entering of the debtor into bankruptcy was approved.

Opening the bankruptcy proceeding may commence when the debtor fails to operate in accordance with the plan of reorganization or the judge has reasonable grounds to stop the procedure of reorganization and suggests the liquidation of the debtor.

Through the sentence that shall decide on the bankruptcy decision, the syndic judge will decide the dissolution of the debtor company and will dispose: raising the right of administration of the debtor; in general procedure, he will appoint a provisional liquidator and will establish his attributions and his remuneration; in simplified procedure, the confirmation of the judicial administrator as a liquidator; the time limit to give the management of the debtor's property to the liquidator or judicial administrator (including the list of documents and operations that have been made after the opening of the insolvency procedure); preparation of a list of the names and addresses of all creditors and their claims that will be given by the judicial administrator to the liquidator, indicating those claims that were born after the opening of the procedure; notification of entering the bankruptcy proceeding.

The liquidation of debtor's assets shall be made by the liquidator under the control of the syndic judge. To give a maximum value to the debtor's assets, the liquidator will appropriately display on the market the goods subjected to liquidation and advertising expenses will be also paid by the debtor. The liquidator will formulate a strategy for the liquidation of goods, by organizing auctions, advertising, etc. The liquidation of assets can begin immediately after a fully inventory of the debtor's assets inventory. Assets can be sold in bulk (as a whole running) or individually. The general meeting of creditors will approve any method used to sell goods, whether it is public auction, direct negotiation or combination of both, depending on the proposal of the liquidator and the creditors' committee recommendation.

The liquidator may engage, on behalf of

and at the expense of the debtor, an evaluator, a person or entity, or will collaborate, with the prior agreement of the creditors' committee, with their evaluator to evaluate the assets of the debtor, in accordance with International Valuation Standards.

Debtor's assets can be evaluated both individually and in bulk, depending on their specific characteristics. Buildings may be sold directly, to the liquidator proposal, proposal that yet has to be approved by the general meeting of creditors. The securities will be sold according to Law no. 297/2004 on the capital, as amended.

Any sums obtained from sales will go into the liquidation account.

All the funds, made by selling the debtor's assets, will be distributed in the following order:

1. Expenses related to the sale of those goods, including expenses necessary for the conservation and management of these assets and payment of remuneration of employees;
2. Claims of secured creditors, which will include all capital, interest, penalties and other expenses. When the amounts realized from the sale of these assets are insufficient to fully cover the payment of the guaranteed debt, the creditor will have an unsecured claim for the difference remaining, debt which will be included in this category and will be paid in proportional. Creditor holding a secured debt against the debtor has the right to participate in any distribution of amounts made before the sale of guarantees property.

Liquidator will have as a task the presenting to the committee of creditors of a report on liquidation proceeds and collection of receivables and a distribution plan from creditors. The report will mention information regarding the remuneration of the liquidator and its payment and also other expenses with the procedure. This presentation will be done every 3 months.

In the event of bankruptcy, claims will be distributed to creditors in the following order:

1. Liquidation expenses; here we include also the necessary expenses to achieve the conservation and management of the debtor's assets, and to pay salaries of employees;

2. Claims arising from the employment relationship;
3. Claims arising from contracting loans from credit institutions after the opening of the procedure, including interest and expenses; these debts that have arisen because of the debtor’s activity after the opening of the procedure;
4. Budgetary claims;
5. Claims of third persons representing maintenance allowances for minors or periodic payment obligations of amounts paid to ensure livelihoods;
6. Amounts set by the judge to help maintain the debtor and his family;
7. Bank loans, including interest, claims arising from the delivery of financial products or services; this type of claims also include rentals;
8. Other unsecured claims;
9. Subordinated debts, which are covered in the following order: payment to an associate or a shareholder who owns at least 10% of the shares of the company, or to a member of the economic group of interest and, later, claims that arose from gratuitous acts.

When there is money to be distributed and their distribution has to be done among creditors who have the same rank of priority, each will be given a proportional amount to the amount stated in the claims table. A holder of a claim in a given category will receive distributions only after the fully payment of the amount of debt of the creditors with a higher rank, according to the order above.

If the assets of an economic group of interest or of a company whose shareholders have unlimited responsibility are not sufficient to pay the total claims from the final consolidated table, the syndic judge will authorize enforcement against members with unlimited liabilities by giving a final decision, which will be enforced by the liquidator or by a bailiff.

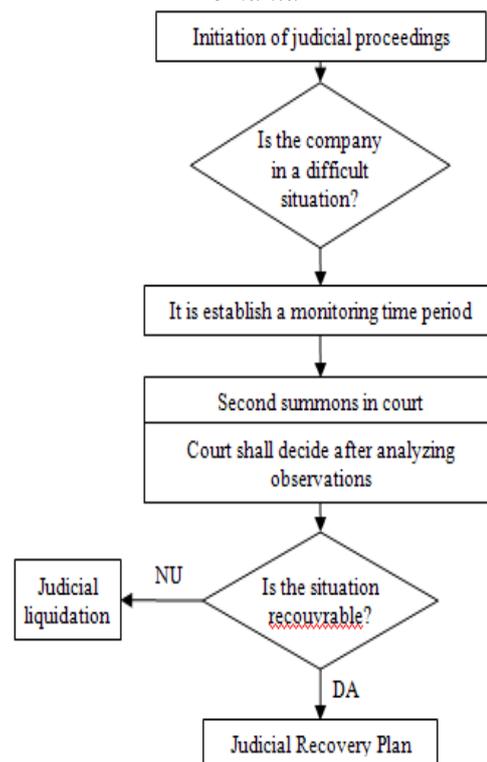
In case of partial distributions, there will constituted provisions for: proportionate amounts due to creditors whose claims are subject to a suspensive condition not yet fulfilled; proportional amounts owed to the owners of bearer notes or securities which have the originals, but they have not presented them; proportional amounts owed as provisionally admitted claims; reserves for

future expenses to cover the debtor's property.

After liquidating the assets of the debtor, the liquidator will prepare and submit a final report in court, together with final financial statements. Syndic judge shall convene the meeting of creditors within 30 days from the posting of the final report, during which creditors may object to this report.

After approving the final report of the liquidator, the procedure will continue with the final distribution of all funds remaining in the debtor's property.

Figure 1: The steps of general procedure of reorganization and judicial liquidation in Romania



Source: Constantinescu, D., Nistorescu, T., *Economia întreprinderii, Sitech, Craiova, 2009, p. 90*

If the situation that the duration of the liquidation procedure exceeds the duration of a financial year, the liquidator is required to prepare the annual financial statements of the company in this situation. The liquidator is also the one that will have to submit mandatory tax declarations, health insurance or unemployment fund etc.

At any stage of insolvency proceedings, provided that it is concluded that there are no assets in the debtor's property or that there

are not sufficient liquidities to cover the administrative costs, the syndic judge is entitled to give a sentence terminating the proceeding. By that, the debtor will be removed from the companies register.

Bankruptcy procedure is closed once the approving of the final report is made by the syndic judge, meaning, with the use of all funds or assets of the debtor. The syndic judge will give a closing sentence for closing the procedure and orders the removal of the company from the register. The procedure can be closed only after the complete liquidation of the assets and after any amounts remaining after the final distribution will be sent to the personal associates accounts.

#### 4. Conclusions

The insolvency system applied in Romania is one that protects more the debtor, but not entirely. In fact, the involvement of courts of law in making decisions on the extent of applying the procedure mostly shows proximity of the insolvency law with the French legislation.

The paper is focused on evaluating the institution of bankruptcy law and insolvency procedures and the effectiveness of their implementation.

Although there is not a common international insolvency frame, the basic principles applied are still the same (market exit of nonviable firms). Due to current economic changes, both nationally and internationally, Romania must continually adapt to international legislation. Because management of economic organizations has a high complexity, is necessary to harmonize Romanian financial accounting legislation and tax legislation to the one used at an international level.

Harmonization has been achieved through cooperation of international institutions such as World Bank, UNCITRAL (United Nation Commission on International Trade Law) or the European Commission, but also because of pressure from partner states. There have been made recommendations in this respect and cooperation agreements or other elements in order to determine the common practices to apply the bankruptcy procedure. The liquidation and bankruptcy legislation is harmonized with UNCITRAL's

recommendations regarding cross-border insolvency.

Together with the Romanian harmonization of accounting with international accounting standards, in the Romanian legislation have emerged new accounting rules or the existing rules have suffered constantly changed. Even with this pressure for harmonization of legislation, international regulations should be adapted to national specificities. However, new accounting regulations and especially the new insolvency regulations corrected unclear aspects of the procedure.

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## The Effects of the Reverse Charge for the Supply of Cereals and Industrial Plants on the Romanian Companies

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### Abstract

*This article's goal is to highlight the main reasons and effects of the adoption of the reverse charge for the supply of cereals and industrial plants in Romania in May 2011 on the companies' activity in our country. In an attempt to diminish the VAT evasion related to sale of crops and grains, the Romanian Government introduced simplification measures for the sale of crops and grains that should also provide a cash flow benefit especially for the Romanian firms involved in cereal trading, thanks to the earlier collection of the inputs' VAT from the state.*

**Key words:** tax evasion, reverse charge, Romania, agriculture.

**J.E.L. classification:** E26, H25, H26

### 1. Introduction

The financial crisis hit Romania a year after some other European countries, but the effects were severe and caused major changes in the economy.

Romania started implementing measures to fight the effects of the economic crisis and to generate more budget revenues as other CEE countries did.

The Romanian fiscal policy swung between budget deficit pressures and measures to stimulate business activities in 2011.

The reverse charge for the supply of cereals and technical plants is an efficient fiscal measure to reduce VAT evasion.

The Romanian authorities wanted to implement this simplification measure in order to combat the tax evasion in agriculture that reached 60% of the bakery market.

### 2. Short history

The Ministry of Finance announced in the summer of 2010 that it called for a derogation from the European Commission (EC) on the application of VAT by reverse charge supplies of goods within the country's grain crops, vegetables, fruit, meat, sugar, flour, bread and bakery products.

After being refused by the Commission, Romania submitted the European forum, in December 2010, a letter to summarize the products that require derogation from the normal tax grain and industrial crops, namely maize, wheat, barley, rye, soybean, rapeseed, sunflower and sugar beet. The application relates to a two-year exemption from the principle of applying VAT to cereal trade.

The Secretary of State for Finance Dan Lazăr AFP said in January that Romania has made this approach to the EC not only to prevent and combat tax evasion, but also in response to repeated requests coming from the business.

In response, the Directorate General for Taxation and Customs Union European Commission (DG TAXUD) approved in mid-January Romania's reverse charge call to grain measure, measure also approved later on, in early May, by the EU Council.

The explanatory memorandum of the draft emergency ordinance states that, according to the commitments assumed by Romania in the context of obtaining authorization procedures for implementing this measure, the reverse charge for delivery of goods in the category of cereals and crops applies for a period of two years the entry into force, i.e. up to 31<sup>st</sup> of May 2013 inclusively. [4]

The Government Emergency Ordinance (GEO) introduces VAT simplification measures applicable to supplies of the cereals

and the technical crops specifically mentioned in the combined nomenclature established through the CEE Regulation no. 2.658/87.

Thus, for the supply of the above-mentioned cereals and technical crops, the person liable to pay the tax is the beneficiary, through the reverse charge mechanism.

The mandatory condition for applying the reverse charge mechanism is that both the supplier and the beneficiary are registered for VAT purposes according to article 153 of the Fiscal code. [1]

### 3. The reverse charge mechanism for cereals and technical plants

On the 4<sup>th</sup> of May 2011, the European Commission adopted the decision to authorize the application of reverse charge in Romania for the supply of the following categories of products considered to have a high risk of tax fraud: corn, wheat, rye, sunflower, barley, rape, sugar beet, soy, two-row barley.

These are detailed according to the Tariff and Statistical Nomenclature and Common Customs Tariff:

*Table 1: The cereals and industrial plants submitted to the reverse charge mechanism*

NC Code	Product
1001 10 00	Durum
1001 90 10	Triticum spelta, for seeding
1001 90 91	Ordinary wheat, for seeding
1001 90 99	Other Triticum spelta and ordinary wheat, not for seeding
1002 00 00	Rye
1003 00	Barley
1005	Corn
1201 00	Soy beans, including those shattered
1205	Rapeseed or wild rapeseed, including those shattered
1206 00	Sunflower seeds, including those shattered
1212 91	Beetroot

*Source: the Emergency Ordinance no. 49/31.05.2011 published in Official Journal of Romania no. 38/31.05.2011*

Pursuant to this decision, discussions had followed at the level of the member states

within the European Council, the final decision belonged to the latter. The simplification measure was applied only after the communication of the European Council's final decision.

The Official Monitory no. 381/31.05.2011 published the Emergency Order of the Cabinet regarding the modification and the completion of the Law no. 571/2003 regarding the Fiscal Code and other financial and fiscal provisions.

Thus, the supplier of cereals and crops will not mention VAT on the invoice, but "reverse charge according to art. 160 al.2 lett.c", and the client will register the tax due to the acquisition in the VAT statement both as collected tax and as deductible tax, without the right to request the VAT return for the acquisitions of cereals and crops.

The provisions regarding reverse charge mechanism are applied starting the day of June 1<sup>st</sup>, 2011 until May 31<sup>st</sup>, 2013, that day included.

Please note that, in order to apply simplification measures for domestic supplies of cereals and industrial plants, the following conditions should be met:

- both the supplier and the beneficiary are taxable persons registered for VAT purposes in Romania;
- on the invoice issued for the supply of goods, the supplier will make a reference to the application of the reverse charge mechanism and he will not disclose the related VAT on the invoice;
- the beneficiary will compute the related tax and he will record it in the VAT return both as collected tax and as deductible tax;
- these measures are applicable only for domestic supplies of goods. [3]

The simplification measure presumes the application of the reverse charge mechanism, meaning that the supplier issues VAT-free invoices mentioning on them the application of the reverse charge mechanism. The buyer will calculate the VAT evidencing it on the invoice and in the sales/purchases ledger and will report it both as input and output VAT in the VAT return. [2]

In accounting terms, the beneficiary will register during the fiscal period 4426 = 4427 with the specific amount.

Registering the tax by the buyer as an

input and output VAT in the VAT return is called the self-liquidation VAT. The VAT collection to the level of the deductible VAT is assimilated to tax payment to the supplier.

In the VAT return the operations will be highlighted as follows:

- the supplier will sign up at line 13 “The deliveries of goods and provision of services exempted with the right of deduction, others then those from line 1-3, and operations subject to the simplification measures” the tax base for the deliveries of cereals and technical plants; the information will be taken from the Sales Journal
- the buyer will sign up:
  - ✓ at line 12 “The acquisition of goods and services subject to the simplification measures to which the beneficiary is obliged to pay the VAT (reverse charge)” the tax base and the collected VAT for the acquisitions of cereals and technical plants; the information will be taken from the Purchase Journal
  - ✓ at line 21 “The acquisition of taxable goods and services with the 24% quota” the tax base and the deductible tax for the acquisition of cereals and technical plants; the information will be taken from the Purchase Journal.

#### **4. The reasons to adopt the reverse charge mechanism for cereals and technical plants**

The main reasons to adopt the reverse charge mechanism can be summarized as it follows:

- fight against the tax evasion including for the cereal exportations
- increase in fiscal discipline
- a better tax collection
- cash flow for the manufacturers thanks to the earlier collection of the inputs' VAT from the state
- increase in the budget incomes
- eliminate the unfair competition, represented by the middlemen, “ghost” firms or agents
- the supply of the merchandise directly to the processor
- the farmers can associate
- the exporters would not be forced to have money tied up in VAT till the Romanian

state returns these amounts

- the cereal price regulation in Romania
  - “Taking into account the urgent necessity to fight the fiscal fraud in the field of cereals and technical plants market through the reverse charge mechanism before the beginning of the harvest period, when the evasion phenomenon appear, the measure will be applied beginning with the 1<sup>st</sup> of June 2011”, it is shown into the Base Note of the draft law published on the site of the Ministry of Finance.

This measure’s goal is to fight the agricultural tax evasion which is considered to have a share of almost 70 % of the entire evasion at a national level.

According to the appraisals presented by the Ministry of Finance, in the period of application of this Emergency Ordinance, the reverse charge for the supply of some goods from the field of cereals and technical plants market inside the country will determine a plus for the state budget of 240 million lei in 2011, 410 million lei in 2012 and 170 million lei in the first six months of 2013”, this is a total plus of 820 million lei, said the minister Ialomițianu. [8]

“By introducing the reverse charge between the economic agents, the VAT will be applied at the end of the supply chain” said Dan Lazăr.

He said that “ghost” companies are established and function during the agricultural campaign and disappear when they should make tax returns and pay obligations to the state budget, including VAT. The general characteristics of these firms are: most were members or shareholders of foreign residents and non-European countries, so they prejudice the state by not paying VAT and other taxes that can not be recovered. [4]

Ștefan Niculae welcomes the implementation of the reverse charge measure for cereals, that should produce positive effects on the agricultural environment.

„On one hand, the reverse charge should reduce the number of agents in agriculture. As we all know, smart boys use this VAT by making shuttle firms with the purpose to recover the VAT from the state, the goods without moving from place. I hope the new measure will reduce a lot the number of middlemen, and the manufacturers could

supply the goods directly to the processors. In this moment there are too many agents.

On the other hand, the measure should help to combat the tax evasion on the cereal exports. In many cases, at exports, the goods leave only on paper, without the physical movement of the cereals”, explains Ștefan Niculae.

The president of Agrostar hopes that the new measure could produce other positive effects in agriculture. „For example, one of these could be encouraging the farmers to associate and so to capitalize the cereals in better conditions”, says Ștefan Niculae. [10]

The introduction of the simplification measures should provide a cash flow benefit especially for the Romanian companies involved in cereal trading. It remains to be seen whether the projected VAT revenue budgeted by the Ministry of Finance for the application of the measure period will become fact. [5]

„We have demanded the reverse charge for cereals because there are farmers in competition with those who sell on the black market and they are doing so because they are forced to.

I think that the most correct and honest thing the state could do is, the moment it takes the VAT on the 25<sup>th</sup> of the month, to give us back the VAT on the 25<sup>th</sup> and then everything will be all right and there wouldn't be any kind of problem. It would have been a more acceptable and efficient measure for us if the VAT was below 10%, and so it wouldn't be very tempting for the ones who want to steal. It could have been made a law that permits us to recover the VAT that we are paying”, said Nicolae Sitaru, the president of the Agricultural Manufacturers Associations League from Romania. [10]

## **5. The effects of the reverse charge mechanism for cereals and technical plants**

The positive effects of the adoption of the reverse charge for cereals and technical plants have already been mentioned, so now we can enumerate the negative ones:

- the mechanism is not applied on the entire supply chain
- the manufacturers must wait between three and six months in order to recover

the VAT paid for inputs

- there are some problems with the manufacturers' cash flow, because they can't use the money collected from the output VAT
- the manufacturers already announced price increases

The processors are saying the bakery black market is diminishing: “The black market has devolved. We can already feel the positive signs of the reverse charge” according to Viorel Marin, the president of the Bucharest National Association of the Milling Industries.

According to Aurel Popescu, before July, when the reverse charge mechanism was introduced, 60% of the bakery market was black market that is 600 million euros of one milliard euros. [6]

The Bucharest Vel Pitar CEO says that the price of bread would have risen with or without the reverse charge.

We must mention that the reverse charge is not an exemption of VAT, but a simplification measure through which the delivery between two taxable persons is made without highlighting VAT on the invoice and without paying VAT between them. Only the final buyer is highlighting the VAT through reverse charge.

In the supply chain in Romania, the last person registered for VAT bills and collects from the final consumer the value of the tax. The VAT is borne by the final consumer, the individuals or the legal entities that are not registered for VAT, and is afferent to the entire supply chain. [9]

Daniel Botănoiu, the CEO of the Romanian National Federation of the Agricultural Manufacturers, declared that this ordinance is successful only if the Fiscal Code will be modified regarding the VAT returns. "It is a good measure, but if the Fiscal Code would not be modified, that is the VAT returns to be paid within 30 days, it would not help the agriculture as it should. In this formula, the manufacturer will be the only one disadvantaged. We all know that the sales of cereals are made only in certain periods of the year, so there will be a greater pressure on the state budget and the VAT returns will delay further. This worries us even more because there are already huge delays with the VAT, and if this adds up, the agricultural manufacturers will be destroyed",

declared for Curierul Național, Daniel Botănoiu.

Considering that the law is not as thorough as they have expected, the agricultural representatives are skeptical about the success of the ordinance. "What the state has given at this moment, for the cereal and technical plants' trade, is a half-law. This ordinance will help the ones that have grain storages in Romania, those who already had a good life. Now they will buy cereals without VAT and they will sell forward to processors with VAT. It is possible for the tax evasion to decrease on the way of the storage owners", declared for Curierul Național, Sorin Minea, the president of Romalimenta.

He also said that for the final consumer, the ordinance would not have any kind of impact. "When the depository will bring to the mill the wheat in order to make flour, the VAT will be applied. So the state provided benefits only for the depositories, they will buy without VAT and will sell with VAT. We can all imagine that at the mill's gate the evasion could increase more, because the depository is tempted to negotiate a certain price with the processor, knowing he will have profit anyway. From this negotiation the processor also gains, and the only ones affected will be the manufacturers. Furthermore, this ordinance does not have anything to do with the final beneficiary, who is the final consumer. They would not feel any price modification, the law would not have any positive impact on them", pointed out Sorin Minea. [7]

"Before the reverse charge, every invoice from the supply chain contained VAT. In this moment, only the first supply chain invoice and the one emitted by the traders do not contain VAT. The rest of the chain stays the same. The mills are the first link that charges VAT. Ideally it will be the reverse charge to include the entire chain, not only the first link - manufacturer/processor. In the first phase, this might bring negative effects, we will probably see a slight increase of prices, but, on the long term, the effects could be beneficial", explained the Bucharest Velpitar CEO for HotNews, Dan Dolghin.

The manufacturers already announced taxes increases, says Dolghin, due to the cash flow problems that they could have. "Up to this point, they were collecting and paying VAT. In this moment they are not collecting

but they are paying VAT on expenses, knowing that will be returned by the state. We all know how easy it is for the state to give back the money. In order not to have cash flow problems, they have announced a raise in taxes. For us, increasing the wheat price means an increase of the expenses without VAT. In prices, these increases will be seen in almost 6 months – this is the interval in which the increase spreads into the market", says Dolghin. [9]

## 6. Conclusions

Summarizing, we can say that the reverse charge mechanism has both advantages and disadvantages, but, taking into consideration that the positive effects are more numerous than the negative ones, we have drawn the conclusion that the balance tips in its favor.

After a survey among the farmer market operators, we can conclude that some complementary measures can be taken in order to improve the reverse charge mechanism such as:

- eliminate the acquisition schedule
- reduce the cereal VAT at 5%
- the farmers can be included into a low risk class
- the reverse charge can be applied to the entire supply chain
- the VAT return from the state in maximum 30 days;
- a monitoring system of agricultural results

The reverse charge mechanism is clearly a measure to fight against the financial crisis adopted by the Romanian government in order to collect more money for the state deficit budget.

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# Results of Analysis of Some Theoretical Aspects of Title IX of the Fiscal Code and Points from Methodological Norms of Appliance the Fiscal Code Title IX: Principles for Establishing Local Taxes and Fees, Particularities of Their Calculation

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## Abstract

*A content analysis undertaken on Title IX: "Local Taxes" in the Romanian Fiscal Code and on those points of Methodological Norms of Fiscal Code relating to Title IX, entitles us to conclude that there are a number of issues and rules generally valid all applicable for local taxes. These issues generally valid rules aren't grouped in a compact, unitary content of the law, they are scattered in several articles of Title IX and during various points of the Methodological Norms of Fiscal Code provisions to Title IX.*

*This is the motivation of our analysis, analysis from which we identified three categories of issues and general rules - valid applicable for taxes and fees, as follows: the first category, including points and rules mainly with theory; a second category of issues and rules about the main role of authorities, especially local ones, in local taxes; a third category of issues and general rules - valid applicable for local taxes which is related to budgetary nature.*

**Keywords:** fiscal code, local taxes, local fees, Romania.

**JEL Classification:** H2, H3.

## 1. Introduction

An analysis made upon the content of Title IX „Local tax and fees” of the Romanian Fiscal Code and upon those points of the Methodological Norms of applying the Fiscal Code, regarding the Title IX, can lead us to the conclusion that there are some aspects and rules general valid that can be applied for the local tax and fees. Those aspects and rules general valid are not

grouped in a compact unit in the frame of the law, they being all over the articles of Title IX and the Methodological Norms of applying the Fiscal Code regarding Title IX.

As a result of this analysis, we identified three types of aspects and rules general valid, applying to the local tax and fees, such as: the first group is focus on aspects and rules mainly theoretical, a second group is related to the authorities' role – mainly the local ones – in the local tax and fees area, and the third category is focused on budgetary aspects and rules general valid applying to the local tax and fees.

Regarding the first category - issues and general rules - applicable for taxes and fees mainly theoretical - includes three types of issues and rules, including: definitions, principles underlying the establishment of local taxes, the assessment of features and local taxes, as they result from the comparative analysis of art. 247 Fiscal Code 1 to 10,14 and 15 points of the Methodological Norms of Fiscal Code, the provisions of Title IX.

In the following part, we will discuss some aspects related to the principles for establishing the local tax and fees and some specific features of determining them.

## 2. Principles underlying the establishment of local taxes

In accordance with point 14, paragraph 1) of Methodological Norms of Fiscal Code, applicable to Title IX Fiscal Code "Local Taxes and Fees", to establish local taxes are taken into consideration the following principles:

a) **The principle of transparency**, under which local authorities are required to operate in a manner open to public;

b) **The principle of uniformity**, according to which local authorities shall organize the execution and enforcement, in special, with the provisions of Title IX of the unit of the Fiscal Code and Methodological Norms of the Fiscal Code - Title IX - **is prohibited the establishment of other local taxes or duties other than those provided by Title IX** of the Fiscal Code. **Special fees** established for the operation of local public services created in the interests of individuals (PF) and firms (PJ), are collected only from them, according to regulations approved by local councils, the General Council of Bucharest Municipality or County Councils, as case, as provided by local public finance law.

c) **The principle of local autonomy**, according to which local councils, the General Council of Bucharest Municipality and County Councils, establish local taxes within limits and under Title IX of the Fiscal Code and Methodological Norms and the Fiscal Code. This principle corresponds to the European Charter of Local Self - Government, adopted in Strasbourg on October 15, 1985, ratified by Romania by Law no. 199/1997, published in the Official Monitor of Romania, Part I, no 331 from 26 November 1997.

According to article 1, paragraph 3) of the Fiscal Code concerning tax provisions supersede any provisions of other regulations, in case of conflict between them, is applied the provisions of the Fiscal Code.

Given the provisions of Article 1, paragraph 3), Fiscal Code, provisions relating to local taxes prevail over any provisions of other regulations, in case of conflict between them is applied the provisions of Title IX of the Fiscal Code.

### 3. Features to calculate local taxes

#### 3.1. Ways of rounding

**Annual local taxes** are calculated by rounding, meaning that money including fractions below 50 „bani” is neglected, and what is more than 50 „bani” rounds in addition to one RON.

For any **intermediate calculations** on local taxes, other than calculation of annual local taxes (which are calculated by rounding to 50 „bani” - see paragraph above), rounding is made by one ron, meaning that any part of it completes the ron, by adding.

The term intermediate calculations on local taxes (see Methodological Norms of Fiscal Code, Section 15, paragraph 2, regarding Title IX), means:

a) calculations for periods of less than one year;

b) calculation of the rebate provided for payment of advance of the **tax due for the buildings** entire year by the taxpayer (art. 255, paragraph 2, Fiscal Code), **land tax** due for the entire year by the taxpayer (art. 260, paragraph 2, Fiscal Code) and the **tax on the means of transport** due for the entire year by the taxpayer (art. 265, paragraph 2, Fiscal Code).

c) determining the levels / values as a result of application of correction factors or tax rates.

d) determining the levels of local taxes consist of a certain amount in lei, the effect of the annual increase under art. 287 of the Fiscal Code. Article 287 Fiscal Code provides that the local taxes (provided in Title IX) can be increased up to 20% of local councils, county and Bucharest General Council, as appropriate, with the following **exceptions**:

- Tax on vehicles for a freight vehicle with total weight authorized not less than 12 tons (art. 262, paragraph 4, Fiscal Code);

- Tax on vehicles for a combination of vehicles (an articulated vehicle or road train) freight with maximum authorized mass of not less than 12 tons (art. 263, paragraph 5, Fiscal Code);

- Stamp taxes provided by law (art. 295, paragraph 11, letter c, Fiscal Code);

- Non-judicial stamp taxes provided by law (art. 295, paragraph 11, letter d, Fiscal Code);

f) any other unforeseen calculations from above (points a) - e)) and not local taxes to the amounts determined for a year.

Whenever, in acts of measurements or calculations, where appropriate, the area to determine local taxes is expressed in fractions of m<sup>2</sup> size, this is not rounded.

#### 3.2 Calculation of terms. Payment period

Generally, the calculation time is considering art. 101 provisions of the Code of Civil Procedure, that:

a) by time is understood the days off, not counting the day when it started or ended the deadline;

b) time limits on hours run from midnight the next day;

c) the period beginning on 29,30 or 31 of the month and ends in a month which doesn't have a day like the previous, will be considered fulfilled in the last day of the month;

d) time limits on year ends on the day of the corresponding day of departure;

e) the term that ends on a public holiday or when service is suspended will be extended until the end of the first working day following. Work is not considered as the corresponding weekly rest days.

The **deadline for payment of a tax / fee**, is the date / dates set by law for tax / duty in question. Eg tax / fee on buildings shall be paid annually in two equal installments by the dates of March 31 and September 30 inclusive. In this case, payment terms for tax / tax on buildings is 31 March and 30 September.

All **terms of payment**, under sections 15, paragraph 6, Title IX of the Implementing Rules of the Fiscal Code, is based on the granting bonus payments by anticipation. For example, for advance payment of tax on buildings, due for the entire year by the taxpayer, until 31 March of that year - which is the deadline - is given a bonus of up to 10%, determined by local council decision. In this case, the payment deadline will be March 31 of that year.

If the payout of any local taxes expires on a public holiday, weekly rest or when service is suspended under the law, the payment is considered within if made before the end of the first working day.

According to art. 248 Fiscal Code, local taxes are the following:

- a) tax and tax on buildings;
- b) tax and land tax;
- c) tax on vehicles;
- d) the fee for issuance of certificates, permits and licenses;
- e) the fee for using means of advertising and publicity;
- f) tax on shows;
- g) tourist tax;
- h) special charges;
- i) other local taxes.

#### 4. Conclusions

We can conclude by saying that a good understanding of these aspects and rules that are general valid, regarding the local tax and fees is very important for the local authorities, for an optimal, legal and efficient management of the local tax and fees, but, in the same time, is useful for the public, for the citizens that are paying these tax and fees. That's way, it is important to made this issue more systematic and presenting the problems related to the principles of establishing the local tax and fees as well as the specific features of them represent a first step for a more complex, but needed analysis.

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## Public and Private in Financial Regulation

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### Abstract

*Financial system regulation and supervision are exercised in most cases, by national or regional central banks and / or other public entities. These entities may regulate and supervise the various components of financial system (banking, capital markets, insurance and reinsurance market, investment funds market, etc.). This exercise in fact intern regulation or national (regional) regulation. In this article we want to emphasize the importance of a collaborative public - private financial regulation. This was outlined possible meanings of the concepts of public financial regulation public and private financial regulation and the relationship between these two types of financial regulation. Then from the meaning of the concept of public - private partnership we have outlined the application of this concept in financial regulation. The first attempts in this regard have resulted in the banking sector in emerging Europe through Vienna Initiative. However we consider it appropriate to extend this partnership to other sectors of the financial system as well as at geographical level. We consider, also, essential that Public and Private Partnership can rely on cooperation and coordination.*

**Key words:** Financial regulation, Vienna Initiative, Public – Private Partnerships, Banking Sector

**Jel clasiffication:** B41, G18, G21

### 1. Introduction

*Financial system regulation and supervision are exercised in most cases, by national or regional central banks and/ or*

*other public entities. These entities may regulate and supervise the various components of financial system (banking, capital markets, insurance and reinsurance market, investment funds market, etc.). This exercise in fact intern regulation or national (regional) regulation.*

In times of financial turbulence is found that the structure and content of financial regulatory system is reaching its limits and becomes ineffective in a new context transformed by the financial crisis. The effect is manifested is rethinking a new system of financial regulation and supervision leading to achievement of the financial system as a whole. Thus, the roles of regulatory entities do so. And here we mention the concern of central banks and other supervisory and regulatory authorities to rethink the financial system of financial regulation, in this new context. It will therefore proposes a new model of public financial regulatory.

### 2. Conceptual delimitations

Periods of financial turbulence and situations present today's financial markets require development of a continuous process of rethinking the concepts of theoretical aspects of financial regulation. In this article we outlined a possible meaning of the concepts of public financial regulation and private financial regulation concept.

In a previous article we established some of the forms of financial regulation act you can know. In the financial system, regulation may consist of several species: deregulation and reregulation, under-regulation and over-regulation, deregulation, micro-prudential regulation and macro-prudential regulation, etc. (Bratu, 2012). In terms of exercise, all these species of financial regulation are from the public level. That is exercised by the

authorities or public bodies authorized to do so: financial regulatory authorities, central banks or similar entities.

#### **A. Public Financial Regulation Concept**

We believe that species of public financial regulation requires action to issue rules and regulations by public authorities specific to work in order to achieve financial system stability. From this we can draw some consequences:

- The consequence 1: Public Financial Regulation is superior being positioned in the center of the financial system because of the role of regulatory bodies we have in this context;
- The consequence 2: Public Financial Regulation is exerted vertically from top to bottom, from regulatory bodies for financial entities, depending on the changes taking place in the financial system;
- The consequence 3: Public Financial Regulation may be multiple, where several public entities regulate different components of the financial system;
- The consequence 4: Public Financial Regulation aimed at achieving macroeconomic objectives, such as financial system stability, monetary stability, protect depositors;
- The consequence 5: Public Financial Regulation is official and is disseminated to all financial market participants and the public through official documents state like laws, ordinances, regulations, rules, etc.

#### **B. Private Financial Regulation Concept**

Consider private regulation, the regulation which requires that species rules and regulations issued by private financial entities to order its own entity or group activity which includes the achievement of efficiency and effectiveness of such entity or financial holding company. In this regard, consider the following consequences apply:

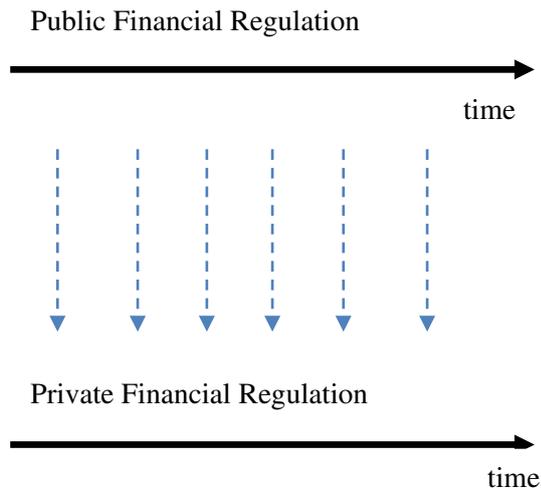
- The consequence 1: Private Financial Regulation is a species of self-regulation. Private financial entities issue rules to themselves;

- The consequence 2: Private Financial Regulation is made horizontally at the base of the financial system, namely the financial entities operating in the financial market in direct relationship with customers of financial services;
- The consequence 3: Private Financial Regulation requires diversity as each financial entity issues its own rules of action in accordance with their own perception of the environment acting;
- The consequence 4: Private Financial Regulation pursue the objectives of individual financial entities, namely the efficiency and effectiveness of activity,
- The consequence 5: Private Financial Regulation may work by professional associations set up by representatives of private financial institutions;
- The consequence 5: Private Financial Regulation is informal to other similar players in the market and is disseminated limited at individual institution or group or financial holding with the national action and / or cross-border, international action.

### **3. Public regulation and private regulation relationship in the financial system**

In the current financial system, public regulation is based and traditional regulation in the field. Exercise public regulatory norms and rules have been started with the advent of central banks and / or creation of public organizations with the purpose of creating conditions for optimal development and functioning of financial markets worldwide. Simultaneously and parallel to withstand market and to realize the objectives initially set, Financials private entities have issued their own financial regulations and the limited scope of action, only at their own.

**Scheme no.1.**



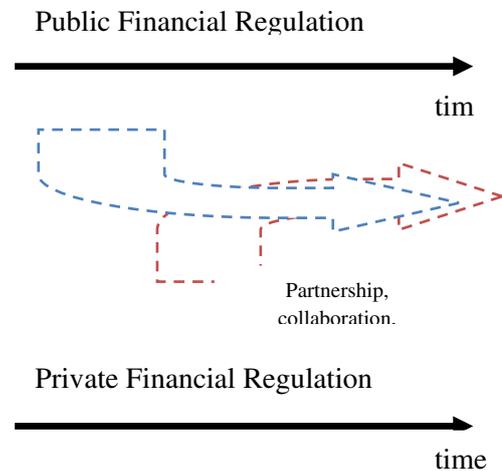
What we find is that the relationship between the two species is one of subordination financial regulation and taxation. Public financial regulation is imposed in some degree to all financial market participants. Thus, any new financial entity established in the field must respect certain rules of action and subsequent initial lifetime, predictable, that entity, if it wishes to conduct financial activities. (Scheme no. 1.)

Public financial regulation is individual and complete public financial regulatory actions and creates some opportunities for financial institution concerned in relation to competition in the industry as well as highly unpredictable operating environment.

Turmoil in the financial system appearing are available most times due to regulation mode of action of public funds. Offered as a new way of thinking of public financial regulation. The goal is long-term survival and functioning of the financial system. Simultaneously and in parallel private and individual specific financial regulations turns to find a new way of "life" of the financial safer and more benefit entity. This time, the goal is survival and medium and long term operation of the entity's financial statements. From these observations we believe that to survive and to compliance with an roles, while the issue of financial regulation of the two species is analyzed in coordination and collaboration. Every person or party or interest group, the financial market would be to target the same general objectives of the financial system as a whole. To achieve those objectives mentioned parties should behave

in partnership way and / or coordinated cooperation to act in time and space. (Scheme no. 2.)

**Scheme no. 2.**



Relationship of partnership, cooperation and coordination between the two levels of financial regulation - public and private - could formalize. The stage of discussions between government representatives and representatives of regulatory financial entities of the state official formalization of agreements to highlight joint participation of the two interests to achieve a financial regulatory framework as appropriate existing complex financial system. Thus, financial regulation could be a significant factor in reducing the possibility of raising the financial turmoil and more than a factor considered by many writers to date, which helps to trigger financial turmoil.

**4. Public and Private Partnership (3Ps) in Financial Regulation**

In terms of realization of agreements or public - private partnerships in finance, the literature is poor in this respect. Until now we have no knowledge of where to end these partnership agreements in the field of financial regulation at public and private.

If we consider the concept of public - private partnership (the 3 "P") will realize that is difficult to achieve this. Because a PPP is a contract by a public authority selects a project that is then developed and applied by a private entity. A Public - Private Partnership is usually defined as a contract development services and government and a

private partner [14]. Governments worldwide have developed Public - Private Partnership as vehicles for delivering a wide range of public services in major areas such as education, construction, transport, health [4]. Meanwhile, other authors consider that the Public - private partnership is collaboration between public and private sectors in an effort to provide a project or service traditionally provided by the public sector. In this case the parties involved in this partnership are governments, investors and creditors [12]. In most cases, contracts for public - private development are underway to taking such form collaborative paradigm for the 21st century. These projects are developed between public actors, private actors, civil society organizations, which provide benefits to each partner and the community itself [18].

Financial system, we believe that a PPP could take the form of agreements between different stakeholders in achieving the common goal of existence of the financial system. Some of the features of a Public - Private Partnership in financial regulation as follows:

- It could be an agreement between public authorities and regulatory oversight (national and / or regional), non-profit civil organizations in the financial (banking associations and / or financial), international financial institutions (Bank of International Settlements, World Bank, European Bank for Reconstruction and Development, International Monetary Fund, etc.), representatives of groups and / or financial holding companies - banking, civil associations of clients in the real economy;
- The agreement aims could be: awareness of the financial system and create a financial regulatory system that contributes greatly to this;
- Cooperation and coordination. Parties should cooperate in developing rules of the game in financial activity and to create specific behaviors to perform coordinate in time and space, to achieve desirable effect of financial regulatory operations.

## **5. Tests of collaboration between public and private financial regulation**

As I stated earlier, the finance is not yet known examples of cooperation agreements or Public - Private Partnership. However, a first step in this direction was made at European level. Public - private partnership agreement signed in the format of coordination in the banking sector called "Vienna Initiative" launched in January of 2009. The essential role of the financial stability arrangements in Central and Eastern Europe. Vienna Initiative aimed to establish a specific action groups international banking activity in the region (particularly those which are systemically important), namely:

- prevent a large scale withdrawals bank exposures (especially in countries where the IMF and EU funding agreements with national authorities, namely: Hungary, Romania, Serbia, Bosnia - Herzegovina and Latvia);
- management of establishing common principles and measures to combat the crisis involving the authorities of host countries and those of countries of origin;
- strengthening cross-border cooperation in the regulatory process, including by exchanging information.

Specific instruments that have achieved these goals have resulted in agreements in the form of bilateral letters with maintaining exposures in the host country (banking groups in Austria, Italy, Greece, France, Slovenia, Germany, Belgium and the Nordic countries and have made commitments to maintain exposures in major host countries of emerging Europe).

In addition to these specific objectives Vienna Initiative aims to investigate possible political and structural problems arising from the regional banking sector. This led to the establishment of two working groups:

- Working Group 1: to analyze the development of financial markets in local currency to reduce foreign currency lending [6];
- Working Group 2: highlighting the role played by credit institutions in attracting European funds [7];

The motivation that led to the conclusion of the Public - Private Partnership was to

provide for coordinated action to maintain financial stability and confidence in local markets and promoting sustainable economic growth. [15]. The parties to the agreement are the regulators in the countries of European banking groups active in national markets emerging Europe. Beside them were and international authorities (European Commission, EBRD, EIB, WB, IMF and the IMF - as observer), bank representatives involved and local authorities in emerging European countries.

So far, "Vienna Initiative" saw two versions – Vienna, Vienna 1.0 and 2.0. Vienna 1.0. is on the other two working groups examining: implications adopting Basel III by banks in emerging Europe, management of bad loans to companies and households. Vienna Currently 1.0. The other is on two working groups examining: Implications adopting Basel III by Banks in Emerging Europe, management of bad loans to companies and Households.

## 6. Conclusions

Regulation of public - private financial base built on Public Private Partnerships can be found in an early stage at present. To achieve the objective of stability of the financial system and making regulation more and contribute more effectively to this aim we consider it necessary to rethink the paradigm of financial regulation to new theoretical principles (the principle of cooperation, coordination and awareness of financial system stability principle for all parties involved in financial and social life) and practical (end of public - private partnerships between public authorities, private financial entities, international and regional institutions in all sectors of finance). We believe that the Vienna Initiative is only a first step in this process and mechanisms that provide efficient and effective financial regulation will be achieved only through cooperation, collaboration and coordination.

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## Financing Local Communities by Special Governmental Funds

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### Abstract

*Local budgets are characterized by a high dependence rate on transfers from the state budget, without the existence of some intense concerns on the creation of own funds. In the category of transfers from state budget there are included the amounts broken down to balance local budgets, the state subsidies and a series of financial amounts from special funds of the Government. This paper comes to detail the mechanism of local financing by the Fund of reserve and the Fund of intervention used by Government. In the recent years, they have become a support source for communities that fail to survive using their current financial resources. It can be interpreted as a variant of political favor to some municipalities, because there are no set some by the law clear criteria required by distribution of these funds.*

**Keywords:** local budget, Fund of reserve, Fund of intervention

**J.E.L. Classification:** H 70, H 71, H 77

### 1. Introduction

The subject of local budgets is complex and difficult to debate in a few pages. Local budgets are the most useful tool to plan and manage the economic financial activity of administrative - territorial units. The structure of local budgets defines the autonomy of local government in relation with the central government. In Romania, there are still discrepancies between the way things should stay in practice and the concrete reality. Local budgets are not based on direct needs identified in the communities, but rather they are made with a greater attention on economic interests and, not even, political. In

a country with a very large geographically diversity, like Romania, it is impossible that all regions to have the same degree of economic development. Budget's balancing mechanism tries to correct these shortcomings and regional inequalities in order to restrict these spreads. No town in Romania is not currently able to survive by its own resources, but is in overwhelmingly depends on the state budget. [1] This can be achieved by changing the construction of public budgets, reducing the financial dependence of localities on the state budget. Do not overlook the fact that local autonomy and decentralization were the defining principles in the organization of local public administration.

This paper aims to study an alternative of funding local budgets in Romania represented by the mechanism of Government's Fund of Reserve and Fund of intervention. The paper is structured in four parts, as follows: it begins with some general aspects on local budgets revenues, then it continue in the second part by detailing the destination of Government's Fund of reserve, the third part focuses on the amounts received by local communities from Government's Fund of intervention, and finally were outlined several conclusions. The research mechanism of this paper consider seeking qualitative and quantitative research methods, among which can be included: applied investigation on the current state of local financial resources policy in Romania, the systemic literature review, the methods of induction and deduction, the graphic representation of investigated phenomena.

### 2. Transfers from Government's Fund of reserve

Whatever the degree of decentralization of a country is, the financial relations between state and local authorities are multiple and complex. In all European countries they are seeking for solutions to ensure a balanced distribution of funds as between different levels of administrative organization, taking account of budgetary rigor that is required at all levels of government. Thus, any transfer of responsibilities from state to local communities must be accompanied by an equivalent and simultaneously transfer of financial resources. A good transfer must meet several conditions: first, they must not be sufficient, but in addition, so that local authorities to be encouraged to achieve their revenues and at the same time must be equilibrium between the power of local authorities and decentralized resources. It is desirable that these decentralized resources to be predictable for a period of time, to allow local authorities to make spending strategy as to accomplish long-term investment objectives.

Of all revenues collected from the state budget, local authorities receive funding as allowances deducted from income tax and VAT. These revenues correspond to a system of taxes sharing between the various levels of government. An analysis of transfers from the state budget as VAT and income tax indicates that more than one fourth of the collected resources of state budget are distributed to local communities. These transfers have peaked in 2008 of 32.9 billion lei, representing 33% of tax revenue collected by the State. Along with these types of transfers, there is an alternative financing method represented by the Fund of reserve available at governmental level.

The state budget of Romania includes the Fund of reserve and the Fund of intervention available to the Government. [2] The Government’s Fund of reserve can be allocate, theoretically, to some ministries or local budgets, based on government decisions, for financing expenses or sudden emergencies during the financial year. Basically, the Government’s Fund of reserve became a source of support for communities that fail to survive their current funds as normally. It can be interpreted as a variant of political favoritism to localities, because no clear criteria were set out in law to grant

money from the Fund. But due to the fact that since the creation of this fund were not sufficiently defined the types of costs that local authorities can do with this money, now the amounts are used for any other purposes than those originally provided by this mechanism funding. Analyzing the evolution of the Fund of reserve and the Fund of intervention in the period 1999 - 2011 it was found that they had an upward trend until 2008, with a peak reached in 2006 when the budgetary Fund of reserve (5,573,543 thousands lei, the equivalent of € 1,581.6 million at the average exchange rate of 2006) and in 2007 for Fund of intervention (582,296 lei, the equivalent of € 165 million at average exchange rate of 2007). In 2007, the Fund of reserve was originally approved to the amount of 128.7 million lei. During the year, it was continually increased, more than 22.25 times than the initial provisions. Similarly in 2008, the reserve fund budget was approved with the amount of 6.2 million lei. It increased 593.22 times until the end of the year. [3] in 2009 and 2010, the situation remained disproportionate for the Fund of reserve, it is found that the amount distributed by the fund are 18 times in 2009, respectively 13 times in 2010, higher than the original provisions.

*Table 1. Fund of reserve (thousands lei)*

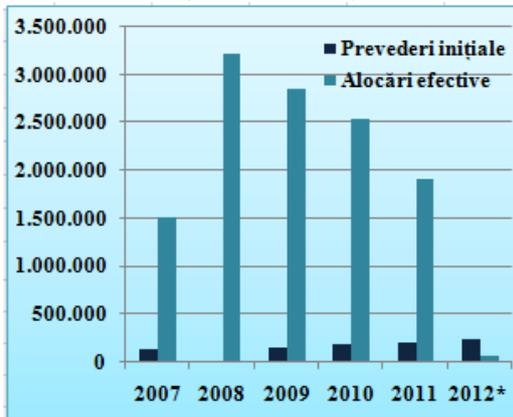
Year	Fund of reserve	
	Initial provision	Alocations
2012*	224.909	71.903
2011	200.000	1.921.585
2010	184.750	2.542.197
2009	152.669	2.850.960
2008	6.248	3.224.762
2007	128.709	1.518.413

*Source: Data processed from the State Budget Law between the years 2007 - 2012 and the Government Decisions of the years 2007 - 2012 (first quarter I)*

But public notification with respect to this problem led to a slowdown in using this method for financing uncontrolled current and capital expenses. For example, in 2011, according to the state budget the Fund of reserve has an initial value of 200 million lei, but according to the 51 governmental

decisions have been used 1921.5 million lei, i.e. 9.6 times more.

Figure 1. Government's Fund of reserve (thousands lei)



Source: Own processing data from Government's decisions and the Laws on state budget

After 2008, allocations from the fund showed a downward trend decreasing by 11.6% in 2009 as compared to 2008 and by 10.8% in 2010 as compared to 2009. 2011 brings a reduction in allocations from the Fund of reserve by 24.4%. Court of Auditors concludes that there are a growing number of decisions of the Government to allocate funds from the budgetary reserve. In 1990 only two allocations were approved by Government decisions, reaching a peak of 386 in 2006 [4], then fell to 58 in 2010 and 51 in 2011. In fact, many beneficiaries were merged into a single government decision.

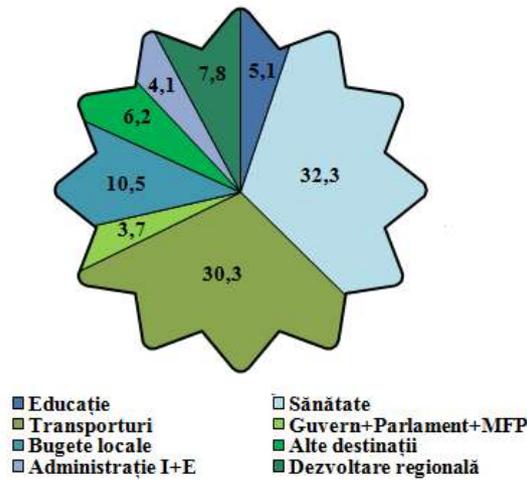
In 2009 local budgets received additions in VAT allocation by 816.6 million lei through allocations from the Government's Fund of reserve, i.e. 28.6% of the amounts distributed, the difference being given to the ministries. [5] This fund was distributed by 60 governmental decisions, of which 25 targeted local budgets: 14 individual and 6 group allocations. 10.6% of 723.9 million lei have been directed to Capital. The counties receiving the largest amounts from the Fund of reserve are 68.4 million Brasov, 48.6 million Suceava, 41.1 million Arges, and 39.6 million Hunedoara.

Mehedinti is the county with the lowest amount received of 4.5 million, followed by Giurgiu, Calarasi, Ialomita and Teleorman. The county of Sibiu has received funding worth 12.9 million lei, or 1.79% of allocations from the Fund of reserve. In 2010

local budgets funding from the Fund was 645.3 million lei, or 25.4% of total allocations from the Fund. 14 of the 20 government decisions supposed individual allocations to local administrative units, worth 220 million lei to Botosani, Olt County, Suceava, Nasaud, Cluj and Bucharest.

Financing local budgets from the Fund of reserve for the year 2011 amounted to 200.8 million lei value, i.e. 10.5% of a total allocation of 580.9 million lei, the remaining 65% being distributed to the ministries. Funding was achieved through 13 government decisions, including 3 collective government decisions (Government Decision no. 649/2011, Government Decision no. 1001/2011 and GD. 1158/2011) on the way to supplement amounts deducted from VAT to balance local budgets for current and capital expenses, or the realization of investment objectives. An analysis by county of the localities that have completed their revenues by this way leads to the following results: the largest amount received from the Reserve Fund in 2011 were recorded in Mures 9.06 million (4.51 % of all amounts deducted as VAT for balancing), Hunedoara 8.8 million lei (4.4%), Timis 7.98 million (3.97%), Neamt 7.88 million (3.93%) and Prahova 7.18 million (3.58). Instead Vrancea 1.49 million (0.74%), Ialomita 1.6 million (0.8%), Constanta 1.86 million (0.93%) and Braila 1.92 million (0.96%) are the counties that obtained the lowest funding from this source. There are significant discrepancies between extreme, Mures received six times more funds than in Vrancea. In terms of Sibiu, it is positioned in the category of counties that have received small amounts from Fund of reserve of 2.7 million, or 1.3% of the total, ranking 7th in 2011. In the first quarter of 2012, by 10 governmental decisions, were distributed 71.9 billion lei from the Reserve Fund, of which 1.5 billion lei to Mangalia and 0.5 million to Horezu.

Figure 2. Government's Fund of reserve destinations in 2011



Source: Own processing data from Government's decisions and the Laws on state budget

Regarding other uses of Fund of reserve in 2011 they were concerned to budgets of ministries of health 620.8 billion lei (32.3%), transport 581.8 billion lei (30.3%) and regional development 150 billion lei (7.8%). Other ministries that received funding are education 98.2 billion lei, defense 21 billion lei, internal and external administration lei 79.6 billion, environment 42 billion lei, culture 32 billion lei and work 14 billion lei. Ministry of Finance and the Government has approved for current expenses and capital 71 billion lei in 2011 from the reserve fund. Among destinations with the character "unforeseen emergency" of 2011 falls 23 billion lei for organizing the annual session of NATO Parliamentary Assembly in Bucharest, 100 million for setting up Radio Chisinau by Romanian Radio Broadcasting Corporation, 0.4 million lei to organize national day at Alba Iulia on December 1 or 1 million lei for the National Theatre 'Radu Stanca' in Sibiu for the theater organization in Belgium.

### 3. Transfers from Government's Fund of intervention

Government's Fund of intervention shall be distributed to the ministries and local budgets, based on Government decisions to finance urgent actions, to eliminate the effects of natural disasters and to support affected individuals. Intervention fund

available to the Government was originally formed in 2007 in the amount of 12.0 million. During budget execution the Fund of intervention was increased by the amount of 571.5 million lei, reaching a total of 583.5 million lei, i.e. it has increased by 48.6 times. Regarding the Government's Fund of intervention in 2008, it was initially created in the amount of 6.7 million to cover expenses caused by natural disasters, then was increased by 220.8 million lei, so that at the end of the year the Fund had a total amount of 227.5 million lei. The increase of Government's Fund of intervention in 2008 was 33.95 times.

Table 2. Fund of intervention (thousands lei)

Year	Fund of intervention	
	Initial provision	Alocations
2012*	7.000	21.000
2011	7.000	0
2010	16.000	14.900
2009	15.000	11.900
2008	6.718	226.832
2007	12.000	582.296

Source: Data processed from the State Budget Law between the years 2007 - 2012 and the Government Decisions of the years 2007 - 2012 (first quarter I)

Transfers from Fund of intervention to local budgets in 2009 were 11.9 million, of which 0.17 million due to the explosion of a city block in Roman, 0.46 million lei in Valcea county for slides land and 11.27 million for 22 counties hit by floods. Investment Fund allocations in 2010 were 14.9 million, of which 2.6 million came to the budgets of localities in Buzau (2 million) and Alba (0.6 million) affected by natural disasters. In the year 2011 there has been no transfer of this fund to finance the local communities, but were paid 874,000 lei to Timisoara municipality due to an explosion in an apartment building. Year 2012 started with two uses of Fund of intervention, i.e. 1 million for people of Holboca (Iasi) following an explosion and 20 billion lei for natural disasters of snow and blizzard in 15 counties (13.2% Buzau, Ialomita 12.9%, 11.8% Vrancea, Galati, Calarasi, Virginia, Bacau, Dambovita, Tulcea, Ilfov, Braila,

3.4%Botosani, 1.3% Giurgiu and 1.2%Constanta).

The Court of Auditors Report for 2009 show that the Fund of reserve and the Fund of intervention should be used as a last resort and only if the other funding options were exhausted for any objective / action. In fact, over the years, the Government appealed to the Fund of reserve for non-urgent situations, as evidenced by the Court of Auditors, which includes data from 1999 to 2009, focusing mainly on the years 2007-2008. The report finds that almost all local governments have received funding from these sources. Court claims that it can be said that requests for funds from the budget reserve / intervention has become a habit that can lead to the idea of parallel financing of the economy, not only by state budget law. Criticism of these allocations rightly concerns the lack of transparency and intervention criteria for granting subjectivity and political interests. This allocation is contrary to that provided by law and it does not show the urgency of these allocations. There is a lack of control both in terms of procedure allocation, but also to control the efficiency of money and amounts received as to not change the money destination. Basically, the Fund of reserve became a source of support for communities that fail to survive with their current funds as normally.

#### 4. Conclusions

We believe that should be eliminated discrepancies between amounts initially established to the two funds and their final annual executions and to eliminate subjective and the clientele destinations of public money. The paper comes to reinforce the finding that while public attention is focused on the destination of these funds, public authorities not intended to enforce the law and to limit the unsubstantiated uses of these amounts.

At local level, building local budget is a major action and an evident complexity to any place that has an impact on the annual economic evolution. There is a breakdown of local communities in two categories: communities with sufficient own resources and communities that lack sufficient funds for operating expenditures of any settlement. At the local level is desirable to make the

transition from an administrative culture to an economic culture. Today the major metropolis becomes economic development poles. For example, local development in France is not considered for a single city, but is focused on developing a network of large, medium and small cities, clustered in urban agglomerations. Formation of large urban cities leads to the formation and strengthening of solidarity. Such logic cannot ignore the competition that exists not only between the major international and European cities, but between the national ones. In France the local competition is manifested both at the metropolitan level, and departmental and regional level leading to better focus and resource allocation.

From our perspective it is necessary a change in thinking and action of central and local authorities. They must give up a Romanian budgetary system that has features of a blotter of added value created by its citizens. Similar to the Romanian society is obvious that the budget is based on consumption of financial resources and not on actual production of financial resources other than fiscal ones, whose production does not require a creative effort. We foresee two solutions to the current situation of insufficient public money in Romania: the first refers to thrift and performance in available public funds, there are money, but their management is inefficient, and the second concerns focus on building activity to create non-tax revenues from dividends and payments of net profits from public companies. We believe that public authorities need to become some better public entrepreneurs, that create added value, create jobs, provide Romanian products on the market. It is a long term solution that does not give the advantage of quick cash resources to the public budget as compared to the version of increased taxes, the easiest by the way. By the attitude of a public economic entrepreneurs we understand the involvement of public authorities in the economy as an economic agent able to deal with national and international competition of the private sector, as a public economic entity which has the advantage of having resources in a strategic sector (all energy, soil and subsoil deposits) and is eligible for European co-financing undertaken activities.

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# The Impact of Basel III on Romanian Banking System

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## Abstract

*The Basel III framework represents an important step in strengthening financial stability by applying new more complex prudential regulations. At a micro- and a macroprudential level, these standards set higher capital requirements and better quality in view of a better risk management, introducing an additional indicator of capital adequacy - leverage, capital accumulation measures regarding periods of stress and introducing two new liquidity standards. The aim of this paper is to highlight the implications of Basel III on Romanian banking system.*

**Keywords:** financial stability, banking system, Basel III, macroprudential level, microprudential level.

**JEL Codes:** G21, G32

## 1. Introduction

The financial crises manifested in recent decades have led to the enhancement of debates between authorities, but also in the specialised literature, on the need for financial stability, which has become an increasingly important goal in the economic decision-making.

The concept of financial stability is a complex one, the economic literature and practice being as yet unable to agree upon a definition or on an evaluation model. Since the purpose of this article is to analyse the impact of introducing the Basel III agreement in the Romanian banking system, I have lingered on the definitions proposed by the European Central Bank and by the National Bank of Romania (NBR).

The European Central Bank defines financial stability as a situation in which the financial system - including intermediaries,

markets and financial market infrastructures - is capable of withstanding shocks and absorbs financial imbalances [3].

The National Bank of Romania defines financial stability in its first *Financial stability report*, as that feature of the financial system of facing systemic shocks on a sustainable basis and without major disruptions, of efficiently allocating financial resources in the economy and of identifying and managing risks effectively [5].

Furthermore, the NBR governor shows that financial stability is, in a broad sense, a situation in which the financial system can ensure efficient allocation of savings to investment opportunities and can withstand shocks without major disruptions. In a more narrow, but at the same time more useful approach, from the perspective of a central bank, financial stability can be defined as a situation characterised by the absence of banking crises and the existence of a certain level of stability in asset prices, including interest rates [4].

For the purpose of ensuring financial stability, authorities use as a general measure the supervision and regulation of the institutional framework. The supervision of markets, institutions and infrastructure can contribute to the rigorous management of financial risks.

In the process of risk identification and analysis regarding financial stability, either microprudential analysis or macroprudential analysis can be used. The microprudential analysis refers to individual developments of financial institutions, aiming at limiting their instability. Unlike the microprudential supervision, the macroprudential supervision targets the financial system as a whole, aimed at limiting instability in the entire system.

Since the banking sector is of particular importance in the stability of financial systems, the concern of the authorities to consolidate the banking system has arisen.

The importance of banking supervision and regulation is evident, since examining the situation of each bank in part allows the supervising body to play an important role in ensuring a stable banking system.

As the evolution of the financial and banking sector was marked by major changes in the business environment, with important implications for the financial stability, it was deemed necessary to rethink the capital requirements of banks, observing at the same time the lack of or failure to cover certain highly volatile segments of the capital market, as well as inadequate risk management practices at bank level.

## **2. Basel III Agreement - the general framework for ensuring financial stability**

In September 2010, the Basel Committee on Banking Supervision (BCBS) has adopted the final proposals to consolidate bank capital and liquidity standards - known as Basel III Agreement. The objective of this agreement is to consolidate the stability of the banking system by applying new more complex prudential regulations.

At a micro- and a macroprudential level, these standards set higher capital requirements and better quality in view of a better risk management, introducing an additional indicator of capital adequacy - leverage, capital accumulation measures regarding periods of stress and introducing two new liquidity standards.

The key elements of the reform imposed by the Basel III Agreement are: quality, quantity and simplification of bank capital.

- **Quality of bank capital**

According to the Basel III Agreement, the quality of bank capital will increase, the banks having to raise the minimum level of common equity from 2%, before applying regulatory adjustments, to 4,5% after applying stricter adjustments. Furthermore, the Tier 1 capital requirement will increase from 4% to 6%. This will be phased in by 1 January 2015. The total capital requirement remains at the current level of 8,0%.

- **Quantity of bank capital**

Under Basel III Agreement, the banks will have to increase the minimum capital ratio to at least 7% in the coming years. In addition, two elements are introduced regarding capital reserves.

The first buffer refers to a fixed target reserve called "capital conservation buffer" of 2,5%, consisting of the minimum capital required, available to absorb losses in times of crisis. Banks with reserves below the target level will face limitations regarding the distribution of capital (e.g. dividends payment, repurchasing shares, bonuses) so as to achieve fixed target reserves.

The second buffer refers to the "countercyclical buffer" that is activated when authorities notice the appearance of the phenomenon of excessive lending, representing a tool of macroprudential surveillance. The role of this countercyclical capital reserve is to protect banks in cases in which the economic cycle changes abruptly and consequently there is a large number of bad loans.

- **Simplification of bank capital**

Under Basel III Agreement, the bank capital will be structured as Tier 1 and Tier 2 capital, level 3 capital being eliminated.

To these capital requirements, an additional indicator of capital adequacy, namely, leverage, is added. Thus, regulators have agreed to test a minimum leverage effect regarding the Tier 1 capital at a level of 3%. Based on the results of the testing period, final adjustments will be made in the first half of 2017. This measure at a macroprudential level will determine the reduction of the systemic risk probability but also the increased resistance of the banking system in face of a crisis.

Not least, the Basel III Agreement provides for minimum global standards for measuring and monitoring liquidity risks. Thus, it is intended to provide short-term (30 days) liquidity necessary for resistance to shock / crisis of liquidity, as well as long-term (1 year), a solid profile of the structural liquidity.

Implementing the new requirements, at a national level, by member countries, will begin on 1 January 2013. They have to translate the principles of the agreement into national laws and regulations before that date.

Therefore, from 1 January 2013, credit institutions will be required to meet the following minimum requirements in relation to risk-weighted assets (RWAs):

- 3.5% common equity /RWAs;
- 4.5% Tier 1 capital/RWAs;

- 8.0% total capital/RWAs.

As approved by the group of observation, preservation of capital buffer can be realized:

- 0.625% in January 2016,
- 1.25% in January 2017
- 1.875% in January 2018
- 2.5%. in January 2019.

Transposing the Basel III Agreement in Europe is in the form of a fourth version of the European Capital Requirements Directive, CRD.

Thus, in July 2009 and February 2010, there were submitted for consultation further amendments of the CRD (CRD IV), concerning: liquidity standards, definition of capital, leverage, counterparty credit risk, counter-cyclical measures, financial institutions of systemic importance, single regulatory framework for the banking sector.

On 20 July 2011, the European Commission adopted a legislative package to consolidate the regulation of the banking sector. The proposal has two parts: a directive regulating the access of accepting deposits and a regulation governing the activities of credit institutions and of investment societies, which will replace the previous directives on capital requirements (2006/48/EC and 2006 / 49/CE).

Through this, the Commission transposes in Europe international standards concerning bank capital agreed at the G20 (commonly known as Basel III Agreement). Furthermore, the Commission also intends to establish a new governing framework, with new prerogatives to closely monitor the banks, as well as a single regulatory framework for the banking sector.

The main implications of the Regulation and Directive covers:

- new requirements regarding corporate governance, including specific limits on the number of mandates for the position of director that a person can hold;
- the financial institutions will have to follow and to actively participate in the activity of the European Banking Authority (EBA) to develop a large number of required technical standards necessary in the implementation process of the Regulation and Directive at a detailed level;
- the financial institutions should closely follow the reporting requirements under the Regulation and to explore the

possibility to integrate these requirements with other changes in the reporting and data management systems;

- liquidity: to improve liquidity for the financial institutions in the short term, the Commission is proposing the introduction of an indicator of immediate liquidity (liquidity coverage ratio, LCR) - the exact composition and parameters of which will be determined after a period of observation and review, in 2015.
- leverage: to limit the excessive growth of the indebtedness degree, the Commission proposes to introduce a leverage ratio to make the object of the supervision, the implications being monitored closely before it becomes a requirement, on 1 January 2018;
- single regulatory framework: a single market requires a single regulatory framework, this way, the regulation is applied directly, without the need to transpose it into national legislation.

### **3. The impact of Basel III on Romanian banking system**

The Romanian banking system is currently preparing to implement the requirements of Basel III, namely, the legislative alignment in what regards the fourth version of the European Capital Requirements Directive Capital Requirements Directive, CRD4.

A first step consists in the fact that, starting with this year, the Romanian banks have gone to new international accounting standards IFRS, 2011 being the last year of reporting bank results, according to Romanian Accounting RAS. This leads to an increased transparency and comparability of the financial reports of banks.

In what concerns the adequacy of capital level, the agreement provides that by 2015 banks must achieve a level of 7% and the own funds ratio must increase from 4% to 6%.

In the Romanian banking system, in mid 2011, Tier 1 own funds account for 80% of the total own funds, and the hybrid capital instruments are missing. Analyzing the structure of Tier 1 funds, we notice that the most important element that has supported them, has remained the social capital. Furthermore, the analysis of own capital (total and Tier 1) shows that the banks in the

system are part of the new Basel III standards on capital adequacy.

The central bank has strengthened the buffer role that Tier 1 play in the total equity funds and the balance sheet of credit institutions respectively, the regulations specifying that Tier 1 should be used at all time, having priority to absorb losses, not to involve fixed costs for the bank and to be effectively available to it, that is, to be fully paid [1].

Table 1. Development of own funds and leverage September 2008 - June 2011 (percents)

	2008	2009	2010	03/2011	06/2011
Percentage of total own funds	100	100	100	100	100
Tier 1 own funds, of which:	72,2	76,4	80,3	81,0	80,1
S o c i a l c a p i t a l	43,7	46,0	50,8	51,7	53,1
S h a r e p r e m i u m s	3,8	4,0	5,7	5,8	5,8
L e g a l r e s e r v e s	34,6	33,4	33,3	30,2	30,2
Current period profit (audited)	-	3,75	2,5	0,0	0,0
Current period losses	-0,7	-2,2	-5,0	-0,5	-2,6
Tier 2 own funds, of which:	22,8	21,6	19,7	19,0	19,9
Revaluation reserves	8,1	6,06	5,6	5,7	5,7
Subordinated loans (net)	15,8	17,2	15,7	15,0	15,2
Subordinated loans (gross)	17,9	20,1	20,3	20,0	20,7
Leverage (Tier 1 own funds / total average assets)	8,13	7,55	8,11	7,96	7,79

Source: NBR Financial Stability Report 2011 and Monthly Bulletins, www.bnro.ro

As regards the solvency ratio, the central bank of Romania (NBR) uses the solvency ratio to assess the capitalization level of credit institutions. The minimum regulated level for the solvency ratio is 8 percent, with consideration of a report of at least 1 between own funds and capital requirements. It should be mentioned that the Basel III Agreement will regulate the minimum levels of the indicators, the monitoring institutions from each country having to meet this minimum level, but they will be free to impose more stringent levels of these indicators based on the specificity of every local market (e.g. Basel II requires a minimum capital requirement of 8%, while the Romanian regulations require that, during the program of financial assistance (until April 2011) [5] concluded by Romania with the IMF and the European Union, banks should hold a capital of 10% minimum).

A too tight link existing between the big banks and the parent banks might have a potential impact on the Romanian banking system - banking in Romania being influenced through lower capital available for investment in subsidiaries of parent banks.

Therefore, a shift is predicted in Romanian banking to new areas which provide the resources necessary to meet the levels of the new indicators (first and foremost) and then to provide loans to the public and private sectors.

Even if the impact of Basel III on the Romanian banking system is considered to be limited, credit institutions have adopted several measures to mitigate the impact of aligning with the new standards. We refer here to:

1. restructuring bank balance sheets  
Basel III Agreement is based on integrated management of assets, capital and financing, credit institutions being unable to optimize assets and liabilities independently.
2. restructuring the business model of banks  
The competition for retail deposits becomes more and more pronounced, and the bond market issued by credit institutions in Romania tends to increase.

The credit evolution will increasingly depend on the capacity of banks to attract internal resources and especially medium and long term resources avoiding the financing on short-term resources. A visible fact is that banks make fewer long-term financing, avoid high-risk lending conditions, focusing on the most profitable activities. Thus, NBR has come to meet these measures which, through the new crediting rules imposed on banking institutions, have reduced the credit period and limited the credit risk.

Therefore, the new regulations imposed by Basel III Agreement will focus in one way or another on all departments of a banking institution, which would affect all components of business models. We refer to revisions as regards the focus on efficient management of capital, liquidity and funding, but also on operational changes.

All these things will be reflected on the profitability of banks - as reserves / capital shocks will increase the cost of capital and reduce funds available for lending, banks with higher ROA need to deal with risks. So banks will try to reduce the range of products and services to simplify supply,

reduce costs and achieve higher ROE cost of capital.

#### 4. Conclusions

Basel III is an important step in strengthening capital rules, its role being to reduce the probability of a new crisis in the banking and hence would lead to strengthening global financial stability.

In this paper we tried to emphasize the two approaches to capital requirements ie at the micro and macro-prudential. At the micro level reforms are designed to increase the resilience of individual banks at times of stress and macro-prudential reforms are designed to reduce the frequency of financial crises.

In Romania, we believe that the banking system is strong, with high-level prudential indicators and credit institutions have begun to reconsider the work to implement the new standards imposed by Basel III

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## Credit Risk Modelling Under the Reduced Form Approach

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### Abstract

*Credit risk is one of the most important aspects that need to be considered by financial institutions involved in credit-granting. It is defined as the risk of loss that arises from a borrower who does not make payments as promised. For modelling credit risk there are two main approaches: the structural models and the reduced form models. The purpose of this paper is to review the evolution of reduced form models from the pioneering days of Jarrow and Turnbull to present*

**Keywords:** credit risk, reduced form models, default intensity

**J.E.L. Classification:** G30, G32,

### 1. Introduction

Credit risk is defined as the risk that one of the parties involved in a financial transaction will suffer a loss, due to a decline in creditworthiness, or a default of the counter-party of the transaction. Thus, an efficient credit valuation should result in a debt pricing that is in perfect correspondence with the risks taken. The credit risk modelling efforts have been numerous in the last four decades, and the specific literature is extensive and in constant development. The majority of credit risk models can be divided under two separate approaches: the structural models and the reduced form models.

The first one builds on the classical Merton framework, modelling the evolution of the value of the firm considering that it defaults when the value is lower than a threshold or when the market value is lower

than the value of its liabilities. Besides the study of [1] key extensions and contributions to the structural form modelling can be found in [2], [3], [4], [5] or more modern studies like [6], [7]

The second approach does not imply a theoretical structure of default. In the reduced-form literature, default is assumed to be a random event with a probability given by a known intensity or hazard rate process. Thus, reduced form models accommodate surprise or unexpected defaults. Standard reduced form models assume that the default is driven by an exogenous random variable and that at any time the probability of default is different than zero. In general, reduced models treat defaults as unpredictable Poisson events.

This paper focuses on the second category of credit risk models as presented above, the reduced form models and discusses its evolution during the last three decades.

### 2. Methodology

In order to achieve the purpose of the paper we consulted academic research ranging from 1990 to present. The research papers were gathered from databases like JStor, EBSCO Publishing, ScienceDirect, Scopus, ProQuest and SpringerLink, as well as from the defaultrisk.com platform after searching key words like: credit risk; default risk; reduced form models, intensity models.

### 3. The evolution of reduced form models

In a study carried out in 1995 [8] bring a new methodology for the valuation of derivatives under risky conditions. In this paper the default process is modelled like a

Poisson process  $N(t)$  with a constant intensity  $\lambda$  and a default time  $\tau$ . The authors also assume that the recovery rate is constant. Besides the novelty degree for that time, one important disadvantage of the model resides in the fact that it does not consider the possible changes in the credit quality of bonds until the time of default. This inadequacy is solved in future extensions. For example, [9] consider different credit classes and also allow improvements or reductions in credit quality. In the above mentioned study, the authors consider the term structure of credit spreads in a model in which default is modelled as a Markov chain. This is the first contingent claims model that incorporates information on credit rating changes in its methodology. The authors assume that the relation between the term structure in the absence of default risk and the bankruptcy process is statistically independent. The model has a wide applicability in risk management as it is useful in calculating the probabilities of default for bonds belonging to a credit class, for a certain time interval and a certain credit class as starting point. In [9] there are considered  $k-1$  credit classes that are characterised by rating, the transition from one class to another being made through a stationary Markov chain. The default moment  $\tau$  is defined as the moment in which the default state  $K$  is reached for the first time. In a discrete time approach the movements of credit rating can be described by the following transition matrix.

$$PM = \begin{pmatrix} p_{1,1} & p_{1,2} & \dots & p_{1,k} \\ p_{2,1} & p_{2,2} & \dots & p_{2,k} \\ \dots & \dots & \dots & \dots \\ p_{k-1,1} & p_{k-1,2} & \dots & p_{k-1,k} \\ 0 & 0 & \dots & 1 \end{pmatrix} \quad (1)$$

Where  $p_{i,j} \geq 0$  and  $\sum_{j=1}^K p_{i,j} = 1$

The matrix elements  $p_{i,j}$  with  $i, j = 1, \dots, K - 1$  represent the probability that one  $i$  rated bond to get to the  $j$  class in the following time step.

The authors decompose risk neutral transition probabilities in an independent time component  $p_{i,j}$  and a dependent one  $\pi_{i,j}(t)$ . The default probability for the  $q_{i,j}(t)$  is expressed:  $p_{i,j}\pi_{i,j}(t)$ . In order to reduce the dimension of the matter, the model

assumes that the proportional adjustment  $\pi_i(t)$  of the empirical probabilities  $p_{i,j}$  depends only on the current rating ( $i$ ) being independent of the following rating ( $j$ ). Given the transition matrix, for each  $k-1$  step the risk premiums are needed. In the model these are obtained from the prices of the  $k-1$  bonds that mature in the next period.

Besides the issues faced in model calibration, one major problem is the fact that the structure of interest rates for all rating classes is rarely available. The biggest disadvantage of the model is the fact that it describes the transition of credit ratings for a single debtor assuming that all the bonds are characterised by the same Markov chain. In practice, credit applications target mainly bonds belonging to different debtors, and such a hedging procedure is feasible only under the unlikely assumptions that all debtors belonging to a credit class are subjected to identical credit changes.

Another assumption of the model is that the changes in credit spreads are caused only by credit rating shifts as a direct consequence of the deterministic default intensities for a given rating in relation to constant recovery rates. This turns out to be another weakness, as in practice credit spread tend to be very volatile for the same credit class.

One way of bypassing this problem is the use of stochastic recovery rates as for example in the study of [10]. In order to explain to logic behind the above model, [11] uses a recovery rate  $\varphi = \varphi(r, x)$  that depends on the interest rate  $r$  and on the state variable  $x$ . The dependence on the interest rate thus allows [10] to incorporate a correlation between the interest rate risk and the size of the default risk. The  $x$  variable is regarded as a firm's specific factor that influences the default. In this context, the recovery rate is given by the equation present below and it is conditioned on the level of the interest rate risk.

$$\Theta(r(t)) = E_t^Q(\varphi(r, x)|r(t)) \quad (2)$$

The authors assume that the interest rate risk is independent of the default moment. Thus, it is clear that  $\Theta(r(t))$  is also independent of  $\tau$ . In this context, the pricing equation for a zero coupon bond belonging to a credit rating class  $i$  is the following:

$$v^i(t, T) = p(t, T)E_t^Q \left( 1_{\{\tau^i \geq T\}} \right) + E_t^Q \left( e^{-\int_t^{\tau^i} \Theta(r)} 1_{\{\tau^i \leq T\}} \right) \quad (3)$$

On an analysis of the [10] framework, [11] observes that if the default occurs before  $T$  the default payment  $X(\tau^i) = \Theta(r(\tau^i))$  depends on the default moment  $\tau$ .

As stated above, the main advantage of the [10] model is the fact that it allows credit spreads to change in time even if the ratings remain constant.

Another study incorporating stochastic recovery rates is [12]. The authors assume that default intensity depends on the evolution of the firm’s stock prices  $s(t)$ . The intensity is given by the following equation:

$$(s, t) = \frac{a}{\ln\left(\frac{s}{s_{crit}}\right)^2} 1_{\{\tau > t\}} \quad (4)$$

Where  $a$  and  $s_{crit}$  are constants and  $s$  comes from the stochastic assumption  $ds(t) = \sigma dz$  where  $\sigma$  is the constant volatility and  $z$  a standard Brownian motion.

In order to model the stochastic recovery rate, [12] start with an arbitrary payment  $X(t)$  for a default moment  $t$  and determine the value of the payment in a future moment  $T$  by the following equation:

$$X(T) = e^{\int_t^T r(s) ds} \cdot X(t) \quad (5)$$

In this modelling context the pricing formula for a defaultable zero coupon bond is present in equation (6).

$$v(t, T) = p(t, T) \left( E(\varphi) + (1 - E(\varphi))Q(\tau > T) \right) \quad (6)$$

The above equation depends only on the expected recovery rate  $E(\varphi)$  and can be calculated for any parameters present in the model. In practical applications, these parameters are deduced from the available market prices.

[13] considers a modelling methodology in which the default time is seen as a Cox process. The author assumes the existence of a state variable  $Y$  that can be characterised by a Markov vectorial process and defines the intensity  $\lambda$  by:

$$Q(\tau > t | Y(t)) = e^{-\int_0^t \lambda(s, Y(s)) ds} \quad (7)$$

Unlike [9] and [12], [13] does not consider the independence between the default moment  $\tau$  and the evolution of the risk-free

interest rate. In his modeling context the interest rate is depending on the state variable  $Y$ .

Under the *recovery-of-treasury-value* hypothesis and using a constant recovery rate the author obtains the following valuation equation:

$$v(t, T) = \varphi p(t, T) + (1 - \varphi) E_t^Q \left( e^{-\int_t^T r(Y(s)) ds} 1_{\{\tau > T\}} \right) \quad (8)$$

Which can be transformed to:

$$E_t^Q \left( e^{-\int_t^T r(Y(s)) ds} 1_{\{\tau > T\}} \right) = E_t^Q \left( e^{-\int_t^T r(Y(s)) + \lambda(Y(s)) ds} \right) \quad (9)$$

For  $\tau > t$  the equation (9) shows the current value of a dollar paid without considering a default and can be interpreted as the current value of a zero coupon bond with a zero recovery rate.

The author also studies the value of the payment at the default time and the value of the cash flows until the default moment. The remarkable result of this study is the capturing of correlation between interest rates and the default risk.

A study that presents a new approach on the modelling of contingent claims that are subject to default and concentrates on applications on the term structure of interest rates for corporate bonds can be found in [14]. Their approach differ from other reduced form models by the way in which the losses given default are parameterised. The authors follow the framework of reduced form modelling by assuming that the default is an unpredictable event that can occur at any given moment, and they model it through a hazard process.

[14] show that the price of a defaultable claim can be calculated by removing from the foreseen payment the short term rate adjusted to default. This covers both the probability and the moment of default and also stands out for the losses in the case of a default. A key element of the pricing equation found in this study is the fact that the average loss rate is exogenously specified. In other words, neither the hazard default rates nor the fractional recovery depend on the value of the contingent claim.

In comparison to other studies, [14] assume at the default time  $\tau$  the risky bond loses a fraction of its value equal to  $1 - \varphi$ . The authors show that this assumption allows them to evaluate a future payment as a

certain payment when applying an adjusted discount rate:

$$R(t) = r(t) + \lambda(t)(1 - \varphi) \quad (10)$$

Where  $\lambda$  is the intensity and  $\varphi$  the recovery rate. Thus the value of the considered zero coupon bond is given by the following equation:

$$v(t, T) = E_t^Q \left( e^{-\int_t^T R(s) ds} \right) \quad (11)$$

In [15] there is offered a methodology for the evaluation of credit default swaps assuming that in the case of default the payment is due to a single entity and there aren't any other claims from counterparties. Instead of using a hazard rate for the default probability, this model incorporates the concept of default density which represents the unconditional cumulative probability of default for a certain period. Assuming an expected recovery rate, the model generates default densities recursively on the basis of data consisting of zero coupon corporate bonds and similar treasury bonds. Thus the structure of default density is used for calculating the premium in credit default swap contracts.

In the model considered in [16] the default time is set by the firm's managers in order to maximize the value of equity. In general, investors can't observe the assets directly and get information only from accounting documents that are characterized by periodicity and imperfections. Thus, the authors start from a Markov process  $A = (A_t)_{t \geq 0}$  where  $A_t$  represents the value of the firm at the moment  $t$  and then expose the process to discrete time adding an independent noise. In this way they obtain a discrete time process  $Z_t = A_t + Y_t$  where  $Y_t$  represents the added noise and it is observed at  $t_i$  moments for  $i = 1, \dots, \infty$ .

The authors relate the distribution of the firm's assets to the information offered to investors, and from this distribution they model the default intensity conditioned by the assets and the default boundary. The specification of the default moment  $\tau$  and of the filtration  $F_t$  makes possible the generation of an intensity for the default moment.

In [17] the model assumes that the default boundary is random and is represented by a horizontal line described by the equation  $y = L$  where  $L$  represents a known random

variable. In this context the default moment  $\tau$  is inaccessible.

In a study that refines the hazard function of [18] by incorporating monthly data instead of annual data, [18] observed that by introducing industry effects the forecasting capacity of the model is greatly improved. The industry specific factors influence both the default probably and the losses given default. Thus the authors report that by estimating the hazard function for each industry the accuracy level is increased. This is consistent with the findings reported in [19].

Moreover, the authors investigate firm specific characteristics using financial indicators like: net income to total assets, total liabilities to total assets, firm size (log of equity market value) relative to the total equity market capitalization on NYSE; and stock return volatility.

The study of [20] starts from a structural model in which investors have complete information in relation to the value of the firm's assets but not about the default boundary. Though considered constant, the default boundary is unknown to investors that have to act under a distribution function of the default boundary. The impossibility of its observation makes the default moment to be an unexpected event. The author also studies the cases in which information is incomplete about both the value of the firm's assets and the default boundary. Unlike the first case, this assumption allows a representation by intensity.

Another interesting reduced form model is [22], aiming at credit contagion, as the propagation of economic distress from one firm to another, assuming it is due to the local interaction of firms in a business partner network. The authors study aggregate credit losses on large portfolios of financial positions contracted with firms subject to credit contagion and provide an explicit Gaussian approximation of the distribution of portfolio losses which leads them to quantify the relation between the volatility of losses and the determinants of credit contagion.

A reduced form model for the processes of recovery rates, is implemented also in [23]. After default, firms continue to operate and the recovery rate is determined by the value of the firm's assets compared to the firm's liabilities. The recovery of the debt may vary

depending on whether the firm defaults or not. Though this process is similar to those used by structural models, the reduced form orientation is given by the use of the informational reduction. The model can offer analytical expressions for the default intensity and also a pricing equation for a zero coupon bond, both before and after default.

The research in [24] introduces an empirical reduced-form model for credit rating transitions. It is a parametric intensity-based duration model with multiple states and driven by exogenous covariates and latent dynamic factors. The model has a generalized semi-Markov structure designed to accommodate many of the stylized facts of credit rating migrations. Parameter estimation is based on Monte Carlo maximum likelihood methods.

The model includes a common dynamic component that can be interpreted as the credit cycle. Asymmetric effects of this cycle across rating grades and additional semi-Markov dynamics are found to be statistically significant. The authors also apply the model to a set of credit rating migrations finding a common risk factor in credit rating migrations. The impact of this risk factor is observed to be higher for downgrades than for upgrades. The authors conclude that this empirical result suggest that upgrades are more subject to idiosyncratic shocks than downgrades.

Both [20] and [25] incorporate the KMV EDF (expected default frequencies) in their reduced form models reporting a mild improvement of the forecasting ability. Furthermore, [25] incorporates the default probability estimation methodology from the theoretic [1] framework reporting a similar result to the above study. Both studies conclude that the reduced form is the most efficient and modern modelling approach to credit risk.

The reduced form model proposed in [26] deals with the pricing of the European style option with credit risk. The authors assume that the interest rate follows the Vasicek model and the intensity of default is a jump-diffusion process. Applying the law of iterated conditional expectation, the authors obtain the expression of the option price as shown in the following equation:

$$C(t, T) = \omega \mathbb{E} \left[ e^{-\int_t^T r_s ds} (S_T - K)^+ | \mathcal{F}_t \right] + (1 - \omega) I_{\{\tau > t\}} \mathbb{E} \left[ e^{-\int_t^T (r_s + \lambda_s) ds} (S_T - K)^+ | \mathcal{F}_t \right] \quad (12)$$

Where  $\omega$  is the recovery rate considered here to be constant,  $K$  is the strike price and  $T$  the maturity.

Then, by changing the probability measures, the authors obtain the valuation of the vulnerable European call option. Applying a numerical analysis, the authors obtain the effects of the recovery rate, the correlation coefficients and the Poisson intensity on the option price.

#### 4. Conclusions

In this paper we showed the evolution of reduced form models from the pioneering days of Jarrow and Turnbull to present.

Reduced form models improved certain deficiencies of structural models by taking changes in credit rating into account besides the actual default. In general these models define the default process and its moment with the help of an exogenous Poisson variable. In this way the default process does not depend on the firm's financial data as in the case of structural models.

In some contexts such as complex credit derivatives the reduced form models appear to be the best modelling choice due to the fact that they can be easily adapted to different conditions and calibrated to arbitrary market data.

Given their characteristics, reduced form models proved successful in practical applications. One of the commercial products that generates reduced form estimations on the default probabilities is the Kamakura's Risk Information Services.

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## Interactions of Derivatives with Central Bank Issues

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### Abstract

*Derivatives are an important part of the process of financial innovation that swept global markets. The growth of derivatives has so many implications on the economy in general and for the environment in which the monetary policy operates. This paper examines the impact that presence of derivatives markets has on the monetary policy transmission mechanism. The effects of derivatives markets is analyzed independently for each of the main channels of monetary policy transmission: interest rates, exchange rates and credit. The conclusion of this paper is that derivatives have a monetary nature that has to be recognized by central banks and included in its monetary targets.*

**Keywords:** derivatives, monetary policy, central bank

**JEL Classification:** E52, E58, G15, G32

### 1. Introduction

During the last decades, the financial systems around the world have undergone a revolutionary change. There has been reached the situation where one can borrow more money at lower interest rates than ever, where one can invest in a variety of tools, appropriate for each risk and profitability profile, and one can share risks with other investors from anywhere around the world. However, although they provide undeniable benefits, all these changes offered by the financial system have a cost, the cost of the savings that have been affected by the current financial and economic crisis.

The extent to which the consequences of the evolution of the financial system could have been anticipated by the monetary authorities or the supervisory bodies of the financial system or the contribution they

might have had in mitigating the effects of the changes suffered by the financial system are topics that have largely been examined and discussed lately. [1]

### 2. Locating derivatives within the new coordinates of the financial system

Starting with the mid 1970s, the pace and nature of financial innovation have changed substantially. Increased volatility of interest rates, the shift to floating exchange rates, increasing indebtedness and financial deregulation, in particular to liberalize capital movements - all have created a demand for financial innovation. Rapid advances in information and communication, along with the evolution of theory in finance field, made it possible to meet this demand. Although extremely important, derivatives - including futures, swaps and options - are just one example of innovation that changed the behavior of financial markets in recent years. In this light, derivatives can be seen more as a consequence than a cause of increased financial market volatility. [2]

The introduction of derivatives in financial markets allows investors to choose the combination of risk and return that optimizes the resources' allocation. For example, futures are more attractive for investors who want to diversify their portfolio: with a small payment (initial margin) you can open a position in derivatives exploiting the leveraged effect. This effect allows the hedger to invest only a part of his portfolio in derivatives; the other part can be invested in bonds with a certain rate of return. This strategy has, as a result, a combination of risk and return that other financial assets cannot guarantee. This way of using derivatives is useful for a speculator too because it can minimize the cost of opening a position on the market. [3]

Banks and their corporate customers' decisions on using derivatives, either as

traders or as hedgers, are ultimately mandated by the dynamics of the macroeconomic environment that is constantly evolving. The exchange rate, interest rate and credit risk arise from the modification of monetary policy and the resulting movement of these indicators in the market, which in turn alter the asset-liability structure of banks and give rise to the specific risks, duration mismatch or credit exposure.

How derivative transactions affect the overall exposure of a bank is a topic that has aroused the interest of financial analysts since their appearance. Especially, derivatives position in the list of causes that led to the outbreak of the current global financial crisis has increased public interest related to derivative transactions that banks and their corporate customers have developed.

Derivatives in the financial markets provide opportunities for various categories of risk management or are the vehicles for investment and saving, but, in the same time, can alter the desired impact of policy changes on the real economy.

### **3. Derivatives effects on the monetary policy set up by the Central Bank**

The role of monetary authority for banking supervision and control to minimize the overall risk results from implementation of monetary policy. Therefore, monetary policy pursued by central banks affect the health of the banking system and thus the financial system as a whole.

Central bank's monetary policy objective is to maintain price stability and low inflation by controlling the rate of monetary expansion. The central bank uses tools such as monetary issuance, overnight interest rates to ensure control over market liquidity. The monetary policy actions have direct impact on financial markets, changing the price of assets in the entire spectrum of maturities and liquidity. Changing prices of financial assets has a direct impact on saving and investment decisions of economic agents and they, in turn, affect the general level of prices and other macroeconomic indicators.

Derivatives bypass this circuit in some critical nodes of it. The way derivatives affect monetary policy transmission

mechanisms to the financial markets can be viewed from many angles. [4]

First point of view targets the inherent *link between the derivatives markets and the underlying asset markets*. Theoretical relationship determines the steady state of prices and the temporary market imbalances have a rapid impact on the price level in other market, leading relationship back into balance. Studies show that the reaction of the liquid derivatives markets to monetary policy actions is faster than the underlying asset markets. The net result is a time adjustment for the transmission of central bank's impulses to the spot financial markets. For some assets, such as government bonds, the reaction to monetary policy changes is very fast, so using interest rate derivatives have only a marginal impact on transmission speed. But for some less liquid assets, whose prices traditionally respond slowly to monetary impulses, such as bank loans or mortgages, the price changes will be greatly accelerated through derivatives. This increases the impact of monetary policy, for example, on the housing component of inflation rate through rapid changes in mortgage rates.

Secondly, derivatives markets *increase the size of global financial market* by introducing new types of products and providing additional information about the financial assets prices. Expression of financial innovation, derivatives occurred by converting mortgages into mortgage securities had a significant impact on the growth of the market segment represented by assets traditionally considered illiquid and with low sensitivity to price changes.

Thirdly, derivatives *make arbitrage operations cheaper and easier*, modifying substantially the effects of transmission mechanisms. Allowing individual operators to modify their financial exposures rapidly and inexpensively, derivatives have the potential to change the sensitivity to interest rate and exchange rate changes, thus altering the response of economic agents to monetary policy actions. But even if development of derivative markets allows the scope of such actions to be transferred between agents, not all agents globally and simultaneously can escape it, any person wishing to escape the risk must find a partner willing to bear. Therefore, the overall economy can not be

made safe from the effects of changing interest rates or exchange rates through the use of derivatives. As a result, derivatives do not diminish the ultimate control monetary policy has on inflation.

Fourth, derivatives prices should provide more accurate information about the nature of monetary shocks, with *lower information costs*. This information should help agents to differentiate between real and nominal disturbances, thereby reducing the real effects of monetary policy. A reduction of the real effects of monetary policy removes the central bank from its goal of stabilizing prices, providing a more limited role for using monetary policy to stabilize real output. [5]

Although derivatives do not substantially alter the effects of monetary transmission mechanisms, they can change the relative importance of the three channels through which monetary policy operates: the interest rate channel, exchange rate channel and credit channel. They can also affect the speed and degree of transmission of monetary policy actions to the floor consumption and thus inflation.

### 3.1. Traditional interest rate channel

Interest rate channel is a classical theme of the current economic literature. Interest rate changes are the core of the transmission mechanism of monetary policy highlighted by the well-known Keynesian IS-LM model.

An increase in money supply leads to declining interest rates, which in time reduces the cost of capital, leading to increased investment spending and thus to an increase in aggregate demand and output. Initially Keynes described this mechanism to operate on the investment decisions of enterprises. Further research showed that population decisions on durable goods and the purchase or construction of dwellings are similar to investment decisions. Causal chain described above lends itself to applications on the consumer spending.

Another important feature of the interest rate channel is focusing on the real interest rate as decisive factor in investment decision, not on the nominal interest rate. The special emphasis is placed on the relationship between short-term interest rate and long-term interest rate, the long term being the one

which influences the investment decision. The link between short-term rate, which can be influenced by Central Bank, and the long term is based on expectations and substitution effects. The spread between short term and long term interest rate captures the market expectation of the movement of the future interest rate. For example, an upward sloping term structure, or a positive term spread, means the market expects the short term interest rate to increase in future. Such expectation and the change in this expectation may alter agents or banks' need for hedging.

The existence of derivatives can affect the interest rate channel in two ways, giving its substitution effect and the income and wealth effects.

First, derivatives may increase somewhat faster speed already with monetary policy actions affect interest rates across the maturity spectrum. For example, following an increase in interest rates, agents will prefer saving, and will cap the expenses. Investment decisions are reviewed, requiring higher capital costs. In terms of future investment costs, the effect of increasing interest rates on investment is always negative and can not be easily compensated. It may be possible, however, to cover the negative *impact of the substitution effect* by using derivatives. A hedger can block the current interest rate for potential funding needs in the future. Or, expecting a rising interest rate in the near future, a bank with more interest rate sensitive liabilities may enter into derivative position today to lock in a lower interest rate as an effort to offset the adverse impact of a higher rate on the value of the bank.

However, there still remain elements that can not be provided, like the exact extent of investment and investment may be unknown. So that derivatives can only have a marginal impact on reducing the effect of substitution. In addition, most agents do not act as hedgers and will face higher costs of capital for future investment costs the same, with or without derivatives. Thus, the existence of derivatives does not significantly impede the ability of monetary authorities to set the short-term interest rates to the desired level.

Secondly, derivatives could affect the relationship between interest rates and propensity to consume, because of trading in terms of risk and / or profitability may

change the way monetary policy actions influence *the distribution of income and wealth*. [2] How this connection could be affected depends on whether the counterparties to derivative contracts have varying degrees of risk aversion and different propensities to consume. If those who bear the risks in these contracts are less inclined to spend the current income than those who cover, derivatives may delay or reduce the interest rate change effect. Indeed, temporary income is transferred to hedgers, whose cash flows and spending plans will not be affected by interest rate changes, they are not forced to give up their spending elsewhere. Will be necessary to assess the extent to which risk transfer taking place in derivatives markets can affect the overall propensity to consume, or causes the transmission speed or degree of interest rate changes to the real economy. To the extent that such changes took place, it should be possible to adjust monetary policy in such a manner as to ensure that the desired effect on target variables is achieved.

Concluding, the existence of derivatives does not significantly impede the ability of monetary authorities to set short-term interest rates to the desired level. In addition, changes in interest rates will continue to influence consumer decisions based on marginal costs, as before.

### **3.2. Exchange rate channel**

After switching to floating rates, exchange rate channel has known a continuous attention from policy makers and researchers of monetary policy, especially in terms of the effects of this policy on the exchange rate and through it on exports and economic activity.

This channel also involves changes in interest rate, leading to capital movements and therefore the effects on the exchange rate. This is because domestic interest rates are lower, domestic financial market investments less attractive and therefore in the context of free movement of capital leads to export of capital and depreciation of national currency. The local currency depreciation leads to higher prices relative to import goods at cheaper relative to exports. Assuming that demand is elastic in the price of the goods exported, export demand increase, leading to increased production.

The imports more expensive lead to a change in the consumption structure of local goods, and thus an increase in aggregate demand.

Differential changes in domestic and foreign interest rates can produce far greater changes in the exchange rate, implying a greater role for the exchange rate transmission mechanism.

Derivatives have further expanded economic agents' capacity to transfer the occurrence of exchange rate changes, by allowing hedging in the futures markets against adverse exchange rate movements. This allows, at least partially, protecting current investment and consumption plans of exchange rate changes, weakening the effectiveness of exchange rate channel in the short term, if the currency risk is transferred to agents less reluctant to risk their consumption decisions are less affected by exchange rate fluctuations.

Hedging contracts extending to longer maturities, particularly through foreign exchange swap market, may also mitigate the effect of exchange rate channel. However, on long term, exporting firms can not delineate their production decisions for the changes in relative prices bring by the exchange rate movements.

It is worth noting that the role of exchange rate channel depends on the openness of the economy and the extent to which effective exchange rate flexibility is accepted by monetary authorities. [2] For countries with fixed rate or narrowband modes, an additional problem to be considered is the effect that derivatives have on the ability of monetary policy to maintain exchange rate constant.

There was the temptation for central banks to use themselves foreign exchange derivatives. These cases have generated powerful contradictions. Thus, if the central bank registers losses from these operations, one can say that it speculates with state money. Also, another accusation is that it could give clear signals to the market for the trends it wants to assign. If the central bank makes profits from such operations, it can be accused of using confidential information on the exchange rate. For these reasons, most economists believe that a central bank should use with caution or not to use foreign exchange derivatives, mainly due to possible charges of conflict of interest. [6]

As mentioned above, the exchange rate and interest rate channels interact each other. The extent that derivatives facilitate asset substitution between different maturities, in different currencies, generate the situation in which a monetary policy decision with concern to the yield curve of a currency can affect the yield curve of other currencies. This could alter the exchange rate channel of international transmission of monetary policy actions, adding another dimension, perhaps, to the channel - a direct link between interest rate expectations of participants from different national financial markets. If derivatives could be causing this relationship expectation, they could certainly be a highlight.

### 3.3. Credit channel

This transmission channel emphasizes the role of banks in the financial system and the special relationship between central bank and all banks in the system. It is important to note that the importance of this channel of transmission depends on the share of the banking system in the whole financial system. Credit channel is considered as complementary to traditional interest rate channel and its effects are as a supplement to the effects arising from interest rate channel.

Transmission efficiency of this channel increases as the reserve requirement from Central Bank is higher as a share of deposits. Also as the commercial banks are more dependent on financial resources from the Central Bank, the probability that this channel of transmission is very is more important. The more a bank intends to hold more cash as a share in the asset, it is much more sensitive to changes in monetary policy and therefore more adaptive has to be its lending policy. This is the case of small banks, very vulnerable to the problems posed by information asymmetry, which have high cash reserves to offset the possible problems due to problem loans.

Banks are using financial derivative instruments to complement their traditional lending activities and to hedge risk-exposure resulting from their lending and deposit taking activities. Thus, derivatives provide incentives for banks to increase their lending activities. [7]

Banks are facing many types of credit risks due by their credit portfolio including different kinds of loans, from large corporate loans to loans to smaller companies, even counterparty credit risks on over-the-counter derivatives. They have used credit derivatives in order to tailor risk in several areas of their credit portfolio. Banks can transfer the credit risk of a portfolio of exposures to investors via securitization transactions, such as collateralized debt obligations (CDOs). In the same time, they can use CDS to get rid of the credit risk of issuers to whom they have a large exposure.

In banking, CDSs are the result of banking regulations such as Basel Agreement, which states that banks must hold capital based on risk assets they hold. For example, for an asset AAA-rated, bank capital requirement that must hold is significantly lower than for a regular mortgage. Consequently, the CDS became increasingly popular among banks which realized they need to sell traditional assets and buy massive securities such as mortgage-based securities (MBS) which, together with the related CDS, receiving the maximum ratings. Demand for credit default swaps has grown exponentially, but this has to mean better targeting of risk as recent events have shown.

However, the concerns of regulators are that these derivative instruments substitute for lending, increase the riskiness of banks, and therefore, increase their reliance on safety mechanisms designed by the authorities.

### 4. Conclusions

The growing use of derivatives, as off-balance sheet instruments, has reduced the transparency of firms and banks' balance sheets. The reduced transparency affected mainly the financial sector, proving the acute need to improve the central bank responsibility for banking supervision, through a better accountancy conducted or disclosure standards imposed.

Introduction of derivatives in monetary objectives, or at least, in the balance sheets of financial institutions holding them, would be one of the most important contributions to defining the new architecture of international financial system.

## 5. Acknowledgements

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# The Role of Stock Exchange in Romanian Market Capital Development

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## Abstract

*It is known that the stock is represented as a “barometer” for the economic and financial life in a country or on international basis, an indicator of world status for business and economic perspectives. Through this role, this becomes a symbol of market economy and an interest object not only for the business circles but also for the whole community. Without stocks, the possibilities of transactions might reduce to direct negotiations between business partners, in the detriment of small agencies. We only need to prove the role of stocks in market economy and especially in financing economy.*

**Key words:** stock market, capital, financial crisis

**J.E.L. Classification:** G10 ,G01

## 1. Introduction

Romanian stock traditions, even if they are not as the ones from western European states and were interrupted for well of fifty years, represent for the present day a rich river of knowledge referring exclusively in the institutional field of Romanian market capital.

Recommencing the stock activities in Romania and analysing the evolution of its main components from refunding to present day, has proved the interdependency with Romanian economic environment evolution as a whole or performance indicators of market stocks being tightly correlated with the macroeconomic ones.

Starting up from a wide documentation, I have found that, in emerging market economy, the market capitals are urged to contribute to fulfilling a supplementary objective: the one of private capital forming. This is the reason for which I chosen to identify together the interaction between the

stock market and the process of privatizing in Romania[1].

## 2. Privatizing of the capital market in Romania

The privatizing of the capital in Romania was designed as an integrated schedule, which included both the component with a free title and the one with private property transfer through selling the actions portfolio withheld by the state and in tight links with the build-off of an capital market which will represent a support and a catalyst for this respective process. The degree of reporting on Romanian stock market to the process of privatizing its self stands out as a modest one, in conditions in which the advantages of privatizing through the stock mechanism have not integrated into the opportunities and conditioning system generated by the Romanian economic environment from that period. And have seemed limited compared with the advantages of using direct negotiations, auctions, the MEBO method, etc.

The market capital insures the realization of capital transfer between investors-owners by multiple coordinates: national, regional or worldwide, inside the same industry or between different ones. The Romanian stock market insured the transfer of capital flows, both for internal and for external coordinates, and by that, contributed to the consolidation of Romanian capital.

The way in which Romanian stocks insured the capital flow transfer, both for internal and external coordinates were tributary to the economic premises and by structure to the capital which found self-commissioned in the mid ‘90s. In this context the stock market has become an economic concentration arena for the ones that had an extra vision, of financial resources and economic knowledge. By own means to the stock market, have been created capital flow between term shareholders and strategic

investors which created strong and profitable businesses. The stock market has stimulated the capital flows on two major directions: the one of the internal transferring to concentrate economic power and the one of international capital allurements. As for the international flow allurements of capital belonging to portfolio investors, but also to the strategic ones, the stock market had a contribution based upon capitalization and termination of the registered throughout time, meaning it was reduced in the first years of evolution and increased with the first years of the new millennia.

### **3. The stock market and the financial crisis**

The topicality of the investigated theme precedes the tsunami which shocked-up the global economy, the economic and financial crisis which monopolized the economy throughout the world in the last years, having an unwanted impact over the stock markets evolution. Thus, the quotations of actions of the great companies listed at the stocks dropped dramatically, the termination from stock market was reduced too much and on this basis, the volume of transactions decreased due to the manifested interests of investors and speculators. The stock indicators have known a decrease as a whole and a distortion to the given information for the potential investors because of the disturbances occurred in the structure of participant companies to their forming basis[2].

The important role that stocks have in the market economy has generated a concern among academics and practitioners to deepen the knowledge area in improvement and expansion of markets and operations to specific adaptations granted to conditions of economic instability caused by economic financial crisis.

As "extremely accurate stock market reflects the overall situation of an economy, and trends and perspectives", the global financial crisis has caused significant fluctuations of market economy in Romania, affecting the stock market. The capital market development is today an important indicator that can provide details regarding the progress of a country's economy.

As the Romanian economy has gone from being an emerging market economy, and getting closer to the status of functional market economy, expectations regarding the outcome of engaging in capital market operation mechanism of the economy register the new coordinates. Rapid mobilization and cost of capital for large projects should become the primary function of our capital market.

Strictly theoretical, the role of stock exchanges is to facilitate the performance of financial instrument transactions that were issued on the primal capital market in order to provide mobility and liquidity investors. The primary market is that segment of capital market where securities are issued for the first time. After issuing and placing titles on the market, they can be traded on the secondary market; the largest segment of the secondary market represented by securities exchanges. In terms of issuers, the role of scholarship is to provide access to financial resources through equity or loan increase. Thus the picture is emerging the financing economy in Romania through the stock market. Bucharest Stock Exchange in recent years has been the scene of both initial public offerings of bonds and shares, both issued by municipalities and by corporations. Loaning by issuing loan stocks and bonds are the two main axes of this alternative financing. Initial public offerings are the first steps towards the success of a company financing through capital market mechanisms.

Main functions of stock exchanges helps to aggregate demand and supply of securities, to make securities transactions, in determining the fair trading and listed securities quotations, and to promote legal and economic security contracts signed and provide official information on the amount of securities traded. Stock exchange offers investors the opportunity to participate in profitable activities of large companies, securities and provides liquidity and portfolio diversification, which can offer companies the ability to obtain long-term financial resources and free advertising. In terms of organization, BSE is established as a non-profitable public institution, operating on the principle of self-activity, and which aims to provide an organized and legal framework for meeting demand and supply in the medium term capital and long.

Conduct of operations in the stock market comes after a rigorous organization, including location and participants in transactions and trading rules. Stock exchange transactions take the form of sale contracts as primary securities or other financial assets, which end in accordance with banking institution rules through authorized stockbroker performing these operations. The primary financial securities categories enter shares and bonds and derivative securities that are exemplified frequently contracts with new financial instruments, operations spot and futures.

As a market economy the corporation becomes important only if stocks and bonds are allowed to be traded, the issue at stake is not the economic motive that causes a corporation to introduce the scholarship, but the possibility of meeting conditions imposed by national legislation to be able to stock and bond in the primary market and then stocks can be bought and sold. Listing requires certain regulations that relate to requirements for admission, maintaining and promoting the stock exchange, in this case the necessary documentation, the obligations of the company issuing the dissemination of information necessary for the proper conditions of trading.

Portfolio investments involve the acquisition of securities organized and regulated capital markets without winning a right to decide and control the concerned company management. However most of the investment portfolio is made by individuals or institutions without legal personality.

In investment portfolio and the ability of labor cost, infrastructure condition, geographical position of the host country in relation to target markets, existence of bilateral, regional or international agreements of the other countries, local market size are practically irrelevant issues and not evaluated. The interest to a potential investor portfolio is: the local market capitalization, its growth potential, quality accounting standards, their level of transparency. Due to globalization transnational corporations expand their foreign direct investment subsidiaries becoming international. To ensure their sustainable growth they will be dependent on sources of funding provided by the actors themselves in the international

market in the form of portfolio investment in securities.

Some states do not strongly encourages investment portfolio, or impose

restrictions given their high mobility compared with direct investment. Indeed the capital of this sort can "escape" from a country just when it needs it, as happened in the mid-90s in Mexico and to the end of the decade in Russia. Romania due to inspired precautions such as discouraging investment portfolio, increased foreign reserves and the creation of a leu-currency balance being managed at that time to avoid the trap.

The correlation between markets is becoming increasingly strong as the market matures our capital, and starts being perceived as foreign institutional investors Central and Eastern Europe, hitherto dominated the markets in the Czech Republic, Hungary and Poland (the latter, in turn, beginning the reconciliation to increasingly significant with more developed markets).

Challenges posed by the economic environment at the stock market to succeed in a dynamic, fast and effective contribution in the stock market and reforming the economic climate business administration are becoming increasingly important. The stock exchange is now called to be a pole of development, dissemination and implementation of a set of policies, rules of conduct and codes of good business practices based on new principles of business administration, likely to respond to recent challenges in creating economic climate effectiveness.

BSE is involved in extending these new Admin business principles to all categories of economic actors, whether they participate directly or indirectly in the stock market. Forms of involvement of the Romanian stock market in reforming the business administration in Romania range from working with international institutions, to their own efforts undertaken to first issuers market exchange rates artificially maintained, respecting the rights of all shareholders, board involvement administration in equidistant representation of all shareholders and all interested parties (stakeholders) in the economy, or the training of managers and administrators based on new principles of business administration.

#### 4. Advantages and disadvantages of the capital market investments

Capital market investments have advantages and disadvantages. The advantages of investing in BSE mention:

- Acquisition of superior returns compared with bank deposits, or units. The best argument for this assertion is in stock indices. A stock index is a statistical indicator that reflects the evolution of market prices of shares making up;
- The opportunity of rapid liquidation of the investment, through this understanding that an investor may at any time sell shares and collect money, which is not possible with real estate investments where the investor is locked to new buyer;
- The opportunity of revaluation of the investment at any time;
- The direct control over own investments;
- The opportunity to use derivatives to call the complex investment strategies;
- The possibility of diversifying risk by investing in more issuers;
- Investment in shares is much more accessible to the investment in real estate assets where the amounts are considerably higher and the potential liquidation of the investment is much lower;
- Cheaper financing opportunities on capital market, increasing the number of investors and market capitalization, beginning to draw attention to large companies;
- Development of new products and financial instruments and their implementation by the scholarship. These include derivatives and stock indices, options, government securities, structured products such as certificates on indices, commodities, currencies.

In conclusion, an investment in stocks done inspired investors to make significant gains and varied:

- Dividends paid annually by companies where you are a shareholder;

- Capital gains;
- Increase in capital gains from free action;

The disadvantages of investing in the capital market note:

- Investment in shares is risky and can result in the diminution or loss of original capital invested. Risk can be reduced by using investment strategies appropriate to resort to financial derivatives, but the risk cannot be removed. A stock market investor must be aware that they may lose;
- Political risk, capital market is very sensitive to political events;
- Economic risk, which can be given by the negative evolution of the economy or negative evolution of the issuer (reporting financial losses from one quarter to another, loss of contracts, reduced turnover, etc.)
- Risk of failure of the issuer;
- Risk and correlation given the globalization of financial markets.

The strategic orientation of the Romanian stock market and progress towards the objectives of this strategy surging precede the final conclusions of this thesis, say their findings in summary:

Regarding the transfer of capital flows, the internal coordinates, and Romanian Stock Market was rather used as a mechanism of concentration of economic power than as a capital transfer mechanism caused by structural or conjuncture economic factors.

#### 5. Conclusions

Portfolio investment capital attracted from the international circuit is promising but modest compared to the induced current international opportunities, limits are given in the main appeal, capitalization and liquidity of Romanian stock market is still low compared with exchanges in the region. Local stock market was heading towards achieving the market maturity through initial steps to finance economic activity. Reaching this stage depends on the consistency with which they will perform this function shortly.

Romanian stock market is concerned and is expected to play a major role in further reforming of business administrations and in

promoting a sense of the term enriched efficiently in the economic climate.

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## Methodology of Analysis and Calculation of Bank Interest Expense from 1000 lei Turnover

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### Abstract

*The article theme is part of the area of financial investigation processes and phenomena occurring at the micro level that focus on effective financial bank interest expenses. Throughout the article we try to show ways of influence and effectiveness of these expenditures that may influence to some extent, but also decisive the economic and financial results of company.*

*The purpose of this article is to highlight the usefulness and applicability of the methodology for analyzing the effectiveness of bank interest costs from 1,000 lei turnover in the firm.*

*We all know that debt was always a risky method, both for the borrower and the lender. In our case, interest are those financial costs that make the cost of borrowing and are the most important component of these expenses that contribute to building capacity to mobilize financial resources.*

**Key words:** efficiency, expenses, interest, turnover, operating assets.

**J.E.L. Classification:** D61

### 1. Introduction

For an economist, the efficiency of spending is not the ease with which it was reduced. Whether it is the manager of a large company or a budding entrepreneur, the main problem which arises is how to obtain an acceptable profit under cost reduction. And one of the issues involved in this important aspect is the reduction of bank interest costs.

To finance the productive and investment activity the economic agents may use the borrowed sources, i.e. bank loans that bear interest. Capital loan usually has a positive impact on the development of financial and economic activity of economic agents, but by its specific form generates interest expense that may sometimes major implications on the level of financial expenses and accordingly on the total costs.[5]

In examining these charges it should be assessed their progress compared with the one from previous period, and to certain provisions, highlighting their changes through the factors influencing them.

Considering the fact that interest result from loans obtained, we can say that they represented and still represent an important component of permanent financial resources attracted by a company with the purpose of developing in normal conditions of its financial and economic activity.

The company that always call for loans would know or should know that debt will always behave the risk of not coping with payment obligations to creditors (repayments and interest), and a large amount of outstanding and unpaid debts can make it insolvent, leading it to bankruptcy. This can certainly occur when the borrowed capital and interest are higher, and economic profitability is lower.

Borrowing capacity in the context of everyday economic life is one of the key elements of financial mobilization capacity of companies because of the role and importance of credit in general, bank lending especially, within the economic-financial mechanism applied in countries with established market economies.

## 2. Theoretical approach regarding the analysis of bank interest costs

Interest is included in financial expenses, representing a component of cost of borrowing. Under IAS 23, they should be recorded as an expense in the period they are incurred, except those which are capitalized. The analysis indicator used is the effectiveness of the interest costs.[4] Borrowing costs relate primarily to interest, but not limited to them, they also contain other costs incurred for loan funds.

Borrowing costs are interest and other costs incurred by an entity with the borrowing of funds. Borrowing costs may include: [7]

- total interest expense calculated using the effective interest method as described in IAS 39 *Financial Instruments: Recognition and Measurement*;

- financing costs related to finance leases recognized in accordance with IAS 17 *Leases*;

- exchange differences on foreign currency borrowings to the extent that they are regarded as an adjustment to interest expense.

Financial expenses include amounts paid for capital used, whether from their own or borrowed. In the case of equity, their cost is represented by the expected earnings to shareholders for the amounts contributed to the company, materialized in dividends or in increase of the value of their shares. If borrowed capital, the cost is reflected as interest paid.[3]

Interest coverage ratio reflects the ability of firms to obtain enough profit to sustain interest on loans. Essentially it indicates how many times the company's profit before paying taxes and interest cover interest expenses.

Companies to complete the necessary financial resources are resorting to short, medium or long term bank loans or loans from other companies. Basically these loans are:

a) long and medium term financial liabilities;

b) cash loan (current liabilities), which are usually necessary to supplement working capital and to ensure the company's liquidity.[2]

## 3. Methodology for analyzing the effectiveness of bank interest expense from 1000 lei turnover

Interest expenses represent the most important component of the financial expenses of a company. Causal analysis of interest expense uses the chain method substitution in explaining the reasons behind the evolution of these costs, using the absolute amount of interest expense and the indicator “interest expense from 1000 lei turnover”. [2]

For the analysis of the interest expenses efficiency we use the following analysis models:

$$\frac{Sd}{CA} \cdot 1000 = \left( \frac{D}{CA} \cdot \frac{Sd}{D} \right) \cdot 1000$$

where:

$\frac{Sd}{CA} \cdot 1000$  - interest expense from 1000 lei turnover;

$\frac{D}{CA}$  - participation share of resources attracted to the formation of turnover;

$\frac{Sd}{D}$  - average interest rate

The average interest rate measures the percentage of the interest paid by the company for all loans and loans made. If it is computed at the outstanding debt it has to be compared with the rate obtained during the comparison, and if it is calculated on the amount of credit used in a certain period of time then it should be compared with the average interest rate on the market.

**I. Deviation of expenses with bank interest:**

$$\Delta \frac{Sd}{CA} \cdot 1000 = \left( \frac{Sd_1}{CA_1} - \frac{Sd_0}{CA_0} \right) \cdot 1000 = \left[ \left( \frac{D_1}{CA_1} \cdot \frac{Sd_1}{D_1} \right) - \left( \frac{D_0}{CA_0} \cdot \frac{Sd_0}{D_0} \right) \right] \cdot 1000$$

**II. The influence of elements:**

1. The influence of the share participation of sources attracted in the formation of turnover:

$$\Delta \frac{Sd}{CA}^{CA} \cdot 1000 = \left[ \left( \frac{D_1}{CA_1} - \frac{D_0}{CA_0} \right) \cdot \frac{Sd_0}{D_0} \right] \cdot 1000$$

2. The influence of the average percentage of interest rate:

$$\Delta \frac{\frac{Sd}{CA}}{\frac{Sd}{D}} \cdot 1000 = \left[ \frac{D_1}{CA_1} \cdot \left( \frac{Sd_1}{D_1} - \frac{Sd_0}{D_0} \right) \right] \cdot 1000$$

**III. To verify we use the following relationship:**

$$\Delta \frac{Sd}{CA} \cdot 1000 = \Delta \frac{\frac{Sd}{CA}}{\frac{D}{Ae}} \cdot 1000 + \Delta \frac{\frac{Sd}{D}}{\frac{D}{Ae}} \cdot 1000$$

$$\frac{Sd}{CA} \cdot 1000 = \left( \frac{Ae}{CA} \cdot \frac{D}{Ae} \cdot \frac{Sd}{D} \right) \cdot 1000$$

**where:**

$\frac{Ae}{CA}$  - efficiency of operating assets;

$\frac{D}{Ae}$  - share participation of loans and debts

to finance operating assets

**I.Deviation of expenses with bank interest:**

$$\begin{aligned} \Delta \frac{Sd}{CA} \cdot 1000 &= \left( \frac{Sd_1}{CA_1} - \frac{Sd_0}{CA_0} \right) \cdot 1000 = \\ &= \left[ \left( \frac{Ae_1}{CA_1} \cdot \frac{D_1}{Ae_1} \cdot \frac{Sd_1}{D_1} \right) - \left( \frac{Ae_0}{CA_0} \cdot \frac{D_0}{Ae_0} \cdot \frac{Sd_0}{D_0} \right) \right] \cdot 1000 = \end{aligned}$$

**II. The influence of elements:**

1. The influence of efficiency of use of operating assets:

$$\Delta \frac{\frac{Sd}{CA}}{\frac{Ae}{CA}} \cdot 1000 = \left[ \left( \frac{Ae_1}{CA_1} - \frac{Ae_0}{CA_0} \right) \cdot \frac{D_0}{Ae_0} \cdot \frac{Sd_0}{D_0} \right] \cdot 1000$$

2. The influence of the share participation of the attracted sources in financing operating assets:

$$\Delta \frac{\frac{Sd}{CA}}{\frac{D}{Ae}} \cdot 1000 = \left[ \frac{Ae_1}{CA_1} \cdot \left( \frac{D_1}{Ae_1} - \frac{D_0}{Ae_0} \right) \cdot \frac{Sd_0}{D_0} \right] \cdot 1000$$

3. The influence of the average percentage of interest rate:

$$\Delta \frac{\frac{Sd}{CA}}{\frac{Sd}{D}} \cdot 1000 = \left[ \frac{Ae_1}{CA_1} \cdot \frac{D_1}{Ae_1} \cdot \left( \frac{Sd_1}{D_1} - \frac{Sd_0}{D_0} \right) \right] \cdot 1000$$

**III. To verify we use the following relationship:**

$$\Delta \frac{Sd}{CA} \cdot 1000 = \Delta \frac{\frac{Sd}{CA}}{\frac{Ae}{CA}} \cdot 1000 + \Delta \frac{\frac{Sd}{D}}{\frac{D}{Ae}} \cdot 1000 + \Delta \frac{\frac{Sd}{CA}}{\frac{Sd}{D}} \cdot 1000$$

**2.3. Case study on implementation of the analysis methodology of the interest expense effectiveness from 1000 lei turnover**

In order to illustrate the methodology for cost effectiveness analysis of bank interest we analyze a hypothetical case which highlights the effectiveness of these

expenditures. For this we use the data in the table below:

Table 1:

Current No.	Indicators	P <sub>0</sub>	P <sub>1</sub>	Deviation
1.	Turnover (CA)	13.750	16.720	+2.790
2.	Amount of interest paid (Sd)	1.540	1.760	+3.300
3.	Loans, credits and payables (D)	7.480	7.920	+440
4.	Operating assets (Ae)	4.620	4.840	+220

To analyze the effectiveness of the interest costs of analysis we use the models above.

$$\frac{Sd}{CA} \cdot 1000 = \left( \frac{D}{CA} \cdot \frac{Sd}{D} \right) \cdot 1000$$

**I.Deviation of expenses with bank interest:**

$$\begin{aligned} \Delta \frac{Sd}{CA} \cdot 1000 &= \left( \frac{Sd_1}{CA_1} - \frac{Sd_0}{CA_0} \right) \cdot 1000 = \\ &= \left[ \left( \frac{D_1}{CA_1} \cdot \frac{Sd_1}{D_1} \right) - \left( \frac{D_0}{CA_0} \cdot \frac{Sd_0}{D_0} \right) \right] \cdot 1000 = \\ &= \left( \frac{1760}{16.720} - \frac{1.540}{13.750} \right) \cdot 1000 = \\ &= \left[ \left( \frac{7.920}{16.720} \cdot \frac{1.760}{7.920} \right) - \left( \frac{7.480}{13.750} \cdot \frac{1.540}{7.480} \right) \right] \cdot 1000 = \\ &= (0,105263 - 0,111999) \cdot 1000 = -6,736 \text{ lei} \end{aligned}$$

**II. The influence of elements:**

1. The influence of the share participation of sources attracted in the formation of turnover:

$$\begin{aligned} \Delta \frac{\frac{Sd}{CA}}{\frac{D}{Ae}} \cdot 1000 &= \left[ \left( \frac{D_1}{CA_1} - \frac{D_0}{CA_0} \right) \cdot \frac{Sd_0}{D_0} \right] \cdot 1000 = \\ &= \left[ \left( \frac{7.920}{16.720} - \frac{7.480}{13.750} \right) \cdot \frac{1.540}{7.480} \right] \cdot 1000 = \\ &= -14,476 \text{ lei} \end{aligned}$$

2. The influence of the average percentage of interest rate:

$$\begin{aligned}\Delta \frac{\frac{Sd}{CA}}{\frac{Sd}{D}} \cdot 1000 &= \left[ \frac{D_1}{CA_1} \cdot \left( \frac{Sd_1}{D_1} - \frac{Sd_0}{D_0} \right) \right] \cdot 1000 = \\ &= \left[ \frac{7.920}{16.720} \cdot \left( \frac{1.760}{7.920} - \frac{1.540}{7.480} \right) \right] \cdot 1000 = \\ &= +7,7399 \text{ lei}\end{aligned}$$

**III. To verify we use the following relationship:**

$$\begin{aligned}\Delta \frac{Sd}{CA} \cdot 1000 &= \Delta \frac{\frac{Sd}{CA}}{\frac{D}{CA}} \cdot 1000 + \Delta \frac{\frac{Sd}{CA}}{\frac{Sd}{D}} \cdot 1000 \\ -6,736 &= (-14,476) + 7,7399\end{aligned}$$

The main conclusion from this analysis is to reduce current interest expense during the previous period.

This analysis model highlights two factors of influence, and explaining the transmission mechanism of their action on bank interest expense from 1000 lei turnover consists in the fact that reducing these costs by - 6,735 lei was mainly due to the reduction in the participation weight of the attracted sources (loans and debt) in forming the turnover, even if their value increased by 440 lei in the current period compared to the previous period.

From the second influence we observe that the average interest rate negatively influenced the interest expense from 1000 lei turnover leading to their increased 7.7399 lei.

$$\boxed{\frac{Sd}{CA} \cdot 1000 = \left( \frac{Ae}{CA} \cdot \frac{D}{Ae} \cdot \frac{Sd}{D} \right) \cdot 1000}$$

**I. Deviation of expenses with bank interest:**

$$\begin{aligned}\Delta \frac{Sd}{CA} \cdot 1000 &= \left( \frac{Sd_1}{CA_1} - \frac{Sd_0}{CA_0} \right) \cdot 1000 = \\ &= \left[ \left( \frac{Ae_1}{CA_1} \cdot \frac{D_1}{Ae_1} \cdot \frac{Sd_1}{D_1} \right) - \left( \frac{Ae_0}{CA_0} \cdot \frac{D_0}{Ae_0} \cdot \frac{Sd_0}{D_0} \right) \right] \cdot 1000 = \\ &= \left( \frac{1760}{16.720} - \frac{1.540}{13.750} \right) \cdot 1000 = \\ &= \left[ \left( \frac{4.840}{16.720} \cdot \frac{7.920}{4.840} \cdot \frac{1.760}{7.920} \right) - \right. \\ &\quad \left. - \left( \frac{4.620}{13.750} \cdot \frac{7.480}{4.620} \cdot \frac{1.540}{7.480} \right) \right] \cdot 1000 = -6,736 \text{ lei}\end{aligned}$$

**II. The influence of elements:**

1. The influence of the efficiency in using the operating assets:

$$\begin{aligned}\Delta \frac{\frac{Sd}{CA}}{\frac{Ae}{CA}} \cdot 1000 &= \left[ \left( \frac{Ae_1}{CA_1} - \frac{Ae_0}{CA_0} \right) \cdot \frac{D_0}{Ae_0} \cdot \frac{Sd_0}{D_0} \right] \cdot 1000 = \\ &= \left[ \left( \frac{4.840}{16.720} - \frac{4.620}{13.750} \right) \cdot \frac{7.480}{4.620} \cdot \frac{1.540}{7.480} \right] \cdot 1000 = \\ &= -15,5087 \text{ lei}\end{aligned}$$

2. The influence of the share participation of the attracted sources in financing operating assets:

$$\begin{aligned}\Delta \frac{\frac{Sd}{CA}}{\frac{D}{Ae}} \cdot 1000 &= \left[ \frac{Ae_1}{CA_1} \cdot \left( \frac{D_1}{Ae_1} - \frac{D_0}{Ae_0} \right) \cdot \frac{Sd_0}{D_0} \right] \cdot 1000 = \\ &= \left[ \frac{4.840}{16.720} \cdot \left( \frac{7.920}{4.840} - \frac{7.480}{4.620} \right) \cdot \frac{1.540}{7.480} \right] \cdot 1000 = \\ &= +1,0319 \text{ lei}\end{aligned}$$

3. The influence of the average percentage of interest rate:

$$\begin{aligned}\Delta \frac{\frac{Sd}{CA}}{\frac{Sd}{D}} \cdot 1000 &= \left[ \frac{Ae_1}{CA_1} \cdot \frac{D_1}{Ae_1} \cdot \left( \frac{Sd_1}{D_1} - \frac{Sd_0}{D_0} \right) \right] \cdot 1000 = \\ &= \left[ \frac{4.840}{16.720} \cdot \frac{7.920}{4.840} \cdot \left( \frac{1.760}{7.920} - \frac{1.540}{7.480} \right) \right] \cdot 1000 = \\ &= +7,7399 \text{ lei}\end{aligned}$$

**III. To verify we use the following relationship:**

$$\begin{aligned}\Delta \frac{Sd}{CA} \cdot 1000 &= \Delta \frac{\frac{Sd}{CA}}{\frac{Ae}{CA}} \cdot 1000 + \Delta \frac{\frac{Sd}{CA}}{\frac{D}{Ae}} \cdot 1000 + \Delta \frac{\frac{Sd}{CA}}{\frac{Sd}{D}} \cdot 1000 \\ -6,736 &= (-15,5087) + 1,0319 + 7,7399\end{aligned}$$

As observed in previous model the sum of interest expenses in 1000 lei turnover decreased by 6,736 lei in the current period compared to the previous period.

Given this analysis model this is due to

increased operating efficiency of the company's assets, which resulted in reduced bank interest expenditure from 1000 lei turnover by -15.5087 lei.

Given the other two factors of influence, the participation weight of the attracted sources in funding the assets and the average percentage of interest we observe:

- both factors negatively influenced the evolution of interest expense in 1000 lei turnover;

- the participation share of loans and debt to finance operating assets determined the increase banks interest expenses from 1000 lei turnover by 1.0319;

- the average interest rate resulted in an increase of interest expense from 1000 lei turnover by 7.7399 lei.

### 3. Conclusions

Throughout the planning, management and control process, in determining the strengths and weaknesses, in identifying and creating competitive advantages, in developing and controlling budgets, etc., the factor analysis method provides a suitable instrument for detailing and quantifying the causes of conditions and developments of phenomena. Factor analysis also provides information necessary to deepen their methods and those obtained by others.[5]

Increased self-financing capacity of the entity while simultaneously reducing the level of bank interest costs 1,000 lei turnover will be possible as long as turnover index is greater than index of borrowed capital or in other words, growth in turnover to exceed the growth rate of capital borrowed: [3]

$$I_{CA} = \frac{CA_1}{CA_0} > I_{CI} = \frac{CI_1}{CI_0}$$

For increasing the efficiency of interest expense is necessary that the dynamic index of turnover exceed the dynamic index of the interest expense:

$$I_{CA} = \frac{CA_1}{CA_0} > I_{SD} = \frac{SD_1}{SD_0}$$

Also in the case of a high cost of borrowed capital, so a high interest rate, it can be obtained a positive leverage by choosing effective actions financed by debt, thus ensuring the use with maximum efficiency and speed of rotation of the entire capital.

**Based on the study we can retain some**

### measures to reduce bank interest expenses such as:

- reduction of the share participation of loans and debts assimilated to the financial coverage of current assets would help banks reduce interest costs to 1000 lei turnover and thus increase their profit;

- increase efficiency of operating assets by reducing the ratio of operating assets and turnover that will be a good situation in the economic and financial performance, situation that will be reflected in reduction in bank interest costs;

- avoid situations that require immediate liquidity shortages, which causes the company to call for interest-bearing bank loans;

- transform the facility of credit line attached to the current account, which allows each collection to be repaid in outstanding credit line with a bank, which may reduce interest;

- avoid contracting loans without any preliminary analysis of their actual return relative to the economic and financial situation of the company;

- lack of real and effective measures to reduce the firm's total costs and hence the bank interest costs;

- increase self-financing capacity of the entity;

- increase the efficiency of bank interest expenses from 1000 lei turnover by bringing forward the dynamic index of turnover on the interest expense.

Advantages of cost reduction measures must be maintained long term in order to ensure competitiveness of the company on short, medium and long term.

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## Critical Analysis of the Budget Process

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### Abstract

*The budget process has an important role in planning the economic and financial activity for the future. It consists in formulating a plan that contains elements that are connected with the main objectives of the company. To meet these objectives it is required a precise specification of them and careful monitoring during the year in question.*

*The budget is done with the purpose to show and control the financial resources available to the company. Budget is important to acknowledge the changes that occur in the economic environment so that decisions on business performance to be based on real data.*

**Key words:** budget process, budget.

**J.E.L. Classification:** G31

### 1. Introduction

A profitable activity requires a balance between revenues and expenses but also a time prediction of expenditure, receipts and payments. [1]

Conducting the company's business must be based on the budget process that involves specifying the expected income, the capital to be invested, the expenses involved and their expectations according to the company's investment plans.

Budgeting differs from company to company. Each company uses different techniques which require time spent differently. The management team responsible for carrying out the budget process has to coordinate and direct this process so as to be in correlation with the company's strategic plan. The team sets budget targets, follows their fulfillment, finds solutions for any differences that arise and monitors company's performance over the

period covered by the budget.

### 2. Necessity, content and structure

The existence of a trader is characterized by financial flows that occur during its evolution. Stage of its development is based on correct identification of weaknesses and strengths and knowledge of the outside.

So that the company to maintain and develop there must be developed an appropriate policy for the economical environment in which that company operates.

This policy is closely linked to the establishment of financial objectives and precise sizing of capital needs so that the company's activity to be profitable.

The budget process is based on realistic targets established by the company regarding the future activity of it and on presenting the policies and programs to be used in order to lead to better achievement of the objectives. This process is mainly intended to check the effectiveness of the usage financial resources available to the company.

Budgeting the activity or action taken by company's management is important because the budget has an essential role in leading and organizing the company. The budget is a tool for analysis and control of the economic and financial activity.

In time, the results for each type of activity of the company are compared to the objectives set out previously to analyze the performance of the company and employees. This comparison is intended to limit the expenses that have not been established.

The budget period is represented by the fiscal year but to have a full and effective control the annual budgets are divided into quarters, months or even weeks.

The budget process begins several months before the year in question and is made by a budget committee consisting of the Director of Budget and line managers (chief accountant, financial manager, sales

manager). Its implementation is monitored by the accounting department which subordinates to the budget committee.

The principal budget of a company has the following components: [2]

- a) sales budget;
- b) costs of goods sold budget:
  - the production budget:

In developing a profitable activity, the company should establish its production in accordance with the sales budget because it may appear the situation when the production does not cover sales forecast. Production budget shows the number of pieces whose production meet the budgeted sales and also the final stock of each product.

- direct materials purchases budget:

In determining the required quantities of direct materials the production budget has an important role. To calculate the total cost of these direct materials we multiply the purchased amount by the unit purchase price forecast. Direct materials purchases budget plays a role in maintaining stocks at a reasonable level.

- direct labor costs budget

As well as in the case of direct materials purchases budget, the direct labor costs budget is prepared based on the production budget.

- indirect expenses budget:

This budget includes the estimated total cost for each administrative cost (maintenance costs, insurance and local taxes, etc.) For companies with complex business, this budget is drawn up for each department and can be divided into fixed and variable costs to better analyze them.

c) selling and administrative expenses budget:

This budget is based on achieving its sales budget because a growth in it entails an increase in advertising spending.

- d) profit and loss forecast:

In preparing the profit and loss account it is needed information coming from:

- sales budget;
- costs of goods sold;
- selling and administrative expenses budget;
- information regarding other types of income and expenses that arise such as the income tax

It is believed that budgeting is based on respecting two basic functions, planning and

control, which depends on company size. Thus, the planning function should be closely correlated with the strategic planning process and it addresses to small sizes companies while the control function is addressed to large companies.

Making it allows management to observe and analyze the effects of individual budgets on annual profit. If the profit margin is too small, the management can make changes in the operational plans so as to improve the budget.

### **3. Characteristics and effects of the budget process**

The budget process is different from the notion of forecasting because it involves establishing a plan that is intended to be followed during the next targeted period.

The budget process of a company has several characteristics:

- enable a control over the management of resources of the company. It is important that both employees and company's leaders to know their rights and duties regarding all resources of the company;

- the implementation of this process involves a firm orientation to a goal: increase sales, reduce costs and increase profitability. It turns out to be important the achievement of a budget as if it were considered only the achievements of previous periods then it would not make good decisions as their accuracy would be missing by the fact that these results are based on past data that may change in future;

- the budget process requires the involvement of all departments of the company in achieving the organizational objectives. It follows an analysis of efforts and results of each department to see the balance between them and the general ones;

- also, this type of process allows the appropriate allocation of resources for every investment project as well as the monitoring of the business performance.

The budget must be finalized until the new fiscal year beginning because it works like a guide for company personnel and warn them about the inconsistencies that may occur.

The budget process involves establishing targets both at the level of the company and of the employees. Human behavior can cause problems if the objectives are too difficult or

easy to reach or if they conflict with those of the employees.

In the case of difficult budgetary goals to achieve, employees tend to feel discouraged by this because they think they will be rewarded according to their efforts. In this case, a viable solution is to involve employees in setting budgetary targets leading to better performance of tasks by them and hence a better achievement of objectives.

In planning the objectives, managers must establish goals that can be achieved but this does not mean setting them below those achievable in a realistic way. In this situation we include budgets that assume personnel higher than what is normally used. This solution is chosen to avoid situations where some staff is missing.

Thus, there are additional costs in an effort to meet budget because if at the end of the budgetary period the budget amount was not spent entirely then different acquisitions could occur to avoid the next budget to be consistent with current expenses.

Also, there may be a conflict of interest at the enterprise level when employees have different objectives compared to the ones of the company.

Using the budgeting by the company has positive effects on its activity if the situation is managed closely. Thus, the budget measures the performance by providing the necessary information to underpin management decisions during the year but also by monitoring the activity making an analysis of the differences that occur by comparing the current revenues with the budgeted revenues.

Once completed, the budget should not remain a fixed plan to be followed as economic conditions change constantly. It is preferable to be reviewed at regular intervals in order to be updated and to maintain a reality base from which to start making decisions.

The budget utility is provided by the fact that it controls the expenses and monitors if the target is met. But it may appear the situation when its effects are not desirable because the budget was prepared wrong. This occurs when drafting the budget focuses on investments that are not important for the proper development of company activities as it does not allow returns.

#### **4. Aspects regarding budget preparation**

##### *4.1 Difficulties in creating the budget*

Taking into consideration the fact that the budget preparation represents a complex process it may appear certain difficulties that may be corrected if the ones who prepare the budget give proof of attention and seriousness.[4]

To highlight the difficulties mentioned previously I present some as follows:

- the period of preparing the budget is expanded as the people involved in the project lose a lot of time and energy;

In this situation it is important to establish some general strategic lines to help reduce the steps in the achievement of budgets. There is also the possibility of creating partial budgets that contain complex calculations necessary to the general budget to avoid the lost time later with the situation.

- the analysis period of the budget targets is extended as the department heads delay decisions on data to be introduced in the budget and negotiations between departments and held with difficulty;

Changes made by the company's managers are applied with difficulty as they were hardly to agree upon.

In this case, it is possible to make different choices to be considered alternatives to the initial budget so that the decision regarding it to be made easier. Thus, shareholders or members may choose one of the proposed variants without wasting time applying the proposed changes to the budget and bring it every time.

In the case of specific budgets, they are analyzed separately and if the General Meeting of Shareholders is not happy with long term budgets then it is chosen the short-term budgets variant.

- the control made on the budget focuses on minor differences and not on the causes that rise to major problems

For a good review of the budget it is necessary a control over all its elements. Because it is impossible to analyze the entire budget in a relatively short time it is chosen a control over the elements where it may appear high financial implications.

- the created budgets may be considered too optimistic or too pessimistic;

As a comparison between the optimistic and pessimistic budget, we can say that it is better the second one because the management company would prefer to give consent on additional resources than on reducing the budget.

- the obtained budgets are difficult to be reviewed and can be considered to be restrictive;
- budgets require high expenses and time in their achievement;
- strictly respecting the budget it is reached the situation when employees focus more on meeting the requirements of the budget than on customer satisfaction.

#### 4.2 Tips in budgeting

Budgeting is a complex task that must take into account certain recommendations, including:

- more realistic estimate of revenues and expenditures;
- good communication and cooperation between business departments;
- collection of useful and realistic information
- use Excel to shorten your time calculations.

Achieving the budget is done by following the necessary steps (information gathering and analysis, budgeting) and may appear the situation when a company decides to form 2-3 variants. Ideally it would be that the start of achieving the budgetary process to take place 3-6 months before.

Also, data to be part of the budget must have a correspondent in the chart of accounts required by accounting legislation. These data must be sufficiently detailed to be comprehensible at the time of analysis. [3]

Previous year's budget should be considered only a starting point in budgeting for next year as a number of changes may occur in the future, such as changing legislation, purchasing power and preferences of buyers. Budget items should be examined thoroughly before being placed as it may appear several sources for the same information.

Although initially the budget is done globally, in the last stage, revenues and expenses are broken down by quarters and months because if they sell seasonal products revenues differ depending on the period.

It is important that in the case of costs to be specified all categories of expenses that may arise in the coming year to avoid the situation of not having funding for those omitted.

The most frequently missed expenses to be introduced in the budget refers to

- costs regarding the staff: recruitment, training etc;
- legal expenses: appears when a company is seen involved in a process;
- launch costs: occur when the company wants to make an investment and should investigate emerging market and other factors.

Is it possible that those who prepared the budget to predict that there may rise unexpected expenses in the future that can not be named at the time when preparing the budget and therefore choose to introduce in the budget an article entitled “Unexpected costs”.

## 5. Conclusions

Based on the above it can be concluded that the ideal budget should be done in close liaison with the company's strategy, should provide solutions of activities to meet the objectives and, most importantly, it should offer high revenues in relation with reduced costs.

The budget utility is to provide information for decision making and measurement of business performance of the company. The main disadvantage is the budget period referred to by the fact that business is in constant change and a medium or long term plan can not have results unless it is updated constantly.

We say that a proper development of economic activities require the presence of a budget as the most important problem that managers would face on it would be the situation when there is no budget.

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## The Need of Avoiding the Double International Assessment

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### Abstract

*Each state of the world has been always established the taxes in order to exhibit both the political and fiscal sovereignty. The state has been able to create its fiscal politics, its fiscal system, which do not contravene to the general international rights, do not favor some countries and do not oblige the states to the international double assessment.*

*As regards the direct taxes, the financial flows amongst states or between states and bodies, regional or internal institutions do not manifest directly under the form of amount transfers over the border, by being subservient to a state or another. The state has not transferred abroad and hasn't received amounts from incomings that signify direct taxes, income taxes or wealth taxes.*

**Key-words:** The double international assessment, The tax, Fiscal politics, Fiscal credit, Taxes exemption;

**J.E.L. Classification:** H21, H23, H25, H27, H30

As result of the contemporaneous cross-border mobility, as regards the persons and capitals, the phenomenon of double international assessment has been emphasized. The double international fiscal assessment signifies the tax submissiveness of the same chargeable matter, and for the same period of time, concerning the same taxpayer related to the two fiscal authorities of different countries. The double international fiscal assessment appeared to only direct taxes (taxes on income and taxes on wealth), no matter the system of perception used: the direct assessment,

source stopping, overtaxes, or additional quotas.

Giving a more complete definition and of large perception met within the fiscal doctrine, “the double assessment signifies the imposing to two (or more) taxes, which are similar over to same topic of the assessment, for the same chargeable matter and as regards the same period of time”. This can be exhibited as either double economic imposing, respectively the submission of the same income or of the same wealth to more taxes within a country; this is related to either judicial assessment or imposing the same chargeable matter twice, in different countries.

The double international assessment is in this way the result of superposing the two fiscal sovereignties, which exercise their right of assessment over the residents of that country.

### The need of eliminating the double assessment

The occurrence of double international assessment has been determined by the diversity of national fiscal systems, of the fiscal politics particularities, as well as by the way of using the taxes and duties at the level of each state. The contracting states had no obligation in order to eliminate the double imposing, where the conventions established were limited to consent the fact that there were interests on eliminating it.

Eliminating the double international assessment represents a need on ensuring the free development of the international economic relationships. The double imposing has become a barrier difficult to exceed to get

in the way of the external trade development and on the permanent extension of the economic, financial and technical-scientific cooperation, so that the elimination or its limitation has achieved an especial importance for ensuring the ascendant progress of the cooperation between states.

The progress of the external changes between goods and the economic cooperation between states have foreseen the discovering of measures and means necessary to avoid the double assessment on its income or on the wealth achieved on the territory of another state, in the view of supporting the international economic relationships.

### Means of avoiding the double assessment

In the running on avoiding the double assessment, Romania concluded fiscal agreements that aim the mean of sharing the assessment rights, wither by offering this rights in totality to one of the states or by sharing it between states for various taxes, which derive from those on the income or wealth.

The means necessary on avoiding the double assessment used within the conventions concluded between states, at which Romania is also part of, are the following:

- The method of exemption, by two admitted variants: the method of total exemption and the method of progressive exemption;
- The method of offering credits, by two particularities: the method of total crediting and the method of limited crediting.

In order to make a comparison of data provided by each member state as regards the taxes, The European System of Accounts was created in 1995, also known under the abbreviation of ESA951, by which finding a common denominator was carried out on classifying the national accounts and, within their frame, of the taxes and duties in the European Union.

#### *The method of exemption (exception)*

In accordance to this method, one might mention that the incomes or the residents' capital specific to a contracting state, which were imposible within the source state, will

be exonerated from the taxes within the residence state.

Regarding the first variant of this method, *the method of total exemption*, the incomes and wealth of a resident submitted to the taxation in the other state will not be imposed anymore within the residence state.

The incomes carried out in the other contracting state, and for which the taxes are owed and excise taxes are paid in the other contracting state, will not be included in the calculation basis of the residence state taxes, and will not be taken into consideration on determining the assessment quota in the residence state.

In accordance to the total exemption method, the tax owed in the residence state is calculated in the following way:

$$ISR_{mst} = VSR * CI_{sr}$$

where,

$ISR_{mst}$  – signifies the tax in the residence state, determined in accordance to the total exemption method;

$VSR$  – shows the incomes achieved in the residence state;

$CI_{sr}$  – signifies the assessment quota in the residence state, for the incomes achieved in the residence state.

As regards the second variant, *the method of progressive exemption*, the wealth or the incomes achieved in the other contracting state will not be imposed anymore in the residence state, but this is taken into consideration on establishing the assessment quota applicable for the total amount. The assessment quota calculated in this way is applied for the incomes or wealth achieved in the residence state.

In order to meet the progressive exemption requirements, the next calculation is used, in order to determine the taxes in the residence state:

$$ISR_{msp} = VSR * CI_{sr}(v_{sr} + v_{so})$$

where,

$ISR_{msp}$  – signifies the taxes in the residence state, determined in accordance to the progressive exemption method;

$VSR$  – shows the incomes achieved in the residence state;

$CI_{sr}(v_{sr} + v_{so})$  – signifies the assessment quota in the residence state for the achieved incomes.

### *The method of crediting*

The method of crediting has taken into account, as regards the determination of the taxes owed in the residence country, the plurality of incomes achieved in the contracting countries. In this way, the taxes owed in the resident state will be calculated as difference between the established excise taxes for all incomes and the taxes paid in the source state for the incomes.

Concerning *the method of limited crediting*, the residence state allows the deduction with tax standard paid abroad, and only up to a lower value or equal to the value paid in the source state. The tax paid abroad will be only deducted up to the limit of internal tax, which might be owed for incomes equal to those achieved abroad. The method of limited crediting is mostly met in the fiscal conventions concluded between Romania and the contracting states, in order to avoid the double assessment.

In accordance to this method, the tax owed in the residence state will be thus calculated:

$$SR_{mcl} = I_{tdr} - VSR * CI$$

where,

$ISRM_{cl}$  – signifies the taxes in the residence state, in the situation of using the limited crediting method;

$I_{tdr}$  – shows the total taxes owed by a resident for the total income of its capital;

$VSR$  – signifies the assessment quota within the residence state.

Concerning *the method total crediting*, the residence state allows the deduction from the total taxes owed abroad, without taking into account its volume.

The tax owed, in accordance to this method, will be therefore determined:

$$ISRM_{ct} = I_{tdr} - I_{ps}$$

where,  $I_{ps}$  – illustrates the excise tax paid abroad.

Instead of the crediting method, one might use the method of progressive exemption, when “in accordance to any arrangements of the convention, the incomes achieved by a resident within contracting state, or the wealth own will be exempted from excise taxes in that state; though, in order to calculate the excise tax over the rest of incomes or the wealth of this resident, the incomes and the exonerated wealth will be taken into account”, or when “in accordance

to any arrangements of the convention, the incomes or the wealth achieved by a resident of any contracting state will be exempted from the excise taxes in that state; this might also take into account the exempted incomes (or the wealth), in the view of calculating the incomes (or the wealth) related to the resident”.

### **Means of avoiding the double assessment on international level**

National mechanisms have been carried out in each state, by protecting the contributors of double assessment, and which do not depend upon the existence of the fiscal conventions. As regards the international practice, there are three basic ways on eliminating the double imposing, meaning:

- A. Taxes exemption – by excluding from the chargeable basic those incomes achieved from abroad sources;
- B. The fiscal credit – by taking into account the foreign excise tax credit;
- C. Passing the fiscal commitments paid abroad into the account of the expenditures carried out by the economic agent, also known under the tax deduction terms;

The first mean of tax exemption emphasizes the assessment exemption of the incomes or wealth, achieved on a territory different from the resident’s one.

The fiscal credit was applied, in contradistinction to taxes exemption, to only the excise taxes. The contributors, resident physical persons, which carry out incomes abroad and for which, in the running of the same period under taxation, have to respect the excise taxes in both the Romania’s territory, as well as abroad, benefiting of the right on deduction, from the excise tax owed in Romania and of the tax paid abroad, in the limit of the external fiscal credit.

Simplifying such definition, one might affirm that the fiscal external credit represents the amount paid abroad with excise tax standard, and recognized in Romania. The incomes achieved abroad by the physical resident persons, as well as the afferent excise taxes, expressed under the form of specific monetary units, but which are not quoted by the National Bank of Romania, will be therefore transformed:

- a) from the currency of the source state into an international circulation currency, such as USA dollars or Euros, using the currency exchange of the source country;
- b) the international circulation currency in lei, using the year mean currency exchange of it, communicated by the National Bank of Romania, from the year of carrying out those incomes.

The external fiscal credit is offered if the following conditions are met:

- the excise tax related to the incomes achieved abroad was paid directly or by source retention, fact proved by documents that attest the payment;
- the tax owed and paid abroad has the same type with the incomes owed in Romania.

Conversion in the national currency of the excise taxes on profit paid abroad will be carried out at the currency exchange communicated by The National Bank of Romania, starting with the calendar year date when payment was performed.

Deduction for the excise taxes paid to a foreign state in within a fiscal calendar year cannot exceed the excise tax on profit, calculated by applying the excise tax quota of 16% to the chargeable profit achieved in the foreign state, or to the incomes achieved in the foreign state.

The incomes for which the fiscal credit is offered are part of the following classes on incomes:

- independent activities;
- wages;
- cession on goods using;
- investments;
- agricultural activities;
- prizes and games of change;
- activities of trade arbitrage.

As regards the excise taxes, the external fiscal credit is determined by the fiscal institution, separated on each class of incomes and by reporting to the world incomes.

### Conclusion:

The world revenues signify the totality of impossible earnings of Romania and of all countries that include revenues of independent activities, wages cession of goods using, accomplished by Romanian physical resident persons.

The external fiscal credit is calculated individually for the incomes carried out in each country. The physical persons of Romanian nationality can justify the achievement of revenues abroad, and the afferent excise taxes, if they prove by documents issued by the fiscal institutions of abroad, by the employer or by any other foreign person that pays revenues taxes.

In the situation when a person achieves earnings and afferent taxes from more countries, the external fiscal credit will be calculated separately for each state, in accordance to the procedure previously mentioned.

The fiscal practice foresees more possibilities on avoiding the double assessment, amongst which: the national regulations, bilateral or multilateral agreements, the jurisprudence, the customary and the doctrine.

The modernization process of the internal fiscal legislation has been directed towards both the plan of perfecting the general system on excise taxes and dues, by comprising the issues related to the international taxation, as well as the way of redefining and updating some specific terms used within the international fiscal legislation, meaning: resident, permanent residence or external fiscal credit etc.

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## Social Insurance(s) versus Social Assistance

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### Abstract

*The economic crisis Romania has been going through strikes heavily the revenues of the general consolidated budget, causing a growing deficit as a result of the imperative expenses which need to be effected. In this category we find social insurance benefits and social assistance benefits which are unavoidably guaranteed by the state, by virtue of its role in economy and of the attributions it holds. Hence, this paper intends to distinguish the different significations and implications of the two concepts, so that, in the future, no foundation for their equivalence could be possible.*

**Key words:** Social insurance, social assistance, social insurance benefits, social assistance benefits and services

**J.E.L. Classification:** H55

### 1. Introduction

The satisfaction of needs which are of general interest involve a redistribution of collected funds at the disposal of the state, by means of public finances, under the form of public expenses. According to their functional structure, a rather important share, in most developed countries, is represented by socio-cultural expenses. These constitute an essential component of social policy supported by the state (the welfare-state) with the purpose of accomplishing three extremely important objectives [2]:

- guaranteeing a minimal income for all the members of the society, no matter the size of the property owned;
- diminishing the insecurity area of the individuals and offering them possibilities of protection in cases of unemployment, disease, old age;

- ensuring, for all the members of the society, some minimal standards of living by way of general public services.

These objectives attribute a social role to expenses targeted at social-cultural activities, which, taking account of their economic role (related to their influence on consumption and, consequently, on the goods and serviced production), activate as real instruments in the organisation and functioning of the national economy.

In Romania, the structure of public expenses for socio-cultural events, as presented by OMPF no. 1954/2006, with its subsequent amendments and additions, is as follows: a) education; b) medical sector; c) culture, leisure and religion; d) social assistance and insurance [12].

In specialized literature [6], the last ones also appear with the denomination of expenses for social security. The concept, used in the European Code of Social Security (ECSS), includes both social insurances and social assistance, and it refers to nine social domains: medical care, sickness benefit, unemployment benefit, old age benefit, employment injury and professional sickness benefit, family benefit, maternity benefit, invalidity benefit and survivors' benefit. The European Code of Social Security is a judicial instrument adopted by the member states of the European Council, in Strasbourg, on April 16, 1964, entered into force on March 17, 1968 and signed by Romania on May 22, 2002 (ratified by law no. 116/2009, published in O.M. no. 331/2009) [14]. It was elaborated on the basis of the provisions in Convention no. 102 of the International Labour Organization (ILO) [15], referring to minimal standards of social security, adopted in 1952. For each of the nine domains listed above, the Code establishes the risk covered, protected persons, benefits granted, eligibility criteria, amount of benefit, period of benefit allowance, and duration of waiting periods.

The Code also establishes certain percentages of social security benefits which must be granted in proportion to the anterior income of the beneficiary prior to the appearance of the social risk.

According to simple definitions, social security designates the corpus of measures, financial benefits or benefits in kind, given with the purpose of protecting the income in case of social risk [16], or social security represents the total amount of institutional methods aiming at repairing (eliminating or diminishing) the damaging consequences produced by different social risks [5]. Social risks can include: sickness, maternity, invalidity, old age, employment injury and professional sickness, death, unemployment, family allowances (according to ECSS).

Hence, social security can be defined as the collection of institutions and regulations, norms and measures which are activated once the social risks appear (or even for their prevention).

More than that, UNO General Assembly qualified the concept of “social security” as an inalienable human right, on the occasion of the adoption and proclamation of the Universal Declaration of Human Rights, on December 10, 1948, which stipulates, in article 22, that “*anyone, as a member of society, has the right to social security*”.

The same right is stipulated by the Romanian Constitution, article 47, alignment 1: “*The state shall be bound to take measures of economic development and social protection, of a nature to ensure a decent living standard for its citizens*” [7].

The concept of “social security” is often assimilated with the concept of “social protection”. An article with a very suggestive title [4] presents an extremely pertinent analysis related to the “connection” between the two notions, resorting to definitions from the judicial area, as well as the national and international theoretical areas. As a conclusion, the author remarks that by using the social protection notion, in a narrow sense, we plead for the synonymy between social “protection” and “security”, making reference to the system of social insurance and assistance, and by using this concept in a broad sense, besides social security, we also refer to labour protection, moral, cultural, civic protection, etc.

Therefore, in a narrow sense, social protection or security includes the institutions, regulations, norms and measures referring both to social insurances and to social assistance, incorporated into a national system of social protection.

In daily activities, these concepts (social insurances, social assistance) are often taken one for another. The gravity of the situation is even greater as it does not appear only in case of uninstructed persons, but also in case of professionals in the field.

The Romanian Constitution itself, in the same article mentioned above, but in alignment 2, records the following differentiation: “Citizens have the right to pensions, paid maternity leave, medical care in public health centres, unemployment benefits, and other forms of public or private *social insurances*, as stipulated by the law. Citizens have the right to *social assistance* according to the law” [7]. Therefore, social insurance and social assistance constitute two of the means to guarantee and respect constitutional rights with the aim to accomplish the objective of social welfare (social protection in the broad sense).

To conclude, after trying to locate the concepts in the social background, we will proceed to clarify their signification starting from some relevant criteria.

## 2. Social insurance

The present-day uncertainty, of almost every step we take, determines us to resort, voluntarily or involuntarily, to a corresponding solution, which is almost indispensable nowadays: insurances.

In general, insurances represent protection instruments while facing risks, which are sometimes inevitable (this entails preventing, removing and repairing their negative consequences), offered by various specialized institutions, in exchange for payment as contribution (insurance premium in the private sector). If these risks are of a social character (involving the state’s intervention), then insurances also acquire the same connotation.

According to a definition [6], social insurances represent those components of financial socio-economic relations which assist – in the process of gross domestic product distribution – in forming, allocating,

managing and employing monetary funds necessary for compulsory protection of employees and retired persons (...) as well as protection of their family members. In other words [1], social insurances constitute an economic contract between generations, the management of its development and the supervision of mutual compliance with the contractual provisions being the duty of the state.

The urgent necessity of social insurances, in a market economy, gives them an objective character. Nevertheless, their existence is strictly dependent on, for the most part, the contributions of those who benefit from them (in exceptional cases they are supplemented by subsidies from the state budget or revenues from various sources).

As a result, they are based on a contributory system due to which the various types of beneficiaries take advantage of a range of social insurance benefits if they comply with some criteria. The types of social insurance benefits include: pension (for age limit, early retirement pension, partial early retirement pension, disability pension, survivors' pension), allowance for temporary labour incapacity caused by employment injury and professional sickness (according to some conditions), death grant, quarantine allowance, unemployment allowance, medical care, allowances for social health insurances etc.

These social insurance benefits are guaranteed by law. The pensions' law, with its subsequent amendments and additions [8], stipulates that the right to social insurances is guaranteed by the state and it is applied by means of the *public system of pension and other rights of social insurance*, and the updated unemployment law [9], in article 1, demands that each person is guaranteed the right to *unemployment insurances*. The major system of financing the protection of the population's health is added to this, and it ensures access to a basic services package for the insureds, represented by *health social insurances* [10].

Most of the social insurance benefits have an unproductive character, representing the so-called “passive benefits”, namely a final expenditure from GDP. Nevertheless, lately, the “active benefits” have started to be used on a large scale, whose aim is, for instance, that of creating new jobs, professional

retraining, offering facilities for those hiring unemployed people, applying measures to prevent unemployment and sickness etc. This entails a growing effectiveness of funds for social insurance benefits, with a double effect: on the one hand, their pertinent usage and, on the other hand, creating added value (productive character) and, implicitly, economic and social development.

### 3. Social assistance

By virtue of the principles which govern our society, in general, (namely social solidarity, equity, reciprocity) and of the role of the state in taking particular “care” of its citizens, social assistance represents a “consolatory form” for those community members who are “less lucky”.

According to law no. 292/2011 [11], social assistance comprises social services and social benefits conferred with the purpose of developing individual or collective capacities so as to ensure the accomplishment of social needs, the enhancement of life's quality and the promotion of the principles of social solidarity and inclusion. Hence, social assistance is also guaranteed by law, each of its components being regulated with special concern.

The law also asserts that social benefits represent means of financial redistribution, while social services constitute the complex collection of measures and actions carried out in order to meet the social needs of persons, families, groups or communities, with the aim to prevent and surpass situations of difficulty, vulnerability or dependence.

Therefore, social assistance endorses the material protection and support for persons, families, groups or communities with special problems, who find themselves in difficulty as a result of economic, physical, psychic or social circumstances, without having the possibility to ensure, through personal means and efforts, a decent living for themselves.

The suppliers of social services and, implicitly, of social benefits, can be the state – by means of central and local public administration – the local community and the civil society.

The right to social assistance is conferred to persons or families who meet the eligibility criteria stipulated by the law, generally, without a monetary contribution

(there are situations when the beneficiaries, depending on their income, can contribute to the financing of social services given to them, or, in exchange, they can perform activities or jobs of local importance for the community, on a monthly basis). As a result, the supply of social services and the granting of social benefits (monetary or in kind), is not based on a contributory system which is especially designed, but it relies on funds allocated, with this purpose, mostly by the central and local public administration (from the state budget, local budgets, collections from various sources etc.), but also by the approved local communities and civil societies.

The system of social benefits, forms of financial transfer, comprises family allowances (state child allowance, complementary family allowance, child raising allowance etc.), social aids (minimal guaranteed income, aid for home heating etc.), allowances and facilities (monthly allowance for seriously disabled adults, monthly food allowance for disabled children with HIV/AIDS etc.), as well as other forms of support (financial support for new families etc.) [16].

From an economic viewpoint, expenses with social services and benefits are considered to be unproductive as of revenues, “overburdening” the state increasingly, in proportion to their growth. More than that, these expenses can slow down the rhythm of

economic growth due to some effects which are contrary to the expected ones (for instance continuous poverty, the growing number of divorces – as a result of social aids given to mono-parental families – etc.). Therefore, it is considered [6] that direct social aids must be conferred in a limited amount, so as not to encourage non-work or to transform the helped persons into permanent assisted people. This is why it is vital that social assistance measures should be corroborated with prevention measures (if they are less costly and in where it is possible) for difficult situations which could lead to allocating funds with this purpose. This needs even more consideration since expenses for social assistance are constantly increasing, from year to year.

#### 4. Conclusions

In order to ensure social welfare, social assistance and social insurances constitute an objective necessity which requires to be accomplished and, at the same time, they attempt to become (and they sometimes succeed) a method of eliminating the “black stains” which block the progress of society in general, and of the individual, in particular.

In order to get an overview of the two concepts explained above, below we include a comparative table based on the criteria we have mentioned.

*Table 1. Social insurance(s) vs. social assistance*

Comparison criteria	Social insurances	Social assistance
1. Nature	Expenses for social security	Expenses for social security
2. Purpose	Ensuring social welfare	Ensuring social welfare
3. Objectives	<ul style="list-style-type: none"> <li>- Constituting funds with implicit destination</li> <li>- Protecting insured categories so as to prevent, remove and repair negative consequences of social risks</li> <li>- Transforming a part of these expenses in investments under the form of human resources (active benefits)</li> <li>- Finding viable solutions for covering budget deficits.</li> </ul>	<ul style="list-style-type: none"> <li>- Protecting, motivating and integrating underprivileged categories</li> <li>- Satisfying (at least at a minimal level) their basic social needs</li> <li>- Finding solutions so that the amount of these expenses should decrease, in favour of solutions for the prevention of difficult situations</li> </ul>
4. Definition	That component of monetary socio-economic relations supporting the formation, distribution, management and employment of monetary funds necessary for the compulsory protection of employed and retired persons, as well	Material protection and support for persons, families, groups, communities that face special problems, or are in temporary difficulty because of economic, physical, psychic or social reasons,

	as of their family members.	without any possibility to ensure, by their own means and efforts, a decent living.
5. Suppliers	The state	The state, the local community and civil society
6. Beneficiaries	The insured persons (when they meet the required criteria)	Categories of people meeting the eligibility conditions according to the law (assisted persons)
7. Financing system	Contributory	Non-contributory
8. Financing sources	Social insurance state budget, unemployment insurance budget, national unique fund for health social insurances, constituted on the basis of contributions and, exceptionally, on subsidies from the state budget or other collections from various sources	The state budget and local budgets, funds of civil societies and local communities and, exceptionally, from contributions or other collections from various sources
9. Forms of manifestation	Social insurance benefits (pensions, indemnities for temporary work incapacity, death allowance, quarantine indemnities, unemployment indemnity, medical care, indemnities for health social insurance etc.)	Social services and social benefits (family allowances, social aids, indemnities, facilities and other type of support)
10. Guarantee method	By the Constitution and other specific laws	By the Constitution and other specific laws
11. Economic character	Passive benefits – unproductive character Active benefits – productive character	Passive benefits – unproductive character
12. Financial character	Parts of GDP as a result of its process of distribution	A part of GDP as a result of its process of distribution
13. Social-economic utility	- It influences consumption and, as a result, the production of goods and services - It provides assistance for the individual’s “wellbeing”	- It influences consumption and, as a result, the production of goods and services - It provides assistance for the individual’s “wellbeing”
14. Current trends/tendencies	Great deficits are recorded, and they need to be covered at the expense of other economic objectives	The growing number of assisted persons and, implicitly, of the amount of social benefits granted.

Source: Own processing based on above information

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## Ways to Increase the Effectiveness of Financial Control in Local Public Administration

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### Abstract

*Financial control in local public administration must be efficient and effective. Now the question arises whether it should be cost-effective. When it discusses the effectiveness of financial control, place, often equate efficient and cost-effective, which give rise to perplexity among those involved in the Organization and functioning of the control. Up to a point, the two concepts have the same content, the efforts made for the Organization, operation and control of the financial cover with revenue and remain and a profit. For financial control work yield can be calculated only if the two pointers, one that refers to the efforts and the size effect of concrete, you can quantify and accurately.*

**Key-words:** public administration reform, quality management, strategies for reform, convergence.

**JEL Clasification:** H83, O47

### 1. Introduction

In the case of financial control, the efforts may designate, but the effects are of two broad categories: direct effects, that you can individualize the control activity in order to compare it with the efforts of such individual (supervisor personnel costs, transport costs, accommodation and subsistence expenses, etc.), and indirect effects, which are propagated or induced into the system without having to be located at the level of financial control.

An attempt was made to quantify the effectiveness of financial control by the rise in this period to some performance indicators, including the amount brought in.

Only to the efforts and direct effects can calculate directly the profitability of financial control, actions for the rest of the following

to apply a general assessment of its effectiveness. It is necessary that the actions of the control to be placed in category efforts and direct effects.

It is necessary that the actions of the control to be placed in category efforts and direct effects.

### 2. Improve the efficiency of financial control

Increasing the efficiency of financial control in local public administration shall remain a coordinated.

Financial control work depends crucially on the determining factor and absolutely indispensable, in implementation of its human element. „In no other human activity plays a role not so important in achieving optimal conditions and efficiency objectives, as in control. This is because by its very nature, general activity and particularly financial control, provides the exercises up to the position of the control, which can be particularly harmful if used improperly or destructive. On the other hand, the system of interests in which automatically and involuntarily almost any financial controller is involved, regardless of the structure and level of verification would have on his influences such as to harm the performance of control under conditions of legal provisions and in accordance with the requirements laid down by the a priori control programmes”(Pereş, 2005, p. 322).

A practical way of increasing efficiency of financial control in the local public administration is switching on a wider scale to control performance, which is a great alternative perspective.

Monitoring performance is fundamental objectives:

- efficiency;
- the degree of economics, involves minimizing the cost of the resources

allocated to achieve the expected results of an activity, maintaining quality passes those results;

- the effectiveness of programmes and activities that public authorities have to be carried out for the benefit of local communities.

Control performance boosts creativity, performance and progress.

Figure no. 1



Another condition for improving financial control in the local public administration is to *ensure the stability and clarity on the regulatory framework under which it is held.*

Frequent amendments and completions of normative acts in the field of finance, at short intervals, hamper and even distort financial control work which must adapt to the changes in legislation that targets were made during that period.

In Romania the instability of legislation, in particular the tax became a phenomenon observed with chronic, and criticized both at home and overseas investors. The new tax Code, in a period of a year and a half, has been changed ten times and still calls for amendments thereto. Fiscal procedure code at the same time, has been amended several times.

Legislative instability affects negatively the work of control by the fact that:

- the lists of themes and objectives must always check amended;
- training of control bodies must be repeated and always adapted to new conditions imposed by legislative changes;

- the risk to err in the control grows, whereas rules are different for the same objective within the period under examination.

Quality of normative acts establishes that texts are written concisely and precisely, no doubt to different interpretations and endless discussions between control bodies and establishments, or persons controlled compartments.

*Rigorous selection and training of personnel engaged in continuous structures or in bins with powers of financial control is a new direction for action for improving financial control.*

Financial control work which does not require professional competence can be achieved without thorough education and training specialist continues those exercises, permanent changes in the law, business law and controlled activity for learning new tools, processes and methods of activity of financial control.

Without people well prepared professional and competent, the activity control does not have the necessary effectiveness and contribution of the financial control efficiency in the use of financial resources is low. At present, this activity of financial control are assigned appropriate training unemployed persons with secondary education, sometimes the other.

*Financial stability-control system* has influence on the improvement of financial control and efficiency gains. Frequent changes that have occurred in the last period of the control bodies of the competence of a body to another work influenced negatively. Financial Guard, the customs authority, the body of Government Control, once they are subordinated to the Ministry of public finances or the Government, other time under the control of the national authority for Control, and back to the Ministry of Public Finances or from the Government. So, instead of having to deal with the activity control and to refine, these institutions are all organized and reorganized at the expense of quality.

Another direction of action that leads to the improvement of financial control activities is *to increase the responsibility and liability of the persons carrying on activities in this area.* Self-employed financial control independence must be compared with the

controlled structures and personnel to be able to analyse, propose or take the necessary steps to remedy the causes that generate or contribute to deviations from the legal rules or objectives.

Increase accountability should be accompanied by increased accountability on the use of time affected the actions control on the measures proposed or taken and, when necessary, and to respond to the damage that they bring to the authorities or control.

*Collaboration and cooperation between the powers of control bins and other compartments of the local public authorities* contribute to enhancing the efficiency of the activity of financial control. Bins of agricultural taxes and fees, budget, financial accounting, legal can provide useful information for stock control. In many local public entities there is no collaboration between organizational divisions involved in the assessment, management, evidence collection, financial resources, a fact that is missing the financial control bodies of a database of documentation necessary for control and efficiency gains. This situation is the lack of manual and the circulation of documents.

*Avoid comparisons and overlays in the activity of financial control* is another direction which can improve the efficiency of financial control. In practical activity of financial control is manifested in some analogies and overlapping organs of control. Duplication in financial control work occur when two or more bodies were established by different rules, tasks of same or similar verification. Duplication in financial control activity arise when the same taxpayer, public entity or the same bin meet two or more financial control bodies or they are very short intervals of time. Overlays and comparisons have negative effects on both the control and supervisory body.

On the changes and update the legislation on various financial control bodies must follow to avoid and kind of parallelism of tasks of a supervisory body.

*The flexibility of financial control* is one way of improving the activity of financial control. Monitoring programs developed by the Court of Auditors, by the local public administration authorities through specialized services, the Ministry of public finances are

useful and are a tool for planning and management which helps to conduct an activity organised. These programs must be flexible, in view of the changes that occur.

In situations where the control programs do not give an opportunity to the adaptations or changes in management instruments are converted into instruments of braking.

Financial control in local public administration can improve with *improving accounting activities*. The accounts and records of the technical-operational and accounting is the most important source of information for financial control and represent the object of control activity.

Accounting is a special activity, knowledge measurement, evaluation, management and control of assets, liabilities and capital and reserves as well as the results of the work done. It must ensure the chronological and systematic registration, processing, publishing, and preserving information about the financial position, financial performance and cash flow for both domestic customers and in dealing with creditors, clients, public institutions and other users, including organs of control. Accounts of public institutions provides information officers with regard to the implementation of the budget of revenue and expenditure at the heritage, as well as the preparation of the general account budget execution. For improving the quality of accounting information, documents, records, accounting and technical-operative they make available to financial control, it is necessary that in all public entities to accounts result in double, economic-financial operations to be recorded in the accounts on the basis of the principles of rights and obligations in accounting (at the time of the creation, transformation or disappearance/an economic value, of a debt or obligation). Are required, the establishment and improvement of the rule by the public entity for all operations conducted, starting from the preparation of supporting documents pending completion of quarterly and annual financial statements.

Another direction that leads to the improvement of financial control in local public administration improvement Act is a Court of law courts. Against some of the measures ordered by the acts of financial control, those who make complaints to the Court.

*Combat and prevent the phenomenon of corruption* among the self-employed financial control contributes to improving such checks with the local public administration. Media in the face of public opinion brings numerous cases of officials of financial control departments involved in cases of corruption (hold assets with values much higher than the income of the salary and other sources of income have not). This phenomenon of corruption in public administration is noticed and criticized by Romanian citizens and foreigners, is critical in all presented country reports drawn up by the Commission of the European Union which relate to our country, but the remedies are timid.

Promoting good governance and a trustworthy public administration entails:

- strengthening national legislation and procedures relating to procurement, in order to promote an effective process, open and transparent procurement to align with European and international standards;
- improving the efficiency, transparency and accountability in the preparation, implementation and monitoring of budget implementation for compliance with international practices laid down by the European Community;
- the establishment of professional and stable public services, with personnel and the maintenance of legality, integrity and transparency through effective legal frameworks, as well as legal review of administrative decisions in accordance with international practices and to promote the implementation of the recommendations of the public service ethics and codes of conduct;
- the establishment of effective external audit institutions and practices at the level of international practices and standards established by the European Court of Auditors and the Member States of the European Union;
- strengthening parliamentary supervision by the Ombudsman institutions and provision of organs investigatoare with sufficient human and financial resources and to ensure transparency with regard to

sponsoring of political parties and electoral campaigns.

*Increasing the prestige of the financial control bodies in the local public administration* and their contribution to the efficient management of public patrimony cannot be financed only with people who have a moral obligation and a flawless, beyond doubt thorough training. Persons working in financial control are compromised and must be removed from the control system.

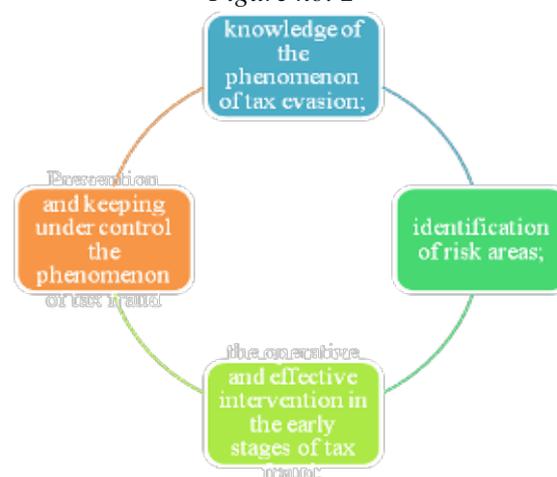
Financial control is able to bring a high contribution *to improve the forced execution of claims by local budgets*. Year by year, not to collect certain percentages of their own local budgets incomes.

Financial control, in particular the tax inspection as part of its public administration has as its main task *the prevention and limitation of tax evasion* and, thereby, increasing the incomes of the county or local budgets. Where evasion is detected, it is most often fails to recover at least part of the budgetary losses. The number of cases of tax fraud is dependent upon the ability to control.

In this case, the question which must be herd people in local public administration to deal with detecting and sanctioning tax fraud?

An excessive number of them would produce a pressure control taxpayers unbearable, hitting directly in their good economic activity went. A number insufficient provision would lead to excessive freedoms intended to contribute to the growth of the phenomenon of fraud. Optimizing control in the financial control of local public administration may constitute a measure likely to lead to (figure no. 2):

Figure no. 2



In addition to the existence of clear, stable regulations, applied fairly and effectively, awareness, reducing fiscal pressure on taxpayers, financial control has a special role in *the prevention and keeping under control of tax fraud*.

Tax avoidance detrimental to society as a whole, through the allocation of the budget incomes, which leads to insufficient financing of social and economic policy of the State, but also by practicing unfair distortion of competition and the business environment.

To ensure the equality of citizens in the face of tax and for maintaining a healthy business environment in which competition to be held correctly, National Tax Administration Agency leads a dynamic and constant struggle to identify and reduce tax evasion.

A direction of action important National Tax Administration Agency is a brisk actions for taxpayers, bad company, while reducing fraud in the collection phase, meaning a reduction in force or to the disposal of assets. Thus, taxpayers with debt outstanding to be notified, you will be able to prevent forced to evade the goods to be valued.

Through its objective of strengthening financial control to businesses that use public funds, National Tax Administration Agency guarantee in relation to the company, financial discipline and compliance with the law by them.

### 3. Strengthening financial control

The use of public funds is a range of risk from the point of view of financial times and evasion of indiscipline. Therefore, subsequent financial control exercised by the State shall be carried out on the basis of annual programs and monthly, quarterly, National Tax Administration Agency continues to follow with great attention to the use of public money in the businesses involved.

The guidelines, which will lead to strengthening financial control in the future, to better management of this activity, through the following actions:

- development of instruments for the management of the business;
- development of a rating system on the basis of indicators of financial controls or

themed background;

- development of methodologies and procedures for financial control adapted to the diversity of operators control;
- development of informative guides for internal use;
- implementation of computerised procedures for the preparation and the grounding of financial control, and on the basis of the taxpayer from the tax.

### 4. Conclusions

Improving financial control in the activity of local public administration is reflected in the contribution brought to the local budgets income growth and increase efficiency, effectiveness and cost-efficiency in the management of administrative-territorial units patrimony.

However local authorities creates the opportunity to provide local communities more public services and at the same time better quality.

It is necessary to optimize control measures to ensure that the economic effect (attracting additional amounts to the budget) to be as safe and effective, and to have obtained the result to avoid transgressions in the future.

Also, the pursuit of the activity of the inspectors should lead to a better use of working time (efficiency).

The lines of action for the implementation of this strategic objective are:

- preparation of quarterly and annual programmes, to organise and conduct monthly business tax inspection based on the results of risk analysis of taxpayers and the degree of risk of territorial areas;
- achievement of fiscal auditing actions for checking the activity of the territorial structures with tax inspection tasks, including how they are fulfilled the objectives set out in the programmes of activity

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## Are there any Solutions for Improving the Quality of Life in Romania?

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### Abstract

*This is a paper that draws the attention on the possible solutions needed to improve the quality of life. People's quality of life should be studied in terms of the social facets of the concept, which combine the micro, mezzo and macro – social levels; it starts with the individual and then moves on to different social groups and human communities.*

*In the past, the attention was focused on a few important economic indicators: GDP, CPI, unemployment rate, level of household income, etc. Now, the quality of life has become an attraction for policy makers.*

*A sustainable high-level quality of life and wealth for all the members of the society is the ultimate goal of the public policy. The attention is currently focused on fostering economic growth and creating more jobs. But will this be enough for achieving a better quality of life and more wealth on the long run?*

**Key words:** quality of life, technology, GDP, CPI, unemployment rate.

**J.E.L. Classification:** O11.

### 1. Introduction

The quality of life can be defined as the value of a man's life, provided that the conditions of human life offer the opportunity to meet many of his needs, the degree to which life is satisfactory to humans; therefore, the quality of life can be seen as a relationship between the existing state and its assessment by the population [1].

The quality of life embraces the multiple dimensions of human experience that affect wealth. The quality of life is expressed through both objective and subjective indicators. The objective indicators are those indicators which are external to the individual and encompass the measures of

material living levels and their components, as well as family life, physical and mental health, work, environment, and so on. The measures relate both to the factors whose increase raises the level of the quality of life, such as the level of nutrition or life expectancy, and to the negative factors, such as pollutants and crime, whose increase lowers the level of the quality of life. The subjective measures are self-reports of personal wellbeing, obtained through surveys regarding happiness, general life satisfaction, prevalence of positive and negative moods [2].

The quality of life indicators attract more and more the attention of policy makers. In the past, the attention was focused on a few important economic indicators, such as: the GDP, the CPI, the unemployment rate, the level of household income, etc. Now, the quality of life has become an attraction for policy makers.

Training, education and culture are indicators of great importance in evaluating the standard of living and the quality of life. The degree of training, education and culture depends on the quality of labor, the quality of the goods and services created, the quality of social and inter-human relationships, the intensity of participation in the scientific, cultural and artistic life, the way social institutions function, management efficiency.

The quality of the socio-political environment depends on the way the conditions for achieving civic freedoms, according to which people can think freely, express their views, capitalize their physical and intellectual skills according to their own belief and manifest themselves freely in all the areas of social life are provided.

People's quality of life should be studied in terms of the social facets of the concept, which combine the micro, mezzo and macro – social levels; more exactly, it starts with the individual and then moves on to different social groups and human

communities, in order to reach the society as a whole. Since the contemporary development “acts as the establishment of two processes, sustainable development and human development”, the quality of life can be considered to be the effect and measure of the economic and social progress [3].

A sustainable high-level quality of life and wealth for all the members of the society is the ultimate goal of the public policy. However, the attention is currently focused on fostering economic growth and creating more jobs. But will this be enough for achieving a better quality of life and more wealth on the long run?

## 2. The Romanian reality

60% of Romanians live on less than 800 RON (Romanian (New) Lei) (around 160 pounds) per capita each month, around 2400 RON monthly for the statistic household, but life is also much cheaper than in other countries. Overall, the GDP PPP/capita is around 45% of the European average, but there are many disparities between the rich and the poor, the urban and rural area and so on. Unfortunately, a lot of people do not have enough money to buy what they need and a significant part of the population has problems covering even the basic needs. Services are, on average, under the Western level, but they are functional. However, if one has enough money, living in Romania is not so bad, especially in the big cities.

Public transportation in big cities is quite good and relatively cheap. Trains are quite expensive and slow. The main roads are usually crowded.

The public health system is not very good (you need to pay for certain services and to tip the doctors and nurses in some cases); in the big cities, private health is a better alternative. Regarding the beautiful regions, all the mountain, hill and plateau regions are extremely beautiful, especially the south of the country. Bucharest is the capital and the biggest city and, like any other big city in the world, has pros and cons; but one should not avoid it.

## 3. How can the quality of life be measured?

The success of a national economy must be measured by the affluence and the quality of life of the citizens. The traditional method of measuring economic success is basically based on one single material parameter, expressed by the GDP. The aspects beyond the pure success measured by production such as the quality of life, environmental richness, the aspects regarding social assets and distribution, are still not sufficiently taken into consideration.

International comparisons of the quality of life conditions almost always point to a strong positive association with the real GDP per capita [4].

The GDP measures the gross domestic product of a nation, which is the market value of all final goods and services produced during a given period. Because the production of goods and services indicates that people are working, earning money and making a living, an increasing GDP shows an increased economic activity, meaning more funds for social programs and more incomes and that people have to increase their own standard of living [5].

The GDP is a good indicator of the quality of life improvement for a large number of people, because it measures productivity.

A country's GDP growth is an excellent indicator of the quality of life improvement, simply because it measures the amount of work that is being done and the productivity resulting from that work. The higher the GDP is, the better is the economy and, therefore, the better is the quality of life.

The GDP is but one factor in an extremely complex world economy. However, in general, even in reductionist terms, GDP growth can indicate a strengthening economy, more jobs and, therefore, more incomes for the individuals. This does not necessarily improve the quality of life, at least not right away. A better job (or any job) is a good thing, but if an individual is thoroughly in debt, it might take some time to improve the quality of life.

A number of other factors influence the quality of life as well: for example, the access to healthcare, vacation or leisure or a healthy environment.

Sometimes, as in the case of happiness and

life satisfaction, the quality of life indicators remain unchanged, even if the real GDP per capita doubles or even more than doubles. In contrast to the results of simple international point-of-time comparisons, history suggests that improvements in many realms of life are not an automatic result of economic growth [6].

#### **4. Measures of preventing the deterioration of the quality of life**

Among the measures that should be taken for preventing the deterioration of the quality of life, in order to introduce a better allocation of the public budget, that is mainly orienting to social sectors, given that, according to EUROSTAT, in 2007 Romania was allocating only 12,8% of the GDP to social policies, compared to the EU average of 26.2% (according to the methodology of EUROSTAT, education expenditures are not considered social expenditures and therefore are not included in these values) we mention [7]:

1. Supporting public policy decisions, recently adopted for vulnerable population categories: introducing social pensions, subsidies for stimulating the employment of different categories of people.
2. Budgetary expenditures, oversized in relation to the existing resources.

a) Social "luxury" non-contributive benefits (or with insignificant contributions):

- Subsidies for some students in public higher education and, in addition, providing scholarships for students with a good and very good situation;

- Service pensions determined at 85% of the last monthly salary income;

- The child-rearing leave until the age of 2 years, granted to one of the parents, plus the excessive values of some allowances of those who have high incomes (up to 4,000 lei);

- Favoring women regarding five years earlier retirement in comparison to men, which is acceptable, given their social role; however, the formula for calculating the pension, which leads to a higher pension income for women corresponding to an equal assured income is not acceptable (for example, according to Law 19/2000, in 2001 the retirement age for women was 57 years and 62 years for men and full contribution stages were of around 25 and respectively 30

years. In these conditions, a 57 year old woman and 62 year old man with 30 years seniority and an assured income equivalent to the average salary at national level had a different treatment regarding pensions, meaning that the man had one pension point while the woman had 1.2 pension points. If we consider the ages and maximum stages under the respective law - five years higher for men - and we consider 40 years of activity for women and 45 years of activity for men, with an assured income equivalent to the average salary at national level, women would get 1.33 pension points while men would get 1.28 points, even if they work for five more years).

b) Budget allocations for institutions and oversized activities:

- National radio and television companies;
- Secret services;
- The ministerial apparatus, including activities abroad;

- The army - based on the employment contracts of the military;

- Participation in international sports competitions;

- Investment and public acquisitions that are not always justified (based on needs) and have excessive costs, various donations and grants.

3. What should there be done in the immediate future in order to improve the living conditions of the population:

- Increasing the absolute level of the budget revenues as well as their share in the GDP, primarily by collecting the amounts owed by taxpayers without exception, by eliminating undeclared work, including the contracts that declare only part of the salary (practiced in the private sector). The state could also obtain resources from its owned properties, including through privatization. It is expected that, without increasing taxes, budget revenues should reach up to 40% of the GDP, compared to around 30% today. In these conditions, the respective value would remain amongst the relatively low ones within the European Union.
- Prioritizing the allocation of budget expenditures for education and research (an absolutely necessary measure in the knowledge society), for

health services and social assistance; Reducing the wages in the budget system by 25% will increase the migration of the professionals from the healthcare system, which is already facing a severe lack of qualified personnel.

- Resizing and possibly redistributing the number of employees from the central and local government towards the areas of the system that are facing deficit;
- Avoiding limiting and homogenizing salaries in the public system (Law 330 considers a ratio of 1 to 12, although in reality this ratio is of 1 to 8, with a very low value for the contributions of the specialists in all the areas to the country's development, the last four levels being reserved for a small number of functions in the public authorities system).
- Monitoring the evolution of school enrolment in general and higher education, preventing school dropout, early school leaving, providing appropriate conditions of study in the rural areas as well (closing schools does not solve the problems of children);
- Strictly applying the principles of the unique retirement system, generalizing contributions, assuring the payment of the farmers' special pensions and social pensions from the public budget and not the social insurance budget. It is necessary to consider the legally obtained pension as a right earned for having a decent life, without sacrifice curves; introducing additional amounts to the pension from the public insurance system for service pension beneficiaries (in fact, occupational pensions). With time, the latter should be generalized to all state employees as a motivational bonus for quality work. The minimum target for the level of old-age and full seniority pension should be 50% of the assured income, updated by the average salary at national level from the year of payment (the value of the pension point), in order to get as close as possible to what is practiced in many countries of the European Union. (As a measure of slowing down the growth of high

pensions, one may enter a maximum limit, such as, for example, a limit of eight times the average pension); fully collecting the social contributions due to the extended social insurance coverage; avoiding early retirement, including retirement pressure on the people who can and want to work, even if they have the transitory or standard retirement age.

It is unacceptable that, on the one hand, early retirement is forced and, on the other hand, the lack of funds for decent pensions, obviously, eliminating the unjustified pensions, is being claimed. One should not ignore the fact that some of the contributions of the young insured persons are now already passing to the mandatory private insurance system (3.5% - currently and up to 6% of the assured income - in the future), which calls for supporting the social insurance budget from the public budget. It is expected that in Romania pension expenditures will have a share of at least 10-12% of the GDP, compared to about 8% today, since the retired represent at least one quarter of the country's population, respectively one third of the adult population [8].

A general measure expected to be implemented in the Romanian society refers to eliminating the appointments in various economic executive positions and public institutions or in the boards of directors made on political grounds. This measure would eliminate one of the sources that lead to the image of privileging politicians in Romania [9].

## 5. Conclusions

Europe 2020, a strategy for jobs and smart, sustainable and inclusive growth, is based on five EU headline targets, which are currently measured by eight headline indicators (see table 1) [10].

The financial crisis has had a major impact on the capacity of European businesses and governments to finance investment and innovation projects. To achieve its objectives for Europe 2020, the EU needs:

- A **regulatory environment** that ensures effective, secure financial markets,

- Innovative instruments to finance the necessary investment - including public-private partnerships.

These long-term growth priorities have been taken up in the Commission's proposals for the next multi-annual financial framework (2014-2020) of the EU.

At present, the European Regional Development Fund, European Social Fund and Cohesion Fund together account for more than one third of the EU's overall budget.

These tools help to ensure that money is invested effectively in order to support smart, sustainable and inclusive growth.

*Table 1 – The EU’s headline targets and the headline indicators for jobs and sustainable growth*

Headline targets	Indicators
75 % of the population aged 20-64 should be employed	Employment rate by gender, age group 20-64
3% of the EU's GDP should be invested in R&D	Gross domestic expenditure on R&D (GERD)
Reduction of the greenhouse gas emissions by 20% compared to 1990 Increase in the share of renewable energy sources in final energy consumption to 20% 20% increase in energy efficiency	Greenhouse gas emissions, base year 1990 Share of renewable in gross final energy consumption Energy intensity of the economy (proxy indicator for <i>Energy savings</i> , which is under development)
The share of early school leavers should be under 10% and at least 40% of 30-34 years old should have completed a tertiary or equivalent education	Early leavers from education and training by gender Tertiary educational attainment by gender, age group 30-34
Reduction of poverty by aiming to lift at least 20	People at risk of poverty or social exclusion ( <i>union of the three sub-indicators</i> )

million people out of the risk of poverty or social exclusion	<i>below)</i>
	People living in households with very low work intensity
	People at-risk-of-poverty after social transfers
	Severely materially deprived people

*Source: European Commission, Europe 2020*

EU funding is helping to support:

- More and better jobs
- The development of new technologies
  - Cutting edge research
  - High-speed internet access
  - Smart transport and energy infrastructure
- Energy efficiency and renewable energies
  - Business development
  - Skills and training
  - Reaching the goals
  - EU tools for growth and jobs
- The Gross National Product (GNP) is the market value of all the products and services produced in one year by the residents of a country. The GNP is widely used for measuring the financial activity of a nation and is also thought to be a measurement for the standard of living. We know that the GNP includes the activities that do not improve the quality of life, such as the costs caused by accidents, criminal actions and natural disasters. This is a reason for creating other measurement systems such as the Index of Sustainable Welfare (ISEW), the Genuine Progress Indicator (GNI) and the Human Development Index (HDI). Some governments are discussing the benefit of moving over to some of these systems.

- Europe 2020
- Reaching the goals

Government intervention should be simultaneous, both in favor of the accession and integration into the EU, and of human development, creating a new dynamic of change in Romania, which would solve the profound inequalities at the human level and creating a fair, competitive and productive society. The human development policy

should include a wide range of targets, such as the per capita income growth, improvement of health services, developing opportunities for education, citizens' access to resources, promoting the participation in public life at a more widely level and creating a clean environment [11].

The strategy for human development in terms of accession and integration into the European Union strengthens the link between economic growth and human development. This strategy highlights, on the one hand, the way in which economic growth can promote human development, and on the other hand, how human development can promote economic growth. Therefore, any response that supports the economic integration process must include two key objectives: equitable distribution of wealth and optimal use of available resources.

## 6. Acknowledgements

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# The Origins of the New York Stock Exchange

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## Abstract

*The origins of the stock market go back to the early 1600s, when the first stock (primarily involving the shipping and spice markets) was issued. Later on, the governments of the time decided to sell bonds to raise money for the wars they were involved in. That is precisely what the new U.S. government did during the Revolutionary War. Since they did not have the funds to pay for the war effort, they issued bonds with a promise of repayment in the future. After the war, those in control of the bonds began trading them for immediate compensation. Also, the nation’s first banks started selling shares of their own companies in order to raise money. Merchants recognized the need for a place to exchange these bonds and shares, as well as commodities, which brought about the set up of commercial centers that eventually became the stock exchanges of America. The largest and more powerful stock exchange in America, though not the first one to be created, is the New York Stock Exchange. Since its inception in 1792, the NYSE has set limits and other requirements for the corporations that wished to have their stock traded on the exchange. This very exclusive nature of the exchange led to its becoming the premier exchange in America and one of the most powerful in the world.*

**Key words:** stock exchange, bonds, shares, brokers, banks.

**J.E.L.:** N21, N22

## 1. Introduction

The largest organized securities market in the world, the New York Stock Exchange has got a long and fascinating history dating back to 1792. The NYSE is known throughout the world as capitalism’s main home in the United States.

But many European countries had a well developed stock trading system long before

the United States of America were settled, with direct links to the shipping and spice trade. The very first official market exchange – the London Stock Exchange – opened in 1698 after having spent its first years as a coffee house.

The NYSE is one of the three main American Stock Exchanges located at 11 Wall Street in lower Manhattan, New York, USA. In terms of market capitalization (the dollar value you arrive at when you multiply each listed stock by the number of outstanding shares), it is the largest stock exchange in the world.

The role of the NYSE in the growth of the US as an economic power is so important that the history of the country itself cannot be fully understood without reference to that of the NYSE.

Being the leading securities market of the world’s largest national economy and listing securities of firms headquartered in other countries still do not make it the most international market in the world.

## 2. Origins of New York City

The city of New York owes its origins to common stock, more precisely to two tradable equity share-issuing companies – the Dutch East and West India Companies in search of economic potential on the North American continent. At the beginning of the 1600s, the Dutch established a few settlements around the mouth of the Hudson River. Henry Hudson, an Englishman employed by the Dutch East India Company in search of a westerly passage to Asia reached this region and noted the abundant beaver population. Since beaver pelts were in fashion in Europe, this was a good opportunity for a lucrative business in the area. The Dutch fur trading post was called New Amsterdam. Later, the Dutch West India Company brought African slaves as laborers. They were the ones to build the wall that defended the town from English and Indian attacks. This wall is believed to have given the name of what is nowadays the well-

known Wall Street. The Dutch colony known as New Amsterdam was later surrendered to the English (1664), who renamed it New York. These dual national origins helped the city become a world financial center by drawing benefits from the Dutch financial revolution and the expansion of the British Empire.

### **3. The American Financial Revolution**

The financial system of the American colonies had a path of its own because of several obvious reasons. The population was mostly farmers who had a lot of land and natural resources and no market orientation whatsoever. Still, they were short of capital. But, as British subjects, the Americans had access to Britain’s modern financial system for short and mid-term credit.

After the War of Independence, the members of the Continental Congress had no experience in modern finance and were faced with a large national debt, both domestic and foreign and no means of paying it since the Congress lacked powers of taxation. In 1787 the Constitution was drafted and in 1788 it was ratified. This led to the creation of a new federal government which took over in 1789. After that moment, a financial revolution was launched in the United States very much similar to the Dutch one two centuries earlier and the British one a century earlier. In 1790 the Congress approved a debt-restructuring plan that meant the birth of the US securities market. It meant for the public debt to be converted into 6 and 3 percent bonds. One year later, another plan was approved – that for a Bank of the United States. The idea behind these plans was for the national debt and the bank to support each other. In the same year, the US convertible dollar joined the world’s major currencies.

Thus, from 1789 to 1791, three key elements of a modern financial system were installed in the United States: sound public finances and public debt management, a central banking institution, and a stable currency.

Alexander Hamilton is a name closely related to the creation and early development of the stock market in the US. He is credited mostly with bringing order and respectability to the finances of the new federal government during his tenure as the nation’s first secretary of the treasury from 1789 to 1795. In truth, Hamilton as treasury secretary did much more than stabilize the finances of the

government. When he took up his duties in 1789, the United States had none of the elements of a modern financial system. When he left office in 1795, it had all of them. Hamilton planned and executed what economic and financial historians later would call a “financial revolution.” It is a term they use to describe the creation, during a relatively brief period of history, of a modern financial system.

During the War of Independence Congress had no power to tax; it could only requisition money from the states, which often did not comply. Money borrowed could not be repaid, making further borrowing problematic to impossible. Continental paper currency had become worthless.

Alexander Hamilton, the first Secretary of Treasury, recommended several financial reforms to Robert Morris, Superintendent of Finance (1781-1784) and other national leaders. They included sound public finances (tax revenues to pay public expenses including the army, as well as interest on old public debts, which would make it possible to borrow more), a stable currency, a banking system, a central bank he already called the “Bank of the United States,” securities markets, and corporations.

At the time only the English and the Dutch had the key components of all modern financial systems. The Americans, Hamilton deduced, needed to institute them if they wanted to secure and maintain their independence, and if they wanted to have a strong government and a prosperous, growing economy.

### **4. The Early Days of the NYSE**

New York was the U.S. national capitol from 1785 until 1790 and Federal Hall was built on Wall Street. George Washington was inaugurated on the steps of this building.

In 1793 the Tontine Coffee House, in Wall Street, was dedicated as the New Yorkers exchange. Before the construction of the Tontine Coffee House the brokers of the Buttonwood Agreement and others did trade at the Merchant's Coffee House just across the road. The Tontine Coffee House was built by a group of brokers to serve as a meeting place for trade and correspondence. In its prime, the Tontine was among New York City's busiest centers for the buying and selling of stocks and other wares, for business dealings and discussion, and for

political transaction. Having had a dual function as a combination club and a meeting room, the coffee house played host to auctions, banquets, and balls, among others. After hours, gambling and securities dealings were practiced that were then deemed less than honest. The coffee house also provided a place for the registration of ship cargo and the trading of slaves. The Tontine was noted as classless; individuals from all social strata met there and collectively engaged in the many civil and economic affairs.

Political demonstrations and violence were not uncommon at the Tontine Coffee House. In the wake of the French Revolution, fistfights between those respectively sympathetic to the British and the French broke out on a daily basis.

Trading at the Tontine Coffee House continued until 1817. The growth of the Tontine's trade proceedings had effected the creation of the New York Stock and Exchange Board (NYSEB), a very important step in NYSE history, and necessitated a larger venue. The NYSEB is recognized as the precursor to the present-day New York Stock Exchange, the largest stock exchange in the world. The Tontine itself was transformed into a tavern in 1826, and a hotel in 1832.

In 1792, the forerunner of the New York Stock Exchange appeared and became part of the securities-market component of the Federalist financial revolution. But the securities market was not confined to New York. Philadelphia and Boston also had securities markets, and the three cities quoted and traded the federal debt issues and bank stock. But New York was the leading market even at that time. New Yorkers, probably because of their Dutch and English descent, seemed to be more speculative and risk-taking participants than Boston and Philadelphia ones. Plus, most of the foreign trade in securities was executed in New York. These initial advantages of New York grew over time.

The securities business was new and had a rather unclear status, with no explicit rules to govern conduct and regulate the new trade.

In 1792 Wall Street suffered its first crash and the New York investment community was devastated. A group of merchants and dealers in stocks in the City of New York met in view of finding ways to properly regulate transactions. The New York legislature passed an act banning public auctions of

securities and making time bargains unenforceable, unless the securities were owned by the seller of waggerer. This was a major setback to securities professionals – brokers, dealers, auctioneers. In order to stay in business and avoid being sanctioned, they had to do something. The legend says that a group of twenty-four met under a buttonwood tree in Wall Street and made an agreement to give preference to each other in their dealings and to fix brokerage commissions at a minimum of one-quarter percent. In other words, they agreed to do privately what the law no longer allowed them to do in public. It is claimed that the NYSE grew out of this 1792 Buttonwood Agreement. Whether this is true or not is quite trivial. What is important to remember is the fact that the initial trading system for securities was flawed and this agreement and maybe others like it managed to correct these flaws and allowed the markets to carry on and to start flourishing.

Twenty-five years later, in 1817, twenty-four brokers (probably a successor of the group of the Buttonwood signers) met, this time in view of constituting an association or a board of brokers that was named New York Stock and Exchange Board. They adopted a set of nineteen rules that all the members were to observe. This formal self-regulation was meant to help them carry on their expending business. Brokers who wanted to join the exchange had to be vetted, and they had to pay a membership fee for their seats. In exchange, members had substantial benefits: access to orderly price-discovery procedures, other brokers, low transaction costs, current securities price information or other valuable “inside information”. Moreover, the members were joined by mutual trust and that attracted customers to the exchange.

Another important event was the construction of the Erie Canal with bond funding. So, during and after the 1820s New York banks became larger and more numerous and kept on employing their funds to finance securities trading. This enhanced the liquidity of New York securities trading, and helped the New York Stock and Exchange Board to solidify its lead over other city securities markets. The banks of New York had their share of advantages and so did the US banking system. The relationship between these three entities was indeed to the benefit of them all.

In the decades subsequent to the 1820s, New York was in the best possible position: it was the largest city in population, it was the nation's leading port, it had the largest banks, and it had the NYSE. Nevertheless, there were hard times along the way. For example, the Black Friday Panic of 1869, the Great Chicago Fire of 1871, and the outbreak of the equine influenza of 1872 would lead to the Panic of 1873, when the NYSE closed its doors for ten days. But after this depression ended in 1879, the stock market began experiencing record growth and the NYSE continued on its path to asserting the position that it has nowadays.

However, in 1835 The Great Fire in New York City destroyed over 700 buildings in downtown New York including the New York Stock and Exchange Board building on Wall Street. This forced NYSE to find temporary space until it could be rebuilt. After rebuilding, the board continued until 1863 when the name was changed to the New York Stock Exchange, which is still in effect today, and in 1865 moved to new location on Broad Street.

Over the next several decades the NYSE experienced both highs and lows, but the most devastating event occurred on Black Thursday, October 24, 1929. This was the start of the Stock Market Crash of 1929, an event that was devastating not only to the NYSE but to the world. The crash was one of the major events that led to a Great Depression where millions of people lost jobs when businesses closed, lost money when the market crashed and lost their homes. The Depression remained for most of the 1930's and not until the beginning of World War II did the country start to come out of the economic difficulties.

## **5. Post-War Development of the NYSE**

After the end of the War and the Great Depression, the country started to enjoy another era of growth and prosperity. The post war Baby Boom led to new businesses starting, a growth in the housing industry and a period of prosperity. This new era led to a steady growth in the New York Stock Exchange. This steady growth has continued until today, but not without periodic downturns. One of the most notable downturns was in October 1987 when the NYSE experienced its second largest one day drop. However, for every drop, the New

York Stock Exchange has rebounded, and it still continues to be the largest and most watched stock exchange in the world.

In 2005, NYSE and Archipelago Holdings (possessing highly regarded market technology at the time) merged with the intention to bring automated trading to NYSE markets and increase efficiency. For the first time in its 213 year history, the New York Stock Exchange became a for-profit company, and began trading publicly on its own stock exchange under the NYX ticker.

The ownership structure of the NYSE changed in March 2006 with the formation of the NYSE Group, Inc., a publicly held company. In anticipation of that change, the last seats on the exchange were sold in December 2005 (some selling for as much as \$4 million). All seat holders became shareholders of the NYSE Group. A merger with Euronext N.V., a group of European securities exchanges, created the holding company NYSE Euronext in 2007. In 2008 NYSE Euronext acquired the American Stock Exchange (subsequently renamed NYSE Amex Equities). Three years later it was announced that NYSE Euronext would merge with Deutsche Börse, operator of the Frankfurt Stock Exchange.

The influence of the NYSE on world finance does not stop with the central NYSE, it has branched out into its NYSE Euronext market with five market places worldwide including New York, Paris, Lisbon, Brussels and Amsterdam. NYSE Euronext handles over 40 percent of trading in world equities. It lists over 950 companies with capitalization above 2.2 billion Euro. The NYSE Euronext is a well-regulated market and is capable of managing many crisis situations and unusual financial circumstances.

## **6. Conclusions**

The New York stock Exchange, currently one of the most powerful nongovernmental bodies in the world, was built from scratch by a number of early 19<sup>th</sup> century New York stockbrokers who managed beautifully to regulate their activity in order to create wealth and capture wealth from nonmembers.

Billions of dollars are changing hands every day right now at the New York Stock Exchange, thousands of companies are being traded, and millions of people are being affected in one way or another. We can trace

the roots of the New York Stock Exchange when it started out as dirt path in front of Trinity Church in East Manhattan 200 years ago, when there was no paper money changing hands and little idea of stocks). At that time, they traded silver for papers saying they owned shares in cargo that was coming in on ships every day. From there the trade flourished.

1792 was the first time that the beginnings of the NYSE could be seen. There were only five securities being traded, along with a couple of bank stocks and three government bonds. In 1817, the NYSE & Exchange Board was formed, and trading became more regulated. The market has grown and rules have changed, but many of the same principals that were established in the beginning remain today.

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# The Romanian Banking System in the Context of the Actual Financial Crisis

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## Abstract

*The performance of the Romanian banking industry represents a true picture of the macro-economic climate, and at the same time it sets the position of the Romanian banking system in the context of current European financial trends. This paper aims at presenting the trajectory of Romanian banks throughout the global financial crisis and the impact they have suffered. Also, it highlights the efforts made by the National Bank of Romania and the European supervisory institutions in terms of ensuring a climate of financial stability.*

**Keywords:** global financial crisis, the Romanian banking system, National Bank of Romania, financial stability.

**JEL Classifications:** G01, G21, G28.

## 1. Introduction

The way in which the European banks evolved affects Romania in a way never seen before, because the internal market is an open field for the foreign investments being at the same time pretty vulnerable and interdependent to the fluctuations of the economies that it interferes with.

The governor of the National Bank of Romania, Mugur Isarescu, asserts that the crisis existent in the USA's mortgage market was the thing that triggered the global financial crisis.

Its causes were profound and they were both macroeconomic and microeconomic. The world economies' impairment degree was caused by a crisis based on the vulnerability of each economy and their exposure to toxic assets.

The way in which people respond to the crisis depends on the fundamental principles which they believe in, on the institutions and the tools they use.

The globalization of the financial markets and of the nations within a global economy will lead to an even higher interdependent economy; in this situation it would be inappropriate for the institutional and political arrangements not to be submitted to changes with the purpose of a higher compliance with the requirements of the power and of the different preferences of those entities existent in the financial markets. (Dumiter F., 2011).

The objective of this work is to emphasize the way in which the Romanian banks were affected once with the global financial crisis. The economic crisis was triggered by the bankruptcy of the Lehman Brothers ' Investment Bank, in the autumn of 2008 and its effects were felt at the level of the European financial markets, a series of cross-border groups claiming interventions of the state in order for them to be saved. The intensity of the crisis was felt and it affected many states, the impact of these ones being influenced by a series of specific factors which outlined the situation of their financial system, at the moment of the crisis release. At the level of the European Union, a series of measures have been established in order to extinguish the identified dysfunctions at a financial field level, among which we mention: the improvement of the surveillance framework of those financial institutions having cross-border activity, the expansion of the communication and cooperation among the EU surveillance authorities and the ones outside the Union, etc.

## 2. The impact of financial crisis upon the romanian banking system

In the context of the financial crisis, the international community supported the reorganization of the financial surveillance framework at a global level, by improving the micro-prudential surveillance standards and by placing a new approach from a macro-prudential perspective. In this direction, at the European level, the Basel III agreement was issued in 2010.

This represents the regulatory framework at a global level for banks and more resistant banking systems (2010) respectively the international framework for the quantification, standardization and the surveillance of the risk of liquidity (2010). The new Basel III standards are different from the standards belonging to Basel I and Basel II by the fact that they have a more expanded coverage and the measures are both micro-prudential (they address to the banks' individual risks) and macro-prudential (they are designed for the risks manifested at the level of the entire banking systems).

Before the admission of the new standards of liquidity and capital into the national legislation, these would benefit from an observation period.

Hence, the requirements for the adequacy of the capital will be valid starting from the 1<sup>st</sup> of January 2019 (respectively on the 1<sup>st</sup> of January 2018, in the case of the requirement concerning the leverage effect) after a transition period which will start in 2013. In a similar manner, within Basel III, the observation period is defined and the liquidity requirements starting with 2011; the dates at which the two liquidity indicators will be valid are the 1<sup>st</sup> of January, 2015- for the short term liquidity indicator (LRC) and respectively, the 1<sup>st</sup> of January 2018, for the structural liquidity indicator (NSFR).

The gradual implementation of the new standards, which was mentioned within Basel III and CRD IV178 can diminish the impact, banks having the possibility to adapt, through the capitalisation of profits, issuing shares, changing the liabilities' structure etc. Regardless of the duration of transition, the measures of consolidation of the capital and liquidities' categories can strengthen the confidence in the stability of the financial system on long term, at the same time

offering to the banks the possibility to diminish any side effects of the crediting conditions and the ones coming from complex activities.

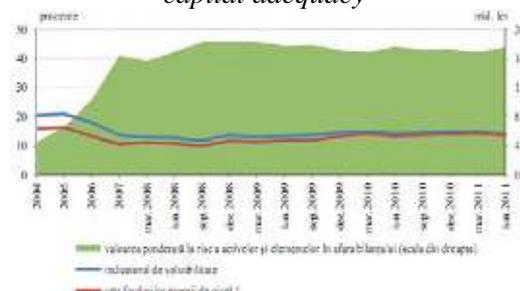
The National Bank of Romania's measures regarding the resistance of the banking system to shock corroborated with the efforts of the credit institutions' shareholders regarding the increment of the capital ground, have assured the maintenance of a high level in the adequacy degree of the capital's banks in Romania.

The National Bank of Romania uses the solvability indicator as the only indicator regarding the level of capitalisation of the credit institutions.

The premises of the impairment capital base were created having as background the increase of the non-efficient loans in 2010, which had direct impact on the impairment of the financial situation and which needed the intervention of the surveillance authorities in order to preserve an adequate level for the solvability indicator.

As it results from presented graphic at aggregated level, it varied around 14% (recording a maximum of 5% in December, 2010).

Figure 1: The indicators evolution of capital adequacy



Source : BNR

Taking into consideration that the minimum accepted level for the solvability indicator is 8%, the level mentioned is considered convenient. The important factors which contributed to this favourable contribution are:

- The maintenance of a minimum level of banking caution adding up to 10%, during the process of banking surveillance, for the solvability indicator established at the beginning of the period of manifestation of the international financial crisis' effects in Romania.

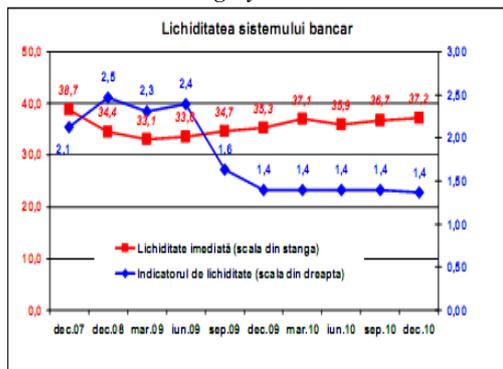
- Fulfilling the commitment of supplying ex-ante extra capital for the banks-mom of the nine main nine credit institutions with foreign capital. In this way, the adequacy rate of the capital must be maintained at a level of over 10% during the entire period of availability of the agreement signed by Romania with UE, FMI and other IFI.

- The solvability indicator influenced favourably the slowing down of the crediting and the placement of the banks' liquidities with priority in state securities. This fact determined the diminishment of the risk weighted value of the assets and element of the balance sheet.

The changes showed up in 2009 within the prudential regulatory framework were underlined not only by the immediate effects of the crisis but also to assure the stability of the financial system on long term. Hence, the National Bank of Romania changed the calculation manner of the liquidity indicator. The methodology entered by the NBR's Norm no. 7/2009, determines for the 31st of December, 2010, a decrease of the liquidity indicator.

This is calculated as a report between the actual liquidity and necessary liquidity, which adds up to 1,38 in comparison with the level of 2,47 correspondent to the year 2008, superior still to the minimum accepted limit(1), mostly by the new calculus methodology.

Figure 2 : The liquidity of the romanian banking system



Source : BNR

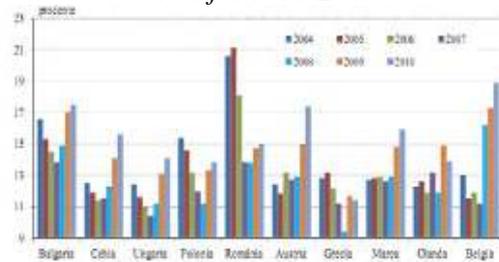
At the end of June, 2011, according to the report of stability published by the NBR, the indicators of liquidity reveal convenient values. Hence, the indicator of liquidity calculated according to the actual regulations adds up to a level of 1, 37 superior to the

minimum accepted degree of 1. As far as the immediate liquidity is concerned, its value is of 36, 6 % in decrease in report with the one from December, 2010, with 0,6 %. In analytic purpose, the National Bank of Romania uses the lever effect, as a measure for the degree in which the own resources of the credit institutions finance the banking activity.

According to the Basel III, the requirements related to capital, the indicator will be included within the prudential regulatory framework, applicable at a community level. The analysis of this indicator on groups of banks regarding the criterion of the size of the held assets reveals the following: the maintenance of an auto-financing degree more reduced than in the case of the big banks (7,1% in June, 2011) and the equalization in the case of the small banks and medium banks( approx. 10% during the current year). The indicator's evolution was influenced among others, by the increase of the 1st level equities and the tightening of the banking assets' volume in the case of many banks from the system in the context of the maintenance of uncertain conditions during the analysed period.

A comparative analysis of the „Lever effect” indicator with the one of countries from the UE indicates that this is comparable recording a level of 8%. It can be noticed the fact that in the graphic presented below the credit institutions from countries of the same origin like the ones of the mom bank which performed an activity in East Europe continue to finance themselves in a smaller degree with their own resources.

Figure 3 : The comparative evolution of the „Lever Effect” indicator in a series of countries from the E. U.



Source : BNR

As far as the globalisation tendency is regarded even though a more correct term for it would be „regionalisation” as the foreign capital found on the Romanian market comes

from E.U. countries we can state that we are more integrated than other countries, the share percentage of the foreign shareholding in the structure of the Romanian credit institutions was of 76, 9% in accordance with the National Banks of Romania.

In conditions of risk and incertitude manifested abroad the following conclusions can be reached:

- In Romania the financial stability continued to be robust;
- The levels of capitalisation, provisioning and liquidity maintained at adequate levels through the exclusive level of the banks. Testing in stress indicates the resistance of the credit institutions at important economic and financial shocks.

### **3. Measures performed by the National Bank of Romania regarding the assurance of the financial stability**

In regards to the financial stability, our country confronted major challenges in the last years. Its level maintained still stable due to the efforts made by the credit institutions, the NBR's requirements in this direction as well as the financing agreement signed by the E.U.'s authorities and the International Monetary Fund, next to the agreements assumed within the European Initiative of Banking Coordination of the main 9 countries activating in Romania.

On the background of the crisis, the National Bank intensified its actions, similar in a certain measure with the ones performed by European authorities, in the plan of the diminishment of the vulnerability in assuring liquidity and capital adequacy.

The changed brought by the regulatory framework regarded controlling the effects of the crisis and maintaining the stability of the banking system. All these changes were linked to the technical requirements assumed by the Stand By Agreement signed with the IMF, which regarded the strengthening of the NBR's position in managing the crisis, in order to assure a fast and efficient intervention in the case of banks with financial problems and assuring premises for forming new credit institutions appropriately capitalized whose share holders to have an appropriate financial situation. (The Government Emergency Ordinance no. 26/2010 meant to complete The Government

Emergency Ordinance no.99/2006 regarding credit institutions and the adequacy of the capital and other normative documents).

In order to correct the accumulated macroeconomic out-balances before the release of the crisis, especially of those from the budget sector becoming necessary to go for the external financing from international financial institutions.

The financial support received by our country on the behalf of a stand by program, for a period of 24 months (May, 2009- May, 2011), adds up to milliards of euro and it has the following structure:

- 12,95 milliards of euro from the IMF;
- 5 milliards of euro from the E.U. representing the facilities for financing the payment balance;
- 2 milliards of euro from the World Bank and BERD.

We mention that granting this finance entailed respecting some conditions which in regards to the banking system were fulfilled. One of important conditions refers to the assurance of an appropriate external finance through the improvement of the trust, this being acknowledged under the name: Vienna initiative. This was entered in 2009 and it obliged the Western European banks (including the Greek ones) to maintain their finance in the CEE countries (including Romania) in order to help the local economies to surpass the crisis. This Initiative supports the Romanian banking system to protect against the bankruptcy risk which could have been generated by the incapacity of Greece to pay their duties to the creditors.

According to the NBR's report, at the end of 2010, from the perspective of the countries which hold investments to the social capital of actual banks and to the subsidiaries of foreign banks, that the first 3 positions within the aggregated capital, where occupied Greece with 25, 5%, Austria with 16, 3 % and at high distance, Holland with 11, 8 %.

The severe economic situation which Greece confronts with at the moment generates panic among the investors in Romania taking into consideration the high holding degree of the Greek banks within the actual banks' capital.

Also, the NBR cooperates with the supervisors signers of the regional

memorandum from countries from East and South-East Europe. Its role is to support the efforts for reaching the surveillance and convergence practices, to coordinate the surveillance process at the level of each banking group from the region, to determine the capital requirements at a consolidated level taking into consideration the risk profile of each banking group but also the important of each cross-border entity for the banking system existent in the host country.

In the case of our country, the NBR as a surveillance authority from the host-country for five subsidiaries of some banking groups with Greek capital (Alpha Bank, ATE Bank, The Romanian Bank, member of the National Banking Group of Greece, Pot Bank, Piraeus Bank) and for other two belonging to certain banking group from Cyprus (Marfin Bank and Bank of Cyprus Public Company Limited Nicosia), while status of surveillance authority from the country of origin is just for one banking group which holds the subsidiary from Cyprus (Transilvania Bank).

The main objective of Romania is to adopt the euro. According to the NBR's governor, Mugur Isarescu, in regards to the economic situation in Romania and the role which the banking system has in the economic development of the country, the Romanian authorities set as a strategic objective of economic politics the achievement of an economic increase on long term through which to „ to regain as fast as possible the socio-economic development gaps in comparison with the E.U.” one of the objectives being the fulfilment of all the conditions which allow the adoption of the Euro as a national currency in 2014.

This is an objective which can be achieved with the condition to adopt and maintain a mix of coherent economic politics, meant to support both the nominal convergence and the real convergence from countries from the euro area. The achievement of the nominal levels and the subscription into the convergence criteria established by the Maastricht Treaty (stabilizing the course, low inflation, interest rates close to the ones from the Euro Area, budget deficit and balances of the mild public debt) represent at the moment, objective which can be reached difficultly in the context of the economic crisis which has already reached the Romanian economy.

Also, the year 2014 should be reconsidered, even if the levels set by the Maastricht Treaty would be resized, all as a consequence of the crisis.

#### 4. Conclusions

In this economic unstable context, it is difficult to quantify certain tendencies of the banking system's evolutions globally as well as nationally.

The evaluation of the evolutions concerning the interdependencies between the states of the world, especially from the perspective of Romania, is difficult to evaluate, as this country is in full development process but still dependent on foreign investments.

The main challenges for the next period can be resumed as it follows:

- Managing the contagion risk which could manifest due to the evolution from the international markets, as a consequence of the sovereign duties' crisis;

- Improving the quality of the banking assets;

- Balancing the structure of the crediting on currencies;

Also, the action directions of the NBR must be oriented towards:

- The continuation of the efforts with the purpose of maintaining the solvability, the provisions and liquidities of banks at adequate levels (inclusively after the IFRSs' implementation);

- Identifying new solutions for a more balanced retaking crediting on currency categories, at the same time with the assurance of a more sustainable debt degree of the debtors;

- The development and the improvement of the management solutions applicable to the credit institutions in difficulty;

- The new agreement signed between the E.U., IMF and WB next to the commitments of the authorities existent in national programs, represent supports for the consolidation of the obtained economic results and of the financial stability and for the continuation of the structural reforms.

The perspectives of the banking sector and of the national financial system depend generally and mainly on rebuilding the trust,

the economy's success in a sustainable release and not at last on the international evolutions.

## 5. Acknowledgments

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# Estimating Potential Output in Romania using Univariate Statistical Filters

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## Abstract

*In this paper, we determine the potential economic growth in Romania using three statistical univariate filters. The techniques used are Hodrick-Prescott (HP), Christiano-Fitzgerald (CF) and Baxter-King (BK) filters. According to our calculations, HP outperforms the other two filters for the pre-crisis period but offers poor end-sample estimates as expected. During the economic crisis, all models indicate a slowdown of the potential growth in Romania. The most reliable estimate for 2011 is offered by CF band-pass filter. BK filter performs poorly in the sample period with the exception of the estimate for 2008 and does not provide.*

**Key words:** potential output, univariate filter, band-pass filter, business cycles.

**JEL Classification:** C32, E32.

## 1. Introduction

Potential output is defined as the maximum level of durably sustainable production, without tensions in the economy, and more precisely without acceleration of inflation. The difference between the actual output and the potential output, called the output gap, provides information whether the economy is operating above or below a sustainable level. Using this information, policymakers are able to do fine-tuning operations in order to bring the actual economic growth as close as possible to its potential. Although the potential output is a supply-side indicator, the output gap indicates the inflationary pressures in the economy, being a key indicator for monetary policy analysis. The potential output is a

theoretical concept and therefore can not be observed directly. Measuring the potential output is not an easy task, as economists have tried different statistical and mathematical methods in order to obtain reliable results.

The calculation of the output gap depends on the model specification, the method of estimation and the time horizon. There are two basic approaches for estimating the potential output (univariate methods and multivariate methods). The univariate methods for estimating potential output are: Deterministic trend, Hodrick-Prescott (HP) filter, Baxter-King (BK) band-pass filter and Christiano-Fitzgerald (CF) band-pass filter. The multivariate methods for estimating potential output are Structural VAR (SVAR) with long-run restrictions, Production function (growth-accounting approach) and Dynamic Stochastic General Equilibrium (DSGE). In this paper we calculate the potential output in Romania using univariate statistical filters, the models implemented being HP, BK and CF.

## 2. Filtering methods

The filtering methods employed to determine potential GDP are easy to be implemented and do not rely on the tight assumptions of economic theory. The filters assume that the registered output fluctuates around a long-term trend. This approach presents several disadvantages. The filtering methods need long datasets and do not incorporate economic theory. The final results depend on certain model parameters that quantify the permanent and transitory components and they are not precisely indicated by the economic theory. Certain filters perform poorly at the end of the samples (so called end-point problem).

Baxter and King (1995), Christiano and Fitzgerald (1999, 2003), Morrow and Roeger (2001), van Norden (2002), Araujo et. al (2004), Benk et al. (2005), Gălăţescu et al. (2007) and Lemoine and Pavot (2009) provide detailed descriptions regarding statistical filters. Azevedo (2007) proposed a multivariate band-pass filter.

### 3. Hodrick-Prescott filter

HP filter is a widely-used statistical method for determining potential output. HP is the oldest statistical filter for calculating potential GDP, as it was first indicated in a paper that circulated in the 1980s and then published in 1997 by Hodrick and Prescott.

The main idea of this smoothing technique is that output evolution is separated in a cyclical component and a trend component by minimizing a loss function. As it was stated in different research papers, HP filter faces end-point (end-sample) problems as the latest data regarding output could be revised. A possible solution is to extend the datasets by introducing forecasts.

### 4. Band-pass filters

An optimal statistical filter requires an infinite dataset (van Norden, 2002; Christiano and Fitzgerald, 2003). This assumption is impossible as the macroeconomic indicators are finite time series. However a reliable filter should tend to an optimal filter according to van Norden (2002) and CF (2003). The main idea of the band-pass (BP) filter is that the business cycles could be defined as fluctuations of certain frequencies (Benk et al., 2005). Therefore GDP evolution could be decomposed into low-frequency, medium-frequency and high-frequency series. Higher-frequency components are considered irregular or seasonal movements while low-frequency components could be seen as long-term trends. BP extracts information within a specified frequency range for the time series. Therefore to implement a BP filter we must first set the considered length of the business cycles (lower and upper limits). The duration of the business cycles is generally indicated by the economic theory. Burns and Mitchell (1946), Baxter and King (1995) and Christiano and Fitzgerald (1999, 2003)

consider that business cycles generally last between 2 and 8 years (8 and 32 quarters). Generally BP filter outperforms HP filter in determining potential output. BP is a linear filter that computes weighted moving averages. BP filters differ depending on the method used for calculating the moving averages. The fixed length filters use the same lag/lead, while the asymmetric filters use time-varying weights. One important limitation of BP technique is that it cannot handle non-stationary time series.

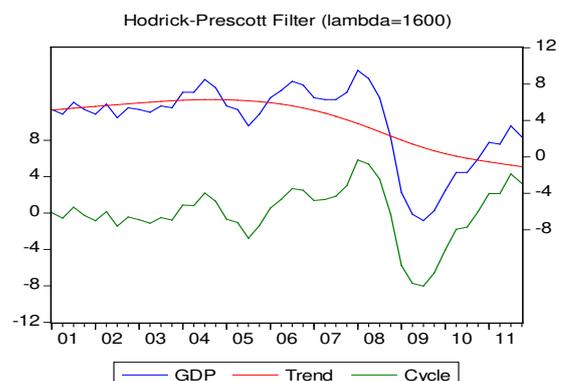
### 5. Database and parameters

The models implemented use quarterly data regarding real GDP evolution from 2001 Q1 and 2011 Q4. The dataset was taken from Eurostat. The  $\lambda$  parameter in HP filter was set at 1,600 as indicated in most working papers for quarterly data. We assume that the length of a business cycle in Romania ranges from 1.5 years to 8 years (6 and 32 quarters) in BP filters. We have set the lower limit of the business cycle at 1.5 years and not at 2 years as indicated in other papers because we consider that Romania faces more frequent structural breaks. BP filters implemented are asymmetric (time-varying) CF filter and fixed length symmetric BK filter.

### 6. Results

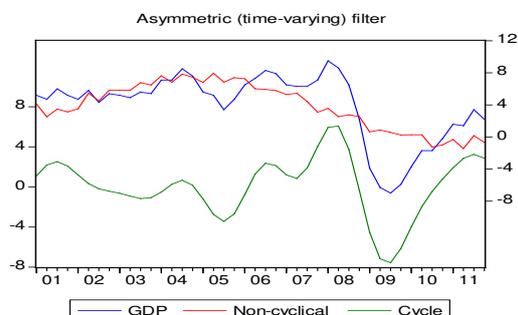
In this paper we estimate the potential GDP evolution in Romania using HP and band-pass filters (BK and CF). The calculations were made in E-views 5. We also compared the final results to the ones provided by Gălăţescu et al. (2007) in an NBR research paper. The results of the estimation are presented in the graphs and table bellow.

Figure no. 1. Hodrick-Prescott Filter



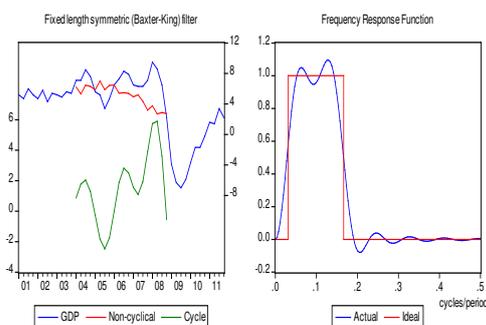
Source: authors' calculations

Figure no. 2. Christiano-Fitzgerald Filter



Source: authors' calculations

Graph no. 3. Baxter-King Filter



Source: authors' calculations

Table no.1. Estimated potential economic growth In Romania using different statistical filters

Time	Hodrick-Prescott Filter	Christiano-Fitzgerald Filter	Baxter-King Filter
2001	5.30	1.97	-
2002	5.69	0.22	-
2003	6.05	-0.95	-
2004	6.27	0.15	1.50
2005	6.19	-2.52	-1.57
2006	5.69	1.25	1.81
2007	4.61	1.99	2.13
2008	2.99	3.85	3.68
2009	1.24	-6.36	-
2010	-0.02	-1.41	-
2011	-0.81	2.71	-

Source: authors' calculations

According to the results, HP filter outperforms the frequency (BP) filters during 2001 – 2009. As expected, CF filter offers better end-sample estimates. We consider that those results should be seen with great caution due to several problems. The dataset used is very short (only 44 registrations) as there were not available registrations for longer periods, while the business cycle length specified in BP models could be inadequate. During 2001-2007, the annualized potential economic growth ranged between 4.6 % and 6.3 % according to HP estimates. In the same timeframe, we consider that CF filter provides unreliable results as it indicates a potential growth between -2.5 % and 2.0 % year/year. The severe domestic crisis as well as the unfavorable conditions in the global economy affected negatively the potential growth. In 2008, the potential growth decelerated at 3.0 – 3.8 % according to the results provided by the three filters, while in 2009 the potential output growth was only 1.2 %. In 2010, potential output growth continued the downward trend according to HP filter, standing at around 0 %. As for 2011, CF filter estimates better potential output evolution in Romania as compared to HP filter. CF indicates a potential growth in 2011 of 2.7 % as compared to the -0.8 % estimate provided by HP. We also noticed that the results indicated by HP filter for the period of significant economic growth are similar to the ones found by Gălățescu et al. (2007). The BK filter does not provide results at the beginning and at the end of the sample. As for the period ranging between 2004 and 2007, we consider that the estimates provided by BK filter are not compatible to the economic theory.

## 7. Conclusions

In this paper, we determine the potential economic growth in Romania using three statistical univariate filters. The techniques used are HP filter and the band-pass filters (CF and BK filters). According to our

calculations, HP outperforms the other two filters for the pre-crisis period but offers poor end-sample estimates as expected. HP indicates an average potential growth of 5.35 % for the period 2001-2007. CF filter provides unreliable results for the mentioned period. During the economic crisis, all models indicate a slowdown of the potential growth in Romania. The most reliable estimate for 2011 is offered by CF band-pass filter, indicating a potential growth of 2.7 %. BK filter performs poorly in the sample period with the exception of 2008.

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## Transfer of Money Abroad

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### Abstract

*In most of the cases, the first concern after committing the basic infraction is to transfer money abroad. The basic rule is that the person whose funds have to be transferred should not assume this risk. At the international level there are networks of professional couriers who take over the transfer action and provide the delivery of money abroad, at the established place. In certain money laundering schemes one may choose to create a foreign trust. The advantage in this case is that the owner of the capital may irrevocably transfer his property right to the trust, thus preventing the confiscation of the capital. The practice of money launderers has proven that these aspects are disadvantages which may be annihilated.*

**Key words:** money laundering, underground bank systems, infraction.

**J.E.L. classification:** G

### 1. Introduction

**Stratification** (or investment) represents stage of money laundering in which the money circulates within different companies, corporations and financial institutions, physically, by deposit or electronic transfer. One aims to physically move the money to other entities in order to separate it from its illegal source in an attempt to disguise its origin. Stratification may involve the following techniques: deposit of cash (taken out of the country by smuggling) in an abroad bank; combining illegal money with legal money; creation of a fictitious account abroad, in order to receive funds and perform

payments with those funds; electronic transfer of money from a national bank account into an abroad account; electronic transfer of money from a bank account A into a bank account B and then into a bank account C etc.; movement of money from company A to company B, and then to company C etc.; sale of different forms of financial instruments (bank cheques, payment orders etc.). A considerable number of operations are performed through off-shore companies.

On the whole, the transfer techniques may be performed (1) by avoiding the bank system or (2) by the official bank system.

**(1) When one decides to avoid the official bank system**, the most used methods are:

- **physical transfer of money** (bulk cash). Previously, the low value banknotes are transformed into higher value banknotes. In the countries where the national currency is not convertible or it has a limited international circulation, it is changed into currency known and universally accepted by any bank: American dollars, euros, pounds, Swiss francs. The physical transfer takes place in the most unexpected ways: in containers, inside which the money packages are mixed with common goods, having the same packaging; in diplomat suitcases; in personal luggage, especially in the case of passenger ships; by incorporating the money packages in certain goods whose structure allow this type of operations (washing machines, vehicles, fridges etc.).

- **compensation** is considered a collateral international transfer scheme. This technique is based on the debt compensation principle which is practised within the legal international commerce. As a technique it is mainly used to transfer money from the

countries where there is a strict currency control or which have non-convertible currency. In such countries, the receipts in the local currency (for example from selling drugs by retail) cannot be always converted in currency, in some cases they cannot be officially converted at an exchange agency or at a bank. For example, the mafia group 1 within the country A owes USD 100 million to group 2 within country B, and this, in its turn, owes the same amount of money to group 3 which is situated in country A. If the international funds transfer had been operated, there would have been necessary two international transfers (group 1 to group 2 and group 2 to group 3) and four bank operations: two for payments and two for receipts. Resorting to compensation one does not operate an international transfer but there are performed two bank operations, a payment operation and a receipt operation. In practice, it is obvious that the amounts of money owed among the parties are rarely integrally compensated. In most of the cases the mechanism is multilateral, respectively several groups from several countries take part in a compensation. In such countries there are companies set up and operating within the law which have the purpose to disguise the amounts of money which were illegally obtained, giving them a legal source through transfers they make from one to another.

- **underground bank systems.** The appearance and development of these systems took place at the same time as the diaspora of different ethnic communities increased. Originally, the underground bank techniques evolved for perfectly legal purposes, reflecting the institutional underdevelopment and /or the lack of knowledge or trust in the official bank systems.

The underground bank systems are based on the same balance compensation principle. The person within country A, who wishes to transfer funds abroad, contacts the underground “banker” and deposits the amount of money. The underground banker transmits a coded message to his correspondent abroad to credit, with the equivalent in currency for the deposited amount, an account at a foreign bank, whose owner is the person who wanted to transfer the money outside country A. In fact, funds

must not be transferred. The transaction balances when a person from abroad wishes to bring money in country A. The operation is clean and it cannot be discovered, especially when it is based on extended family relations, typical for certain ethnic communities who live and carry on different businesses abroad. Transfer of money resulted from infractions **by using the official bank system** involves numerous protection measures. Although the jurisdiction differs from a country to another, it mainly refers to the automatic information with regard to the amounts of money deposited in a bank which exceed a certain limit legally established (USD or € 10,000) or/ and information with regard to any suspicious bank transaction.

Until the period 1980-1985, the banks usually accepted large packages of sums in cash from unknown parties without too many formalities, and they either send them abroad, or they converted them into bearer financial instruments. After 1990 the conditions in which the banks develop operations of large values and for unknown people have become stricter and this determined proliferation of new techniques:

- **deposit division.** Illegal funds are divided into small amounts, below the bank’s report limit and deposited in accounts by people specialized in this activity. The money is withdrawn from these accounts through cheques or other payment and credit instruments;

- **obtaining exemption from reports** (for the amounts which exceed the report limit) associated or not with the bribing of the bank personnel, allows deposit of larger amounts of money, whose use subsequently becomes legal;

- **facade companies.** There are created companies within the law for which there are made up plausible explanations regarding the bank deposits which they constitute and, similarly, for their transfer abroad. Generally, the façade companies, are based on activities through which they can mix legal money with illegal money, on the one hand and on the other hand, they have international commercial operations with goods and services in order to perform transfer of funds; the payment amounts are divided between the “suppliers” within several countries; the amounts, in decimals, are transferred resorting to different transfer techniques -

telegraphically, SWIFT; the prices for the imported products are less than the prices for which the same products are re-exported etc.

Once the money get abroad, the first stage is finalized – separation of money from the basic infraction which generated it – and then one goes to the second stage of the money laundering cycle – hiding and disguising its nature, with the purpose to cover its tracks (the country and source).

Therefore, “covering the tracks” implies, in the main, two actions carried out in two different countries, chosen according to pre-established criteria which meet the objective:

- **choosing the country for financial refuge**, usually, where the legislation and bank secret provide trust, safety and confidentiality of the deposit (banks from Switzerland, Austria and Luxemburg are generally preferred);

- **choosing a country with a less strict legislation (often, non-existing) regarding the establishment of foreign companies**. From this point of view, there are two types of countries: those where the establishment of a company may take place ad-hoc by paying a tax and concluding simple formalities regarding the identity of the person and the source of funds, which often represent a statement and presentation of an identity document (Cayman Islands, Virgin Islands, Panama etc.) and countries which “specialized” in selling “foreign” companies authorized to carry out businesses abroad only, and the established companies are protected by laws regarding corporation secret.

In the past, Liechtenstein was the favourite place to create this type of trusts. Laws which provide the “protection of the trusts’ capitals” are mainly found within the territories which were or continue to be British colonies.

## **2.Return of clean money to the person who committed the infraction**

**Integration** is the final stage of the money laundering process, in which the money representing the profit from the criminal activity is now used within financial transactions which seem to have a legal character. Within this stage there are made investments in businesses, there are granted personal loans, assets are purchased, so that all the transactions performed should seem

legal. The three stages may take place distinctly, but they also might be carried out simultaneously or, more often, they might overlap.(1)

The following might be considered **basic rules for money laundering**:

**a. Anonymity** through which the transaction with values obtained from infractions has to be similar to other legal transactions within the environment or the place where they take place. In essence, the cash should not leave any tracks which might lead to its origin. Within the economies in which cash is often used for acquisitions of lower or higher value, the disposal of the cash does not represent a risk for the offender.

**b. Speed**, respectively the rapid circulation of values, in order not to be discovered. Once the cash has entered the fiscal system, either it is or not within the origin country, the money launderer may use the advantages created by the progress of information technology, modern methods of transmitting the money, in order to rapidly put it into circulation. The electronic bank transfers may transfer large amounts of money almost everywhere around the world within a few minutes, without its owner being forced to go to the bank or involve bank’s employees.

**c. Complexity**. By dividing his funds into several transactions and because of the speed of these operations, the money launderer makes it difficult or impossible for the investigators to reconstruct the track of the money. Transfers from an account to several accounts within other countries and the subsequent re-directing from those countries creates a multinational complex circuit, which makes it difficult for the investigators to track them.

**d. Secret**. Despite the fact that the bank secret has a legal purpose and a commercial justification, this might lead to the appearance of different financial paradises, which offer protection for the offenders.

The main **techniques to dissimulate the illegal origin of the profits** are:

-**overestimation of the price for different goods** by means of an invoice whose value is higher than its real value or by a partially or totally false invoice;

-**false commercial transactions** integrated within a legal business by means

of: repeated and rapid transactions in cash from a currency to another, use of multiple bank accounts, repeated opening and closing of accounts, electronic bank transfers from the account of a legal person into the account of a natural person, performing external transfers of large value using multiple monetary instruments, bank or traveller's cheques, credit operations, investments, fictitious collaterals;

**-returned loan method.** A part of the funds illegally transferred abroad return to the offender or the company he manages in the form of loan. This operation is then followed by the return of the amount borrowed, plus the interests agreed by the parties and possibly different delay penalties, leading to larger and larger amounts, which enter the legal circuit;

**-insurance policies,** by frequently changing the beneficiaries, payment of bonuses larger than the usual ones and the subsequent request that the reimbursement should be made by a third party, receipt of insurance bonuses by brokers or financial intermediaries within off-shore centres who do not comply with the publicity or registration rules, to which they are not contractually obliged.

The most well-known systems used money laundering are:

**a) Off-shore destinations,** respectively those countries or territories which accept fictitious implants of companies, areas with flexible regulations regarding control of currency exchange and freedom with regard to taxes and which offer, at the same time, almost without exception, an impenetrable bank secret and a lot of rights to the private companies. When the money is transformed into a form which can be transferred or can be used for smuggling, in most of the cases, it is transferred to an off-shore centre. Fiscal paradises represent one of the most utilized procedures for fraud fiscal evasion at the international level.

**b) Shell companies** are those companies which do not have independent assets or own commercial operations and are used by their owners in order to carry out their businesses or to maintain control over other companies. A company of this type is registered within the country where it is set up, but it is not transacted within the capital market and it does not operate independently.

Because these companies are not illegal, the money launderers, tax evaders and terrorism financiers can easily convert them and use them in order to hide the illegal source of incomes. It is easy to set up these companies and they can be connected with other fictitious companies throughout the world. If a company is set up within a jurisdiction with a strict legislation in order to have the bank secret protected, it is almost impossible to identify the real owners administrators of the company and, that is why, it is impossible to track the illegal funds which are returned to the real beneficiary.

**c) Freelances,** respectively lawyers, notaries, accountants etc., who carry out a significant number of activities in order to support their clients, organizing managing their financial and commercial businesses. First of all, they provide assistance to natural and legal people within domains such as investments, company establishment, administration, management etc. Some of them tend to be specialized in identification of different commercial companies or off-shore locations in order to use them in money laundering schemes, drawing up all the necessary documentation, which gives a legal appearance to the businesses.

**d) Alternative money transfer systems** which allow the money to circulate around the world without using the conventional bank system. They might be used for legal or illegal purposes, in various forms. For obvious reasons, these systems are attractive, being used on a large scale by the organized crime networks and dangerous offenders, for laundering the profits from infractions, as well as to avoid fiscal taxes customs' obligations.

**e) Casinos** are vulnerable to being manipulated by the money launderers due to the speed and intensive nature of games with cash, and also due to the fact that within a great number of countries, the casinos provide clients with a wide range of financial services. The services available within the casinos are similar, in many cases, to those provided by banks and they can include debit accounts or charge accounts, facilities for transmitting or receiving of funds directly from other institutions, currency exchange services and cash receipt services.

**f) Internet.** The risk of money laundering is very high due to the fact that the Internet

provides easy and almost universal access; it eliminates face to face contact and it is extremely rapid and efficient in eliminating frontiers.

**g) Non-profit organizations** which collect hundreds of billions dollars annually from donators and distribute this money to beneficiaries. Both their administrative expenses, as well as the amount and necessity of making expenses may be exaggerated and their utility might be difficult to estimate.

### 3.Conclusions

Although the mechanisms within this domain are often very elaborated by the multitude of the performed operations, in essence, the mechanism of “covering the tracks” is based on a simple scheme. Before depositing the money into an account, the professionals in money laundering resort to certain preparatory activities. These actions take into account the fact that, after 1990, in the case of certain official investigations regarding the source of large amounts deposited in a bank, there is an increased risk for the bank to no longer keep the bank secret and support the researches carried out by the authorities. For these reasons, the funds are not kept in the account of a single person, but in the account of a company. Generally, the professionals in money laundering prefer buying a company which has a background of the current activity in order to increase the source of money from a legal business. Therefore, during the first stage, the company is set up under a less strict foreign jurisdiction, and then a bank deposit on behalf of the company is created in a country chosen as a financial refuge. Thus, between the money launderer and the authorities involved in tracking this type of infraction appear certain barriers: one with regard to the bank secret, and the second, at the level of corporation secret and, in some cases, a supplementary protection may be created, as the third barrier, represented by the lawyer designated to set up and manage the company, lawyer who benefits from the privilege of being the client’s lawyer. In practice the track followed by the money is more and more sinuous: the companies may be capitalized through shares to bearer, thus there are no mentions regarding the owner, the people who physically own the shares or

the company’s owners; one resorts to successive bank transfers from country to another, each of them having its own jurisdiction; the money is cashed from a bank and deposited in another bank within another geographic space etc. This type of operations takes place on a regular basis, up to the moment when it is appreciated that the sources of money would be extremely difficult, if not impossible, to be identified, respectively “the track was covered”. Among the integration techniques we mention: setting up a foreign company (generally within the fiscal paradises) and opening a bank account for it, so that, later on, the money should be transferred from this account as loans, payments, based on letter of credits, consultancy fees, wages, commissions etc.; deposit of money in cash in a bank account, giving it the appearance of resources from sales; payment of wages, commissions or fees to a company or a natural person, performed by companies which received money which was stratified by foreign or national companies; receiving money from a casino or the lottery to make the funds seem legally obtained from gambling. Nevertheless, in most of the countries, almost all the transactions of large amounts are not performed in cash, but by using other payment instruments (cheques, credit cards), that is why the expense or deposit of large amounts in cash leads to suspicions. For this reason, the offenders have created various techniques and methods of inserting the cash into the financial system, namely:

- dividing large amounts of money into smaller ones and deposits made by several people into different bank accounts or using the respective amounts in order to purchase other payment instruments, such as bearer bonds payment orders;

- cash smuggling, by illegally taking out of the country an amount of money in cash and introducing it into another country, generally having less strict rules, usually by couriers;

- combining illegal funds with those which come from a legal business with cash, amounts of money which then are deposited together.

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# Aspects and Considerations Regarding the Corporate Governance in Romanian Banking System and Financial Reporting Standards

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## Abstract

*Drawing on the lessons learned during the last crisis, started in mid of 2007, on the global economy, and especially the negative impact over the international banking system, was issued by the Basel Committee on Banking Supervision a set of principles for enhancing corporate governance practices for banking organizations.*

*Enhancements to the framework and mechanisms for corporate governance in banks should be driven by such benefits as improved operational efficiency, greater access to funding at a lower cost and an improved reputation. In Romania, National Bank of Romania has an important role in in order to increase the enhancement of the corporate governance in banking system.*

*A core role was played by the implementation of the International Financial Reporting Standards in Romanian banking system in order to support o sound corporate governance.*

**Key words:** corporate governance, banks, supervisors, Basel Committee.

**J.E.L. classification:** E42, E58

## 1. Introduction

To address fundamental deficiencies in bank corporate governance that became apparent during the financial crisis, the Basel Committee on Banking Supervision has issued a final set of principles for enhancing sound corporate governance practices at banking organizations. Given the important financial intermediation role of banks in an economy, the public and the market have a

high degree of sensitivity to any difficulties potentially arising from corporate governance shortcomings in banks.

Corporate governance presents a great relevance both to individual banking organizations and to the international financial system as a whole, and merits targeted supervisory guidance.

The Committee's guidance assists banking supervisors and provides a reference point for promoting the adoption of sound corporate governance practices by banking organizations in their countries. The principles also serve as a reference point for the banks' own corporate governance efforts.

The principles also emphasize the importance of supervisors regularly evaluating the bank's corporate governance policies and practices as well as the implementation of the Committee's principles.

An important role in implementing corporate governance in banking is played by the internal audit in banks. In this case on 2 December 2011, the Basel Committee released its consultative document “*The internal audit function in banks.*”

In this paper are presented: an overview of bank corporate governance, the principles for enhancing corporate governance issued by Basel Committee on Banking Supervision, the role of supervisors in enhancing corporate governance in banks in Romania and the importance of implementation of the International Financial Reporting Standards in Romanian banking system in order to support o sound corporate governance.

## 2. Overview of bank corporate governance

Effective corporate governance practices are essential to achieving and maintaining public trust and confidence in the banking system, which are critical to the proper functioning of the banking sector and the economy as a whole.

From a banking industry perspective, corporate governance involves the allocation of authority and responsibilities, for example the manner in which the business and affairs of a bank are governed by its board and senior management, including how they:

- set the bank’s strategy and objectives;
- determine the bank’s risk appetite;
- operate the bank’s business on a day-to-day basis;
- protect the interests of depositors, meet shareholder obligations, and take into account the interests of other recognized stakeholders; and
- align corporate activities and behaviour with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations.

Supervisors have a keen interest in sound corporate governance as it is an essential element in the safe and sound functioning of a bank and may adversely affect the bank’s risk profile if not implemented effectively. Moreover, governance weaknesses at banks that play a significant role in the financial system, including systemically important clearing and settlement systems, can result in the transmission of problems across the banking sector.

Well-governed banks contribute to the maintenance of an efficient and cost-effective supervisory system. Sound corporate governance also contributes to the protection of depositors and may permit the supervisor to place more reliance on the bank’s internal processes. In this regard, supervisory experience underscores the importance of having the appropriate levels of accountability and checks and balances within each bank. Moreover, sound corporate governance practices can be helpful where a bank is experiencing problems. In such cases, the supervisor may require substantially more involvement by the bank’s board or those responsible for the control functions in seeking solutions and overseeing the implementation of corrective actions.

Good corporate governance requires

appropriate and effective legal, regulatory and institutional foundations. A variety of factors, including the system of business laws, stock exchange rules and accounting standards, can affect market integrity and systemic stability. Such factors, however, are often outside the scope of banking supervision. Supervisors are nevertheless encouraged to be aware of legal and institutional impediments to sound corporate governance, and to take steps to foster effective foundations for corporate governance where it is within their legal authority to do so. Where it is not, supervisors may wish to consider supporting legislative or other reforms that would allow them to have a more direct role in promoting or requiring good corporate governance. [1]

### **3. The principles for enhancing corporate governance issued by Basel Committee on Banking Supervision**

The primary responsibility for good corporate governance rests with boards (supported by the control functions) and with senior management of banks. In addition, banking supervisors have an important role in developing guidance and assessing bank corporate governance practices.

There are also many others entities that can promote good corporate governance, including:

- shareholders - through the active and informed exercise of shareholder rights;
- depositors and other customers - by not conducting business with banks that are operated in an unsound manner;
- external auditors - through a well-established and qualified audit profession, audit standards and communications to boards, senior management and supervisors;
- banking industry associations - through initiatives related to voluntary industry principles and agreement on and publication of sound practices;
- professional risk advisory firms and consultancies - through assisting banks in implementing sound corporate governance practices;
- governments - through laws, regulations, enforcement and an effective judicial framework;

- credit rating agencies - through review and assessment of the impact of corporate governance practices on a bank’s risk profile;
- securities regulators, stock exchanges and other self-regulatory organizations - through disclosure and listing requirements; and
- employees - through communication of legitimate concerns regarding illegal, unethical or questionable practices or other corporate governance weaknesses.[1]

Other institutions such as the OECD, the World Bank and the Basel Committee on Banking Supervision are involved in corporate governance, with the latter formulating a set of principles such as ethics and transparency, as well as accountability.

Each bank should implement the principles for enhancing corporate governance issued by Basel Committee on Banking Supervision, which are presented briefly below:

**“1) Board practices**

The bank’ board should actively carry out its overall responsibility for the bank, including its business and risk strategy, organization, financial soundness and governance. The board should also provide effective oversight of senior management.

**(2) Senior management**, should ensure, under the direction of the board, that the bank’s activities are consistent with the business strategy, risk appetite and policies approved by the board.

**(3) Risk management and internal controls**

A bank should have a risk management function (including a chief risk officer or equivalent for large banks and internationally active banks), a compliance function and an internal audit function, each with sufficient authority, stature, independence, resources and access to the board. At the same time all risks should be identified, assessed and monitored on an ongoing firm-wide and individual entity basis.

An internal controls system which is effective in design and operation should be in place.

The sophistication of a bank’s risk management, compliance and internal control infrastructures should keep pace with any

changes to its risk profile (including its growth) and to the external risk landscape.

Effective risk management requires frank and timely internal communication within the bank about risk, both across the organisation and through reporting to the board and senior management.” [1]

**4. The role played by National Bank of Romania, in its capacity as supervisory authority for credit institutions, non-bank financial lenders and payment institutions, in enhancing corporate governance in Romanian banking system**

Supervisors have a keen interest in ensuring that banks adopt and implement sound corporate governance practices. The Basel Committee on Banking Supervision sets forth several principles that can assist supervisors in assessing bank corporate governance.

These principles were implemented in Romania by the National Bank of Romania, as follows:

***Principle 1 “Supervisors should provide guidance to banks on expectations for sound corporate governance.”***

National Bank of Romania requires to all Romanian banks to have robust corporate governance strategies, policies and procedures, adopted, in these sense was adopted the Government Emergency Ordinance No. 99 of 6 December 2006 on Credit Institutions and Capital Adequacy and the Regulation no 18/2009. At the same time National Bank of Romania share industry best practices and emerging risks that are relevant to the bank’s business practices through the regulations issued in this sense.

***Principle 2 “Supervisors should regularly perform a comprehensive evaluation of a bank’s overall corporate governance policies and practices and evaluate the bank’s implementation of the principles.”***

National Bank of Romania evaluates the Romanian bank’s overall corporate governance policies and practices on a regular basis, at least once a year, through on-site inspections and off-site monitoring. At the same time National Bank of Romania communicates periodically with a bank’s

senior management, board, those responsible for the internal control functions, internal auditors and external auditors in order to fulfill its tasks and to maintain the financial stability of the entire Romanian banking system.

***Principle 3 “Supervisors should supplement their regular evaluation of a bank’s corporate governance policies and practices by monitoring a combination of internal reports and prudential reports, including, as appropriate, reports from third parties such as external auditors”.***

National Bank of Romania collects and analyses information from banks with a frequency commensurate with the nature of the information requested, and the risk profile and significance of a bank (at least once a year).

In this sense, for monitoring and evaluation purposes, the National Bank of Romania periodically reviews key internal reports of the banks.

***Principle 4 “Supervisors should require effective and timely remedial action by a bank to address material deficiencies in its corporate governance policies and practices, and should have the appropriate tools for this”.***

National Bank of Romania has a range of tools at its disposal to address material corporate governance deficiencies of a bank, including the authority to compel appropriate remedial action these tools are presented in Law no 312/28.06.2004 – the National Bank of Romania’ statute and Government Emergency Ordinance No. 99 of 6 December 2006 on Credit Institutions and Capital Adequacy The choice of tool and the timeframe for any remedial action are proportionate to the level of risk the deficiency poses to the safety and soundness of the banks or the relevant financial systems surveyed by the National Bank of Romania.

***Principle 5 “Supervisors should cooperate with other relevant supervisors in other jurisdictions regarding the supervision of corporate governance policies and practices. The tools for cooperation can include memorandum of understanding, supervisory colleges and periodic meetings among supervisors.”***

Cooperation and appropriate information-sharing among relevant public authorities, including bank supervisors, central banks,

deposit insurance agencies and other regulators, not only for issues related to corporate governance but also more broadly, which can significantly contribute to the effectiveness of these authorities in their respective roles are realized by concluding the next Memorandums of understanding by the National Bank of Romania:

- Memorandum of understanding between the National Bank of Romania and the National Bank of Moldavia in the field of banking supervision;
- Memorandum of understanding between National Bank of Romania and Banking Regulation and Supervision Agency – Turkey;
- Memorandum of understanding between the National Bank of Romania and the Central Bank of Cyprus concerning their co-operation in the field of supervision of credit institutions;
- Memorandum of understanding between Banca D'Italia and the National Bank of Romania concerning their co-operation in the field of supervision of banks;
- Memorandum of understanding between Bank of Greece and National Bank of Romania concerning their cooperation in the field of banking supervision;
- Memorandum of understanding between the National Bank of Romania and the Bundesanstalt für Finanzdienstleistungsaufsicht in the field of banking supervision;
- Memorandum of understanding between De Nederlandsche Bank N.V and the National Bank of Romania in the field of banking supervision;
- Agreement between the Commission Bancaire and the National Bank of Romania regarding mutual co-operation and exchange of information in the performance of banking and prudential supervision;
- Memorandum of understanding between the Hungarian Financial Supervisory Authority and the National Bank of Romania in the field of banking supervision;
- Memorandum of understanding between the Federal Ministry of Finance of Austria, the Austrian Financial Market Authority and the National Bank of Romania concerning their co-operation in the field of supervision of credit

institutions;

- Memorandum of understanding on high-level principles of co-operation among the banking supervisors of South Eastern Europe;
- Memorandum of understanding on cooperation between the financial supervisory authorities, central banks and finance ministries of the European Union on cross-border financial stability;
- Memorandum of understanding between the Banco de Portugal and the National Bank of Romania concerning their co-operation in the field of banking supervision;
- Cooperation Agreement between the Banco de España and the National Bank of Romania.[7]

Another key role in enhancing good corporate governance in bank is played by the system of business laws, stock exchange rules and accounting standards that can affect market integrity and systemic stability. In this sense the National Bank of Romania, under its regulatory scope implemented the European regulations regarding banking activity in Romania.

In this purpose National Bank of Romania took the necessary legislative and administrative measures for the direct application of such EU documents.

As part of the arrangement signed with the International Monetary Fund, the European Commission and the World Bank in 2010, the Romanian authorities committed themselves to introducing the International Financial Reporting Standards in the banking sector as of 1 January 2012. The adoption of the new standards is in line with the global trend of harmonising national standards with international financial reporting ones, given the current economic and financial developments, which point to the globalisation of banking operations and hence to an increased need for consistency worldwide of the accounting rules underlying the released financial information.

The IFRS implementation took by National Bank of Romania, in its capacity as regulatory authority, laid down in Order no. 27/ 27 dec.2011, in Order no. 28/27.12.2011 and in Order no. 29/28.12.2011 provides the following key benefits: (i) accurate perception of financial reports, regardless of the users' origin; (ii) avoiding competitive

disadvantages for credit institutions operating in the global marketplace, also in terms of access to international capital markets; (iii) ensuring a higher degree of transparency and comparability of financial statements; (iv) ensuring the consistency of accounting treatments and disclosed information by applying unitary accounting standards across all credit institutions both individually and at a consolidated level; (v) warranting comparability between the information disclosed in publishable annual financial statements, at consolidated and individual levels, and – if applicable – between such information and the data disclosed for prudential supervision purposes.

Major novelties inspired by IFRS-compliant accounting standards consist of: (i) using expert judgment in estimating the value of impairment losses; (ii) a financial asset or a group of financial assets is deemed to be impaired in case of objective events that have an impact on future cash flows and that can be reliably estimated; estimated losses as a result of future events, regardless of their probability of occurrence, shall not be recognised; (iii) the effective interest rate method shall apply to the deferred payment of the amounts representing the effective remuneration of a financial instrument; (iv) the introduction of new accounts (such as: for the distinct disclosure of adjustments related to the impairment of groups of insignificant financial assets and of collective adjustments related to generated, yet unidentified losses from the impairment of both significant and insignificant financial assets; for disclosing the amounts, other than receivables and related payables, taken into account when calculating the effective interest rate – e.g., commission fees received and paid respectively – and which need to be amortised via the effective interest rate method); (v) account restructuring (e.g., the accounts covering the three categories of securities, namely trading, placement and investment securities, shall be restructured in line with the types of financial assets laid down in the IFRS; the income statement shall be renamed according to asset and liability accounts; derivatives accounts shall be restructured in line with IFRS classification and disclosure requirements); (vi) the elimination of several accounts (such as *Receivables written-off, still followed up* and

*Penalties claimed*, considering the asset recognition criteria; off-balance-sheet receivables shall be assessed in terms of fulfilling the asset recognition criteria, so as to be reincorporated in the balance sheet, where they will remain until such assets no longer generate future benefits); (vii) harmonising the terminology with the IFRS.[3]

The areas identified by the National Bank of Romania as being influenced by the conversion to the IFRS refer to provisioning, solvency, currency position and Tier 1 capital.

#### 4. Conclusions

Drawing on the lessons learned during the last crisis, started in mid of 2007, on the global economy, and especially the negative impact over the international banking system, made the necessity to be set on global economy principles for enhancing corporate governance practices for banking organizations.

These principles were issued by the Basel Committee on Banking Supervision in order to assist supervisors in assessing bank corporate governance.

In Romania, a core role in enhancing corporate governance practices issued on international level is played by National Bank of Romania, in double status: as supervisory authority and as regulatory authority.

National Bank of Romania has also an important role in maintaining financial stability, attributable to its capacity to act as a monetary and supervisory authority.

Risks and vulnerabilities identifying and assessing is an ongoing process for the financial system as a whole and its component parts, because the financial stability monitoring has a preventive scope. The occurring and development of malfunctions, inappropriate risk assessment and inefficient capital allocation can affect the economic and financial stability.

In the same time, the implementation of the International Financial Reporting Standards in Romanian banking system had an important role in order to support a sound corporate governance.

National Bank of Romania drafted in 2011 the necessary rules to be enforced for IFRS

implementation, so as to maintain a prudent approach in 2012, as well, across credit institutions applying the standardised approach to credit risk. In this purpose, the accounting records shall incorporate the impairment adjustments determined exclusively in line with IFRS treatment. If their level is insufficient from a prudential perspective, own funds and prudential indicators – whose calculation requires the use of the net value of related exposures – shall be adjusted accordingly.

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## Macroeconomic Developments in Romania in the Period 1991-2011

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### Abstract

*The issue of economic growth and determinant factors has been intensively debated, constantly being topical, especially in the conditions of the world financial and economic crisis.*

*The purpose of this work is to analyze the evolution of the main macroeconomic variables acting on the level of economic growth and the correlations between them.*

**Key words:** economic development, unemployment rate, inflation rate, budgetary expenditures

**J.E.L. Classification:** G38, H68, O11.

### 1. Introduction

International financial crisis were felt inevitable the Romanian economy, being broadcast on banking, financial, currency, investment or mortgage channels, materializing its influence in economic development. Romania was deeply affected by unfavorable economic situation recorded worldwide, which results from the analysis of important indicators presented in the paper.

Economic growth is an important objective of economic policy mainly due to the fact that it is focused on improving grade satisfy of human needs and wider society. Economic development can be considered fundamental to human existence. It is given by the highlighting and employment, although, in the situation of the manifestation of structural rigidities in the economy, there may be a high unemployment, economic growth amid.

Unemployment became a feature accompanying all economies, being recognized both existential but and from point of view of negative effects on the economy and individuals. From the studies

effectuated result that between the economic growth and unemployment there is a reverse conditioning: when there is a period of growth, the unemployment rate declines, and if it is a phase of recession, the unemployment is rising. In the crisis period the phenomenon of unemployment is largely, being affected a great many people. At EU level there is an increase of almost two percent compared to 2008, a trend that was registered in Romania. The negative effects are evident on the labor market and worsening employment conditions in other European countries have increased the unemployment. The impact of global economic crisis on the labor market in Romania has materialized in the loss of job, temporary, as unemployment due to technical or permanently by termination of employment contract, which generated an increase in unemployment. To highlight these issues, we analyzed quantitative indicators reflecting the degree of labor unemployment.

The analyzed period has imposed a structure on the intervals 2000 - 2008 and 2009 -2010 because economic development and its influence on the elements specified was different. In the first period, there was a positive growth, with falling unemployment and rising incomes earned in the state budget. Subsequently, Romania experienced two consecutive years of economic contraction (2009 and 2010) which caused a substantial decrease in real income from taxes collected.

The purpose of this study is to identify and analyze the impact of global financial and economic crisis on economic growth in Romania, with direct influence on labor market and on budget revenues and the correlation between the macroeconomics indicators.

To meet this goal, the paper is structured as follows:

Section 2 The evolution of the economic growth's, unemployment, income and

expenditures of general consolidation budget in Romania from 1991 to 2011

Section 3 Correlations between macroeconomic indicators

4 Conclusions

## 2. The evolution of the economic growth's, unemployment, inflation rate, incomes and expenditures of general consolidation budget in Romania from 1991 to 2011

Economic growth, reducing inflation and unemployment, reducing the budget deficit and the meet of public needs are some of the most important objectives of any savings. Of most times, attaining of the design parameters is subject to the combined action of a set of macroeconomic factors. Identify them and the interdependencies between them does not imply considerable difficulties, however, the empirical tests have revealed that, most of the time, exist and factors by other nature than economic (by most often, the interference of politics in the economic sphere determines a deviation from normal economic laws, actually which reduced the applicability of the econometric modelling). However, should not be neglected the foundation of macroeconomic policy on medium and long term, using the models of sustainability known. Assessing the macroeconomic developments in our country can be achieved on the basis of a presentation of the abovementioned indicators, for a significant period.

The economic growth is sized at the real GDP level, determined according to practice economic, with the help of the next relationship:

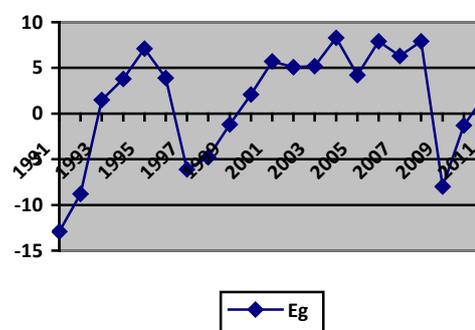
$$PIB_1^r = \frac{PIB_1^{ert}}{D_{PIB}}$$

where: DPIB is the deflator of the gross domestic product.

In the period under review, there is an alternation of intervals that marks a positive or negative economic growth. The first two years of study interval reflected a difficult period from economically point of view, due to the transition from centralized economy to market economy. The 1993-1996 period reflects a moderate increase in GDP, difficulties recorded between 1997 -1999, after which the trajectory of the national

economy it changes by 2008. Obviously, the economic and financial world-wide crisis, has not avoided Romania, fact highlighted by the dramatic transition from a positive trend of 7.9% in 2008, to a negative trend, by 8% in the next year. It is considered that Romania entered into recession since 2009, fact marked by the reducing of GDP for two consecutive quarters (by noted however that in that year was registered a decrease in imports by 11.1%, obviously, not because of measures taken, and a increase exports by 2.9%). A graphic reflection of the trend growth is suggestive (figure 1).

Figure 1 The evolution of economic growth in Romania during 1991 - 2011

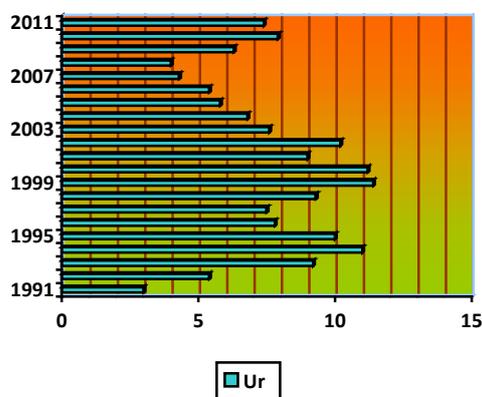


Source: own processing of the data recorded on table

From the analysis of economic growth cannot be omitted and a correlation with unemployment rate (although, the manifestation of rigidities by structural ordin may determine the existence of a high unemployment rate and in economic growth periods). Spre exemplu, în anul 1995, o rată de creștere economică de 7,1% a fost însoțită de o rată a șomajului de 10%. For example, in 1995, a growth rate of 7.1% was accompanied by an unemployment rate of 10%, while in the year 2009, a negative economic growth rate (-8%) was accompanied by an unemployment rate of 6.3%. In the first four years from the analysing period is an increase in unemployment, and the positive evolution of economic growth from 1993 - 1994 has not led than only a slow-down in the growth of rate of unemployment. Restructuring of economic branches, permissive rules on collective redundancies, but the economic fluctuations and the intensification of economic and financial crisis are a few

factors that have determined the evolution of unemployment rate (figure 2).

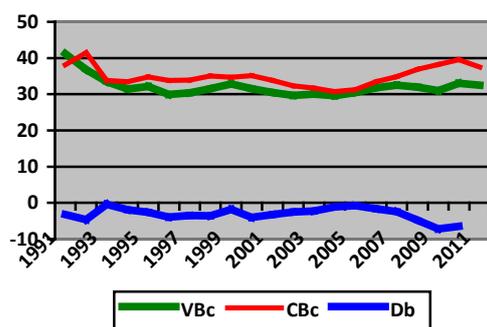
Figure 2 Unemployment rate in Romania between 1991 - 2011



Source: own processing of the data recorded on table 1

The evolution of general consolidate budget revenues, expressed as a percentage of GDP, shows a decrease of approximately 21% in the analyzed interval. The highest rate recorded in 1991 (41.7%) while the lowest level corresponds to 2002 (29.7%). The trend of the total expenditure is approximately similar to that of income, which resulted in maintaining the budget deficit within acceptable limits (except interval from 2008 to 2011, when there was a significant increase – figure 3).

Figure 3 The dynamics of incomes, expenditures and consolidated general budget deficit in Romania



Source: own processing of the data recorded on table 1

By the way, in 2011 Romania has ranked 9th among countries with the largest deficit, expressed as a percentage of GDP after Ireland (-13.1%), Greece (-9.1%), Spain (-8.5%), the United Kingdom (-8.3%), Slovenia (-6.4%), Cyprus (-6.3%), Lithuania

(-5.5%) și France. In contrast, the lowest deficits were recorded in Finland (-0.5%), Luxembourg (-0.6%) and Germany (-1.0%) while Hungary (+4.3%), Estonia (+1.0%) and Sweden (+0.3%) registered a government surplus.

Obviously, the trend of the two indicators is influenced not only by factors such as changes in legislation, taxation, conduct of electoral processes, improving tax revenue collection but also for the inflation level. The rising inflation leads to lower real level of income and expenditures, which leads to increasing of the deficits in real size.

The inflation rate had a favourable evolution in the sense of reducing the range studied (a point of inflection was recorded in 1997, continuing the trend of reduction the year 2005 being the first in which it was under 2 figures. The lowest level corresponds to year 2011, while in 1993 there was a record level by 256.1%.

The evolution of presented indicators is shown by the data from table no 1.

Table 1. The evolution of the macroeconomic variables in Romania between 1991 - 2011

Year	Ce (%)	VBc %GDP	CBc %GDP	Rs (%)	Ri (%)
1991	-	41,17	38,1	3	170,2
1992	-8,8	36,77	41,43	5,4	210,4
1993	1,5	33,44	33,79	9,2	256,1
1994	3,8	31,47	33,44	11	136,7
1995	7,1	32,13	34,74	10	32,3
1996	3,9	29,95	33,8	7,8	38,8
1997	-6,1	30,35	33,86	7,5	154,8
1998	-4,8	31,52	35,08	9,3	59,1
1999	-1,2	32,82	34,67	11,4	45,8
2000	2,1	31,5	35,1	11,2	45,7
2001	5,7	30,5	33,8	9	34,5
2002	5,1	29,7	32,3	10,2	22,5
2003	5,2	30	31,7	7,6	15,3
2004	8,3	29,6	30,7	6,8	11,9
2005	4,2	30,49	31,29	5,8	9
2006	7,9	31,8	33,5	5,4	6,56
2007	6,3	32,5	34,9	4,3	4,84
2008	7,9	32	36,9	4	7,85
2009	-8	31	38,2	6,3	5,59
2010	-1,3	33	39,5	7,91	6,09
2011	2	32,5	37,5	7,4	3,14

Source: Bulletin of Ministry of Public Finance 2006-2011, Annual Report of National Bank of Romania

Where: Ce represented the economic growth; VBc – the revenues of consolidated general budget; CBc – the expenditures of

consolidated general budget;  $R_s$  – unemployment rate;  $R_i$  – inflation rate.

### 3. Correlations between macroeconomic indicators

To the analyze correlations between the presented indicators we use the regression method, the regression function allows estimation of the independent variable explains some evolution to the dependent variable. The general regression equation is:

$$y_i = b + a x_i + \varepsilon$$

where:  $y$  is the dependent variable;  $x$  – the vector of independent variables;  $a$  – parameter reflecting the influence of the independent variable;  $\varepsilon$  - random variable, interpreted as an error.

With the help to the SPSS programme can be determined the regression equation for the identify the correlation between economic growth and unemployment:

$$y = 0,187 x + 0,074$$

The standard error of estimate is 2,5284. The coefficient of multiple determination shows that the variation of unemployment rate is the result of variation to economic growth rate in proportion by 35% (I mentioned before that can be recorded and deviations from normality, under the action of factors other nature than economic, fact which can identify by the correlation matrix between economic growth and unemployment rate – table 2).

Table 2 The matrix correlation between economic growth and unemployment rate

Eg	-13,9; -1,2	1,5; 4,2	5,1; 8,3
Ur	3; 6,3	1991;1992	2005
		2006;2007; 2008	
	6,8; 9	1997; 2009; 2010	1996; 2011
			2003; 2004
	9,2; 11,4	1998; 1999	1993; 1994; 2000
			1995; 2001; 2002

Source: own processing of the data recorded on table 1

A study effectuated in the most powerful 10 states from USA present the relation between economic growth measured by GDP and output gap and employment, the author establishing an interval of 0.31 to 0.16 (by 0.47 for the U.S. as a whole) to quantify the intensity of employment, concluding that

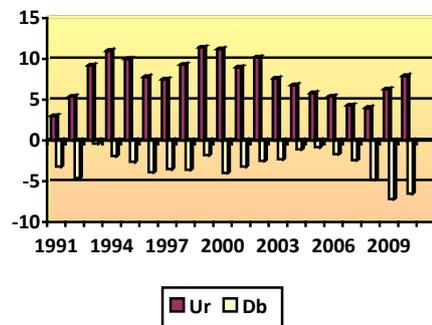
there is an immediate impact on the growth of employment but it generates effects continue for several quarters [7].

An interdependence that is manifested in the cadre of economic cycle is that between the unemployment rate and budget deficit.

The researches effectuated has shown that an increase in unemployment rate, amid an economic recession leads to increase the budget deficit as a result of increased unemployment benefit costs and to the reducing of the tax revenues by reducing the number of taxpayers [3; 5]

From the analyzing of presented dates, it observed that in Romania rising unemployment does not lead to immediate increase in the budget deficit (is differences recorded 2-3 years), even as reduction in the rate of unemployment does not correspond to a reduction of the deficit, which shows the action of several factors on its (interest rate, inflation rate, fiscal policy measures, exchange rate, the manifestation a strong financial and economic crisis).

Figure 4 The evolution of unemployment rate and the consolidated general budget deficit in Romania in the period 1991 - 2011



Source: own processing of the data recorded on table 1

It is found that an increase in the unemployment rate does not to the increase of expenditures budget, as would be logical and vice versa. Such a situation may correspond to restrictive budgetary policies or any neconcordance between the statistical dates and economic reality.

The budget deficit is an indicator that influence the economic growth on long-term. Thus, the increasing of the budget deficit negatively influences the volume of investments, and thus the volume of capital, with direct repercussions on the production capacity. Therefore, the maintaining such a

situation on more period will generate the reducing the supply of goods and services. At the same time, to reduce the deficit, it can act either in the increasing sense of incomes (obviously increase taxes remains the first option, with further implications on the volume of economic activity) be in order to reduce costs (Regardless of the category established for diminution, its will record negative effects). The empirical studies on the impact of budget deficit on economic growth did not lead to clear results (were confirmed and short or long term effects and neutrality hypothesis).

Cashin, using dates for 23 developed countries from the period 1971 – 1988, has concluded that between government transfers, public investment and growth is a positive relationship and between distortionary taxes and growth is a negative relationship [1].

Consequently, the maintenance of budget deficit under control, strengthening mechanisms and improving tax revenue collection can contribute to economic growth.

#### 4. Conclusions

The effects of financial and economic crisis were felt in Romania, fact marked by the evolution of macroeconomic indicators. From the analysis effectuated, we draw some conclusions, presented below.

Sizing budget deficit impact on economic growth requires identifying to the indicators containing relevant information, corresponding for the period analyzed, the aim to the analysis and the real macroeconomic conditions.

Deficit financing in Romania was made frequently on account of state loans, which require a careful management of public debt.

Fiscal and budgetary policies play a fundamental role in stimulating economic growth in macroeconomic policy mix.

Unemployment, inflation, budget deficit, current account balance, and growth are variables that are interrelated but are subject to influence and political factors, legal, military, social, i.e.

Reducing the budget deficit enables macroeconomic stability, reducing inflation and a sustainable level of current account deficit.

Romania's case shows that the policies

implemented to mitigate the economic crisis - financial crisis, contained many errors (actual data shows many anomalies in terms of economic laws).

The implementation of integrated policies and not structured for individual goals can generate real growth, an adequate standard of living requirements comparable to other European countries.

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## Accounting Risks of the Entity and the True and Fair View

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### Abstract

*The objective of the financial situations is to provide a true and fair view of the entity. The failure in adequately representing the accounting information highlights the accounting risks. Therefore, an increased attention should be paid to remove the threats that risk activities face within the entity. Accounting risk management can be achieved only by conducting financial audit missions that contribute to their reduction and present an accurate picture.*

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**Key-words:** accounting risks, financial audit, financial situations, true and fair bview, accounting report.

**J.E.L. Classification:** M42

### 1. Introduction

In the context of globalization everybody desires harmonization that could contribute to bringing the international accounting rules by which to develop a set of standards and principles of coherent and converging to the improvement of accounting. More than that, we want a common financial reporting which generates a series of effects for the entities such as greater transparency; facilitating decisions by developing a common information system for certain sectors of activity, reducing compliance costs.

Ensuring an appropriate balance between the fundamentally qualitative and the information strengthening characteristics presented in the financial statements is a prerequisite to produce useful decisions. The financial statement users need clear data, explanations, words and relevant information when making decisions regarding an investment, a sector development and credibility they have with a particular entity.

### 2. Threats of the true and fair view

The scandals occurred in America as a result of some famous failures, we mentioned here the cases of Enron, WorldCom, Xerox, and the use of creative accounting led to lowering the confidence of users of the financial statements in the activities developed by the accounting experts and of the data presented in the financial statements. Due to the perception that the public had on the accounting profession, on the 30<sup>th</sup> of July 2002, one of the most important laws with special impact on the profession, known as the "Sarbanes-Oxley Act" was developed

Sarbanes-Oxley requires all publicly traded companies to implement internal control systems whose ultimate goal is the accuracy of financial reporting, and increasing the potential investors' confidence. More than that, the application of Sarbanes-Oxley wanted to place the accounting profession on the first position for the audit of the financial statements in accounting services designed to endorse a true and fair presentation of the financial position, of the entity performance.

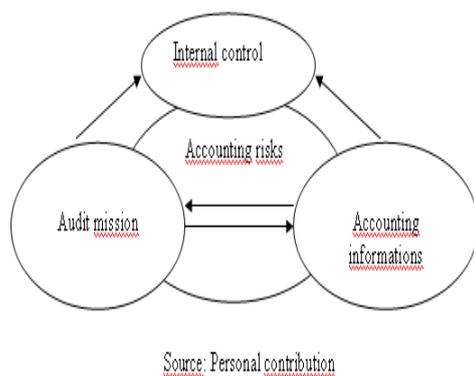
**The true and fair view, objective of the financial situations, could be defined through the honest, complete, correct (no errors) situations.**

Achieving the goal of fair presentation is often overshadowed by the production of risks in the financial reporting process hazards that could lead to a less credible representation of information in financial statements. Among these we could mention: the difficulties in the accounting activities, sometimes lack of regulations for accounting recognition of economic events, activities performed improperly accounting, accounting personnel involvement in activities without adequate powers, proper separating responsibilities of employees in a

entities, inadequate allocation of duties for accounting activities, etc..

The identification and the management of the accounting risks to limit them can be achieved by implementing the internal control system, performing various audit missions and the proper use of the accounting information.

Figure 2.1 Interconditioning scheme for the true and fair view



### 3. Risks of the process of accounting reporting

The accounting reporting should include accurate accounting information to reflect the exact situation in which the economic entity is. The accounting information that represents the object of the reporting is subject to risks. It is therefore necessary to identify the accounting risks in order to reduce them to an acceptable level for the reporting to make an accurate reporting.

**Accounting risks are generated starting with the application of the accounting principles, as follows:**

a) The principle of the activity continuation;

It implies that the entity operates in the best conditions, without going into liquidation or reduction of activity.

As a result, there are a number of accounting practices that generate a number of risks, as follows:

- The delimitation of some financial and accounting exercises along the entity's life, according to which the following items are determined: the financial position, the financial performance and the cash flows of the entity. The

risk arising from misunderstanding or misinterpretation of this principle can lead to an erroneous image of the financial position, of the financial performance that can influence the economic decision of the users of financial statements.

- The usage of the historical cost and current value (of utility) in evaluating assets, equity and liabilities, income and expenses. The evaluation of the balance elements using the historical cost and the current value (of utility) creates a risk of undervaluation of assets and expenses and the overestimation of the risk elements of equity, debt and income.
- The separation in time of the revenues and expenses. This type of activity generates the possibility of erroneous recognition of the above elements in a time when they should not be recognized, and thus appears the risk of assessment and presentation of the results of the entity that do not reflect a true and real picture.
- The impact of the inflation on the accounting activities.

The inflation risk can influence the reduction of the purchasing power, which is reflected in the procurement of goods and services of the entity.

b) The principle of consistent accounting methods and of accounting evaluation. It consists of the continuity of applying the accounting rules and standards regarding the correct accounting and evaluation of the balance sheet items. By applying this principle they ensure a proper presentation of the financial position as well as time comparability of the accounting information.

The failure or the misinterpretation of this principle generates a risk assessment that is where the financial statement users are affected due to the failure criterion of comparability resulting in an assessment that affect their decisions.

c) The principle of caution. It involves the accurate assessment of assets, equity, liabilities, income and expenses to avoid overestimation or underestimation of the result.

According to this principle, it is not allowed to overstate the assets and income, respectively the understatement of the debts

and expenses elements taking into account the depreciation, the losses and the possible risks of the activity generated by the activity developed in the current exercise or the previous exercise. Thus, the risk of transfer of uncertainties in the future exercise will be avoided.

The failure or circumvention of the principle leads to form a distorted image of the financial position and the presentation of an inaccurate image of the entity performance.

d) The principle of exercise independence. It means that the transactions and other events are taken into consideration only when the payment as well as the collection of cash is made. According to the regulations in Romania, this principle regards the delimitation in time of the revenue and expenditure for the financial exercise for which the reporting is made, without taking into account the date of receipt of payment amounts.

The consequence of the application of this principle is the allocating revenue for the year in which they were engaged, respectively their registration at the time of acquisition and expenses as they are engaged.

The risk of not applying this principle is the annual presentation of a performance higher or lower depending on the success or the failure to record in accounting some income and expenses. Tracking certain documents (invoices from suppliers and invoices from customers) via certain non-accounting instruments (cash flow, treasury flow table) reduces the risk of going into payment default.

e) The principle of separate evaluation of assets and liabilities. According to this principle it is necessary to separately evaluate assets and liabilities. The failure to observe this principle generates an erroneous evaluation of the components of financial statements, which affect the financial position and the financial performance of the entity.

f) The principle of intangibility. It refers to the fact that the opening balance sheet for each financial year must correspond with the closing balance of the previous financial year. The failure to observe this principle entails the loss of all the qualitative characteristics of the information drawn from the financial statements. It also automatically

lead to the failure of the other accounting principles.

g) The principle of netting. According to this principle, compensation is not accepted between assets and liabilities or between the items of income and expenses. Therefore, all assets and liabilities should be recorded separately in the accounts based on justifying evidence. However, any offset between assets and liabilities of the same body may be registered only after proper accounting of the revenues and expenditures and compliance regulations. The failure to observe this principle leads to a wrong position and financial performance of the entity. In this case, the calculation of any performance indicators is questionable in terms of relevance of results.

h) The principle of the economic prevalence over the juridical one. It states that the disclosure of the component elements of the balance sheet and profit and loss account is made taking into account the economic operations, not only their legal form. The misinterpretation of this principle leads to an inaccurate presentation of the economic rights and obligations of an entity in the financial statements.

i) The principle of materiality. It requires that the financial statements present all important information which may affect the external users' decisions. The risk of failure of this principle can generate unnecessary costs, which affect the entity's financial performance. When applying the accounting principles, one should know the rules and the regulations well enough in order to avoid such risks, because the information in the financial statements would suffer.

**The registration of the financial and economic operations in accounting is not possible without their priory recording certain documents that certify their accomplishment. Therefore, the data recording books (the journal ledger, the stock ledger and the general ledger) is subject to certain risks such as [7]:**

- The inexistence of some written procedures on how to draw up the journal ledger, the stock ledger and the general ledger;
- The lack of timely update the documents mentioned above;
- The lack of a person responsible for preparing the accounting records;

- These documents are incorrectly filled out.

**With regard to the archiving activity of the financial and accounting documents here we find a number of risks, such as [7]:**

- The lack of procedures for archiving the financial and accounting documents;
- The failure to designate responsible persons regarding archiving;
- The lack of training people on how to archive documents;
- The lack of providing an adequate space for archiving;
- The inadequate preparation of the financial and accounting documents for archiving;

**Retrieving the accounting information and recording them in justifying evidence can be achieved with the help of some software programs. The risks arising out from this activity are [7]:**

- The lack of some written procedures regarding the operation of the information system within an entity;
- The lack of providing responsibilities to the persons who have the right to operate and consult the information system;
- The lack of protection against access by unauthorized persons through a system of passwords;
- The separation of powers of the users with role of control from those with executive role;
- The lack of systematic training of the staff responsible for the system use;
- The unauthorized access to the financial and accounting information from the database.

We mentioned at the beginning of the paper that because of the risks of the accounting activities, the credible presentation suffers. The usage of the balance sheet items, their accounting generates risks that affect the efficiency and effectiveness of the entity, both of them influencing the objectives. Thus, **using and recording the assets generates risks such as [7]:**

- the inexistence of some written procedures regarding the accounts of the aforementioned balance sheet items;
- the accounting procedures is not known by the staff assigned to this task;

- the failure to designate the persons responsible for establishing accounting;
- the existence of some people responsible for the assets accounts but who do not have the necessary studies to accomplish this task;
- the erroneous highlight of the payments / expenses incurred to purchase corporate property or building them;
- the erroneous highlight of the costs of acquisition, production and output value by non-respecting the principle of consistent evaluation methods;
- non-updating the receivables from claims in the justifying documents;
- misstatement in costs other than those related to the nature of these operations;
- the lack of some written procedures regarding the work organization and operation of the cashier;
- the lack of some written procedures regarding the accounts of cash and bank transactions;
- the misstatement in other accounts of the amounts carried by bank or cashier;
- the lack of systematic control of those responsible for treasury activities;
- the failure to ensure the security space for cashier;
- the inexistence of some written procedures regarding the accounting costs for the entity staff;
- the failure to currently inform the staff;
- the placement of the staff in nonspecific professional activities.

**If we focus our attention on the capital entity, we can identify risks such as:**

- The failure to identify all related parties;
- The failure to establish the correct balance sheet value (the amount of the subscribed and paid capital; the amount of legal reserves and other reserves; the amount of profit or loss) at the end of the year;
- The failure to verify balances at the opening and closing of the exercise of capital elements;
- The failure to identify those responsible for managing the operations of capital (authorized persons legally entitled to sign, the person authorized to record the actions taken, the persons responsible for distribution of dividends and the persons authorized to seek

contributions of capital to new issues of shares);

- The changes in the structure and the volume of equity (increase or decrease of capital, issuing shares, the distribution of profit) have not been known by the entity members and shareholders.
- The possibility of not having correctly recorded the entity reserves in the balance sheet;
- The failure to correctly present the financial statements, in accordance with the accounting regulations of the reserves;
- The current accounting regulations regarding the entity reserves that are not consistently applied;
- The procedures regarding the accounting of liabilities are not known by the assigned staff;
- The impossibility of repayment of the loans contracted at the established times.

The risks regarding the provisions and the contingent liabilities are generated by the fact that the managers must correctly estimate these elements. Thus, there appear the risks involved in making the best estimate. Also, the staff involved in this activity, without having the right skills, can lead to a wrong estimate of the provisions and the contingent liabilities. It should be noted that the estimate is made without being based on justifying evidence and hence a number of risks for the users of the financial statement.

Also, there is a link between the risk and the caution principle, namely that the risks may involve increasing the value of the debt, of the results, of the expenses incurred but the economist must take into account the caution principle in order not to overestimate the elements of equity, debt and income, respectively not to undervalue the assets and the expenses.

Consequently, in accounting there is a multitude of risks generated by the elements of balance sheet that must be taken into consideration and develop a series of measures to reduce them. Moreover the national and international laws must be respected with regard to the correct accounting of all balance sheet items to have a credible image. The conduct of the financial audits helps to identify the risks

mentioned above. The procedures applied by the auditors point out the elements of the balance sheet presented in the financial statements, the removal of the irregularities where they were identified and providing recommendations that regard the accuracy of the situations and the risk reduction to obtain a true and fair view.

#### 4. Conclusions

Accounting quantifies, processes and transmits the financial information of an entity, makes the connection between the developed activities and decision factors. But, in spite of all this, there is a series of risks arising from the activities, risks affecting the smooth running of the entity where appropriate action is not implemented in terms of minimizing them.

The reduction of the accounting risks has an impact on the way in which the financial situations are presented, situations which present the overview of the entity.

The contribution of the audit to reduce the risks will be reflected primarily in the reliability of the financial statements and then in the specific objectives of the entity.

The elaboration of some strategies regarding the management of risk accounting is considered to be the main wish to get a true and fair view.

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## New Trend of the Internal Audit

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### Abstract

*The internal audit through its characteristics, area of applicability and objectives contributes to the improvement of the developed activities adding extra value to the entity. The proper planning and implementation of the internal audit will contribute to the smooth running of the entity even during the economic crisis. Moreover, the reorganization of the internal audit taking into account the emerging trends and the new directions certifies that this sector brings benefits to the entity, benefits embodied in the performance of the operating entity.*

**Key-words:** internal audit, management, threats, performance.

**J.E.L. Classification:** M42.

### 1. Introduction

The need to react promptly to the market conditions today, characterized by technological development and globalization, requires an entity to be fast, flexible and responsive to changes in order to be able to achieve its strategic objectives.

In this context, entities must pay particular attention to the threats that are subject to, threats that generally affect the smooth running of activities. This requires the implementation and operation of the internal audit department, which contributes to their identification and reduction to the lowest possible level.

### 2. Management counseling

The internal audit function has seen numerous evolutions so far, since its appearance until today, a reason for which we present various aspects that represent the basis of its performance within an entity.

The internal audit is a function of assistance offered to the manager in order to carry out the activities in the best conditions by: finding shortcomings in the processes undertaken by the entity, informing the management and proposing solutions to correct them.

The internal auditor, through his activity, tries to find solutions to the problems arising in one entity, solutions that aim at: implementing an advanced control system, risk management for the operational activities and improving the process of management.

Consequently, according to the above, we observe that the internal auditor acts from the position of an advisor, consultant, specialist who possesses a range of qualities, meaning that:

- he has professional standards under which he operates;
- he uses techniques and tools that provide efficiency and effectiveness in the work done;
- he has independence and authority;
- the activity he develops is not subject to daily pressures derived from work obligations.

A study conducted in 2010 by one of the largest auditing firms named Deloitte decided to interrogate 70 entities via an online questionnaire, which was granted in the second half of 2009.

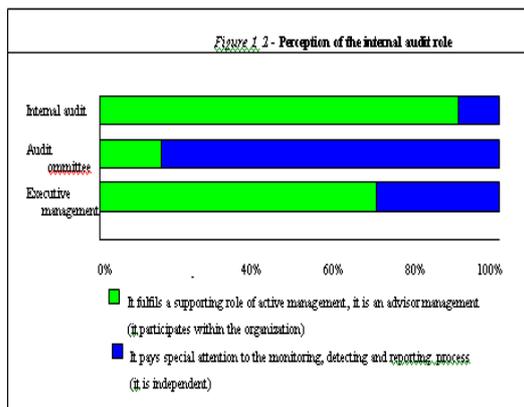
Deloitte Touche Tohmatsu Limited (DTTL) is a British company with a liability limited by guarantee and "Deloitte" is the brand under which many specialists belonging to worldwide independent entities

(all of which are members of the group) collaborate to provide audit services, financial counseling, risk management and further fiscal services to some carefully selected clients.

After questioning three samples (members of the audit committees, internal auditors and executives), the study intends to identify the main directions of internal audit activity over the next five years[1].

Following this study, we identified the key elements for the management of the internal audit activity, namely: the role and the focus of the future function of internal audit, the areas of interest for the internal audit and the size of the internal audit department.

In what the role and the focus of the audit are regarded, we revealed that the internal audit function will evolve to the role of management consultant.



Source: Adapted from Deloitte (2010)

The results obtained from carrying out this study emphasized the idea that the role of the internal audit function may take different aspects, starting from an independent insurance function to a basic management advisor.

But, in spite of all this, we believe that the audit function must find a balance between the two roles based on the achievement of the entity objectives if we want to create performance.

### 3. Aiding the employees without judging them

The internal audit is a function that plays an important role in controlling the activities developed within the entity, in order to add a value.

The recommendations arising from the audit help the employees to optimize the operations they develop. Therefore, the internal auditing is not auditing persons, but it focuses on the processes undertaken by the entity. In the report issued by the auditor it is clearly stated that there should be no names of people, which means that the auditors' recommendations could have some effect on the employees.

Consequently, the internal audit contributes to the improvement of the activities and not to the judgment of the actions made by the persons in the entity.

### 4. The auditors' independence and objectivity

The internal audit function is aimed at monitoring, detecting and reporting the main irregularities occurred in an entity as well as making recommendations that will contribute to the smooth running of the activities.

Throughout the course of the mission, the auditors must show both independence and objectivity. The auditors' efficiency consists of the organizational independence to the management system, which allows an objective assessment of the activities subject to the audit.

The auditor's objectivity represents a neutral attitude, independence of mind and judgment, lack of compromise and removal of any constraints that restrict the smooth running of the activities they perform. In other words, the auditor should see things as they are and make his own opinion which clearly must reflect the current situation. Independence means honesty, sincerity and trust.

According to the Professional Standards for Internal Audit, the principle of independence is viewed from two perspectives:

- the independence of the internal audit compartment, according to which it must be subordinated to the highest hierarchical level in the entity, without any subordinated operational service;
- the internal auditor's independence, according to whom any auditor must be independent from the processes he audits.

The activities developed by the auditors under the principle of independence and

objectivity are nothing but their professionalism.

The internal audit areas of interest, identified through the research conducted by Deloitte in 2010, are considered to be:

- from the executives' perspective, they mention: operational audits, both in computerized processes and in the non-computerized ones;

Thus, we support the idea that operational audits and IT and non-IT processes will be areas of audit in 2015. Moreover, a KPI (Key Performance Indicator) will be implemented for each audit function performed within an entity.

- from the audit committee's perspective, they mention: the attention focused on the financial sector (expenses, costs and revenues).

audit) enhances the entity's performance, as it consists of verifying the procedures and the methods applied to determine efficiency and timeliness.

With regard to the dimension of the internal audit department, most internal auditors consider that it will increase in the future due to the increasingly important role within an entity. While the executives' opinions are divided, some of us believe that the department will be developed, and others believe that it will remain at this stage.

Therefore, the internal audit must have a tendency to meet the needs of the entity. Through the activities it carries out, the internal audit must prove that it has a series of tools to provide added value to its operating environment.

## 5. Conclusions

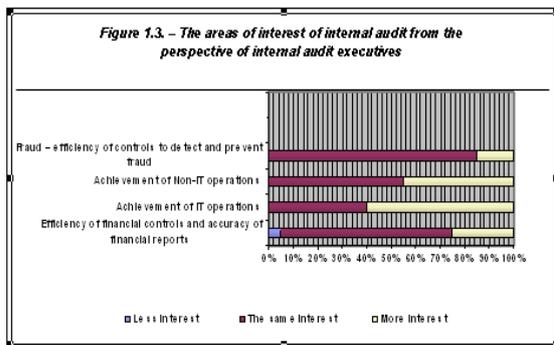
The internal audit activity is considered to be an activity used to improve the operations within an entity. This can only be achieved through a disciplined approach of the control processes, and the processes of risk management and entity governance.

According to the labor they perform, internal auditors are considered “the key to the success of an organization”. Their goal is to solve the toughest problems that the entity must face. They constantly struggle to find the best ways to meet the objectives of the entity by improving their skills continuously. They not only offer advice only for the encountered problems, but they also anticipate them, playing an important role in avoiding disasters.

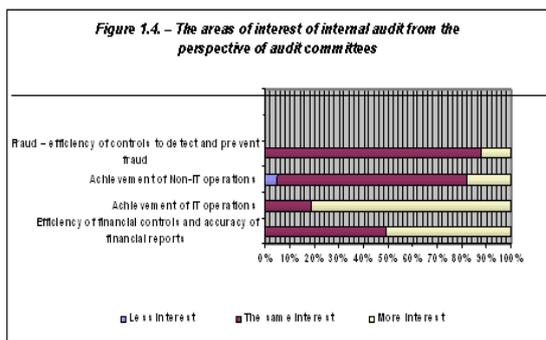
Education and professional experience should make the auditor a competent person, informed with all trends in business, thus ensuring independent, objective and professional counseling for managers.

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Source: Adapted from Deloitte (2010)



Source: Adapted from Deloitte (2010)

From the things presented here, some special attention should be given to the financial resources, given the current environment, as if there is a correlation between the three elements (expenses, costs, benefits) the entity will be able to operate without being affected by the economic crisis.

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# Historical Highlights of the Capital Flows Evolution in the Romanian Economy

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## Abstract:

*In the last few decades everyone agreed that capital inflows benefit the recipient countries, contributing effectively to economic growth and sustaining the investments in the real economy with long term positive effects but in the same time it was observed that the import of capital represents an import of risk, and this risk tend to growth exponentially in time of crisis. The analysis developed in this work has a start point in the vast existing literature trying to explain what drives the capital flows especially into and from the emerging countries. This paper discusses Romania's experience regarding the financial flows, the evolution and the changes in the profile of capital flows to and from Romania. The conclusions include aspects of the financial integration's growing impact on capital flows and level of capital flows in time of crisis in the Romanian economy.*

**Keywords:** capital flows, Romania, foreign direct investments, portfolio investments, others investments

**JEL classification:** E22, E44, E58, G01

## 1. Introduction

The present global financial crisis demonstrates clearly that liberalization of capital flows and globalization also present side effects. The '90s were mostly dedicated to the financial deregulation and the globalization of financial markets. Everyone agreed that capital inflows benefit the recipient countries, contributing effectively to economic growth. At the same time it was observed that the import of capital represents an import of risk.

The dramatic increase in capital inflows, especially the short-term, volatile ones, will

exert high future pressures on the capital outflows. In these conditions, a major concern for any economic policy decision-makers of a country is how to effectively manage the capital flows. Understanding the factors underlying these contradictory flows represents the key to select the correct solutions for an optimal legal framework.

This paper discusses Romania's experience in attracting and managing financial flows and the challenges that have emerged following the increase in the level of financial integration.

The conclusions include aspects of the financial integration's growing impact on capital flows and the implications of financial integration on monetary policy and other types of policies regarding the financial market stability.

## 2. The drivers of capital flows

There is extensive literature dealing with the issue of capital flows to and from emerging countries.

Some authors believe that the capital flows are determined by external factors, also known as "push" factors, business cycles in the developed countries having an important role ([7],[12]). Other authors advocate in favor of the internal factors, also known as "pull" factors, considered essential in attracting capital flows ([5], [6], [8]).

There are also studies that analyze the role of trade liberalization and financial liberalization of capital movements. Also, a considerable number of authors focus on institutional quality in emerging countries, which along with trade liberalization would represent important drivers of capital flows ([1], [11], [19]).

Undoubtedly, we can state that both internal factors and external ones matter when talking about capital flows entering and leaving a country.

Interestingly, while FDI is the least volatile segment of private capital flows as a whole, - the so-called cold money (there are also empirical studies in this regard:[2], [3]), the portfolio investments are often pro-cyclical.

The current financial crisis, as well as those of the '90s, has raised questions about the effects of financial integration. [13], [14] investigated whether the emerging countries that have, sometimes prematurely, opened their markets, , benefit from financial integration or, on the contrary, are more exposed, exhibiting very important disadvantages.

The key features identified by the literature as determinants of a successful financial integration are macroeconomic policies, development of financial markets, institutional quality and corporate governance ([13], [16], [17]).

Both the Asian crisis and the global crisis have shown that, while FDIs have remained relatively stable in a country, being determined by the fundamental characteristics of that country, the areas of banking market, money market and capital market have recorded a significant volatility.

### **3. Historical highlights of the capital flows evolution in Romania**

In order to realize the analysis of the evolution and changes in capital flows, the influence of these flows on the Romanian financial market we collected data from several institutions - National Institute of Statistics - data on Gross Domestic Product, balance of payments;- National Bank of Romania - data on balance of payments and banking assets structure of the Romanian banking system;- Bucharest Stock Exchange

Romania is a country with a gross domestic product in the past five years ranging between 120 and 140 billion €, and a present gross domestic product per capita around 7000 €. Having an international currency reserve that has constantly increased, currently being placed between 35 and 37 billion euros and an external debt reaching 84-85% of GDP, Romania manages to fit into the accepted limits of the convergence criteria established by the Maastricht Treaty, striving hard to keep its budget deficit below 3% of GDP. In terms of

the balance of payments situation, Romania recorded a trade deficit of 11%, while the current account deficit remains close to 4% of GDP. On the background of crisis, these gaps have been reduced due to lower consumption and economic slowdown.

The global crisis has affected the world economy and effects such as the rising unemployment, the increase of inflation, the decrease of purchase power have determined an augmentation of the level of anxiety perceived by consumers, leading to a reconsideration of their priorities [15] and, on a global level, the slowdown of all economic activities had an impact on the capital movements.

In these conditions, Romania has managed to attract, in the last 10 years (2002-2011), an investment flow of 99.65 billion euro and to export investments of 53.74 billion euros, recording a positive difference of 45.92 billion euros of direct foreign investment. In terms of portfolio investment Romania registered inflows of over 27 billion euros, while the outflows were approximately 23 billion euros, with a plus of over 4 billion euros.

Most of these capital flows were in the other investment category, with inflows over 346 billion euros, while the outflows summarize 294 billion euros and with a difference of 52 billion euros.

Taking into account all capital flows, 473,521 billion euros entered Romania, and 370.574 billion euros came out, the net difference attracted being 102,967 billion euros.

This was the case of the past 10 years since Romania started to be attractive to investors, with the economic situation stabilized after 2000, and a real and consistent improvement of the country's economic indicators. In addition, from the economic and political point of view, Romania has become attractive in terms of its accession to NATO (2004) and EU (2007).

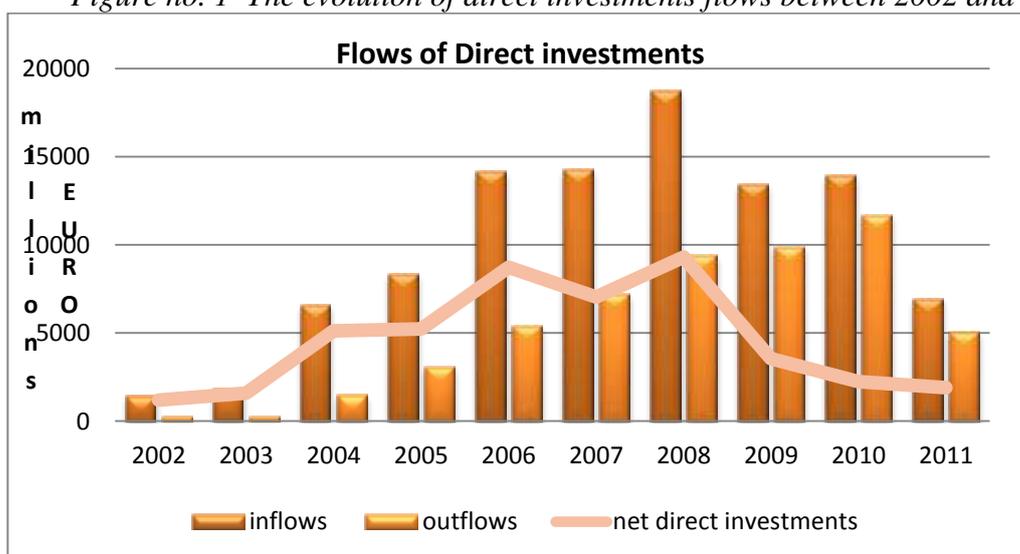
Historically, the direct foreign investment in Romania was the main concern of the authorities, their growth being permanently lauded by the governors, a higher level of foreign direct investment an element of pride for any prime minister.

At the same time, portfolio investments have started to grow in importance,

especially after Romania joined NATO, a fact registered by investors as a safety element. Despite the increasingly intense worldwide competition, by 2008 there was a growing net flow of investments, as Romanian investors increased their activities as exporters of capital on the international markets.

The evolutions shown in the figures below highlight the increasingly intense presence of Romanian companies as investors on international markets, which showcases their ability to diversify their operations, and is in line with the government’s policy to promote Romanian players, both regionally and globally.

Figure no. 1 The evolution of direct investments flows between 2002 and 2011

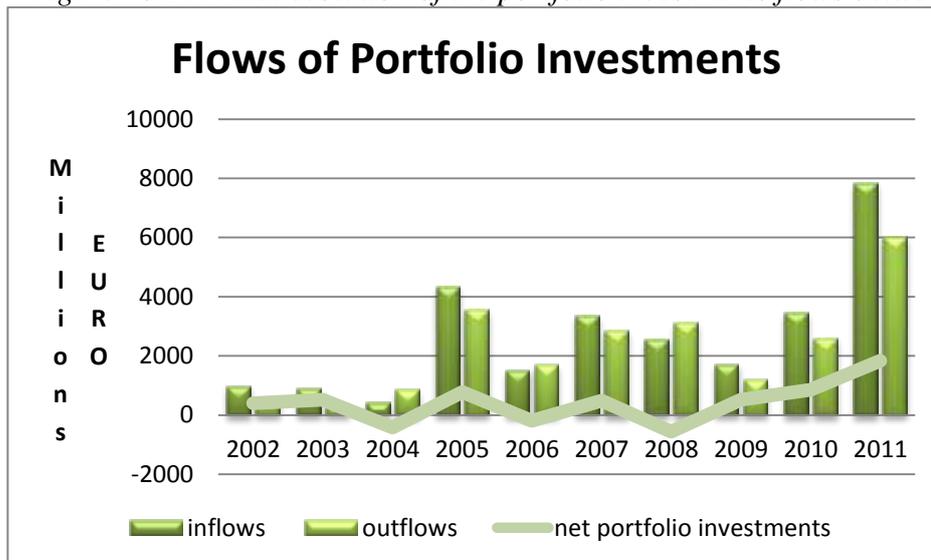


In 2002, the first year of the period analyzed, the world economy experienced a moderate revival, amid the growing U.S. private consumption, the economic expansion of the Asian countries and the European Union candidates.

Romania managed to catch this wave of widespread economic growth, as the private consumption in Central and Eastern European countries was driven by the foreign direct investments, the real wage growth and the prospects of EU accession. With an annual GDP growth of 6%, Romania managed to take the second place in the area, after Slovakia. Along with other countries in the region, Romania has benefit of improving conditions to access the international capital markets and the increasing interest of non-residents for the domestic capital markets, leading to increased net inflows of investment, both direct and portfolio investments.

For the first time, Romania benefited from the greatest opening up in terms of economic access to foreign loans and credits to date, that could be used mainly to strengthen the official reserves, given the fact that the current account deficit was fully financed by foreign direct investments and portfolio investments. From this moment forward, the direct investments began to rise to significant amounts over 1 billion euros, with a similar situation in other capital investments, which was close to 6 billion euros, and an important value recorded at long-term loans and credits, of almost 4 billion euros. We can say that was the historical moment from which the foreign direct investments, the portfolio investments and the other capital investments have started to matter to the Romanian economic balance and recovery (see Figure 1 (FDI), Figure 2 (portfolio investments), Figure 3 (others investments))

Figure no.2 Annual evolution of the portfolio investments flows between 2002 – 2011



If in general the investment volumes registered an upward trend with some short term adjustments, the evolutions of each of the three components: direct investments, portfolio and other investments, were very different.

Both the magnitude and the volatility of the investment flows to and from Romania have grown together with the intensification of integration process into the global financial system but each component presented particular features, different maximum and minimum points and different inflection points, depending on various internal and external factors.

Thus, foreign direct investments grew almost explosively during 2002 - 2008 due to continued privatization process, with short intermittent episodes of decline, the most pronounced of which was in 2007, due to the reduction on share holdings, caused by the absence of large privatizations and reinvested profits.

2008 was the year in which Romania registered a premiere: the direct investment recorded net inflows of almost 9.5 billion euros, compared with 7.5 billion euros in 2007, the increase reflecting the growth of the net debt inflows due to increasing global aversion to high risk financial instruments, the liquidity needs and the short term interest differentials, and the efforts made by the global investors trying to modify their investment portfolio in favor of countries of residence. FDIs in Romania recorded, at the end of 2008, the value of 48.798 billion

euros, up 14% from the balance at the end of 2007. 2008 was actually the peak year in terms of volume of the FDI in Romania, which was called “the Balkans dragon”, representing the only EU country in which the foreign direct investments increased as a share of GDP.

Unfortunately, given the dramatic economic decline of 4.1% in the euro area recorded in 2009, due to lower private capital expenditures and a tightening of the international trade, the foreign direct inflows declined significantly compared to 2008 in eight states that joined the European Union after 2004, including Romania.

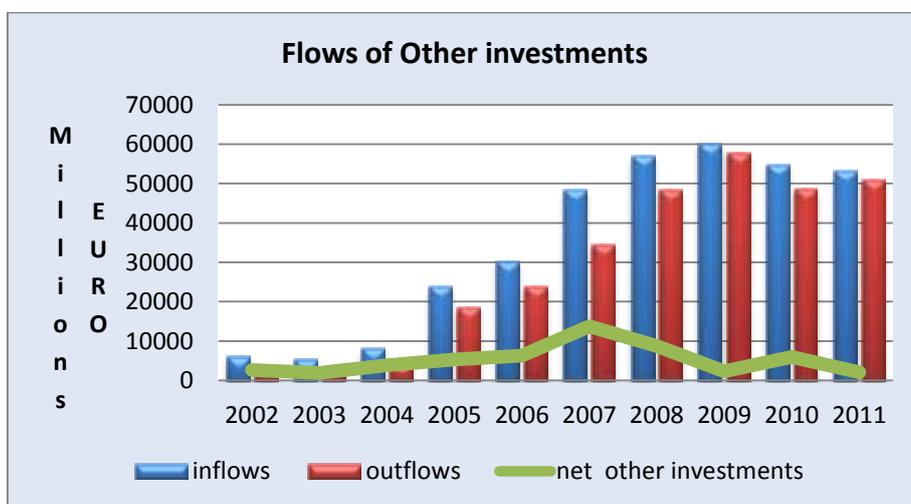
In 2009, the net direct investments in Romania amounted to only 3.5 billion euros, down by 61.9% compared to the previous year, a compression trend which persisted in 2010 and 2011. Showing high volatility, the foreign direct investments in Romania contradict the general principle according to which the flow of direct investments is less dependent on the economic crisis situations. It demonstrates, in the case of Romania, but also for other countries in the region, that the emerging Central and Eastern countries are still considered high risk regions. If, in terms of direct foreign investments the developments in recent years are trending down, not the same can be said about portfolio investments (Figure 2).

Showing a considerable magnitude and volatility, the portfolio investments exhibited significant growth in 2005 and, paradoxically, during the economic crisis in

2010-2011. Moreover, the historical maximum for this type of investments is recorded in 2011, at nearly 8 billion euros. If in 2004 a significant increase in portfolio investments was due to bond issues made by the City Hall of Bucharest (500 billion euros on the Luxembourg market) and the Romanian Commercial Bank (500 billion euros on the London market), the portfolio investments in 2011 of about 1.9 billion euros, 2.1 times higher than in 2010, came mainly from the bonds issues of 1.5 billion euros made by the Ministry of Finance on

foreign markets. The difference is attributed to the transactions with government securities made by the banking sector on the secondary market. We remark that the investor interest for government securities has maintained level, supported by the slight improvement of the BBB country rating – corresponding to a reduced investment risk category as recognition of the continuing efforts for economic stabilization, resulting in lower inflation, reduction of the budget deficit and keeping the current account deficit at a moderate level.

Figure no.3 Annual evolution of other investments flows between 2002 and 2011



Regarding other foreign investments, we find a historic maximum value of inflows (60 billion euros) and outflows (57 billion euros) in 2009, as a result of the movement of “hot money” in the economy, as high levels of credit for the bank subsidiaries by parent banks was maintained due to the Vienna Agreement (figure 3).

#### 4. Conclusions

The analysis undertaken on the capital flows targeting Romania showed the opportunities they brought, but also their volatile nature. In these circumstances, the authorities have been subjected to various challenges, primarily in an attempt to decouple the benefits of these new investment flows to the potential dangers of triggering speculative bubbles.

In a globally integrated economy, this process of decoupling a country from the financial stress and the risks emerging from

other economies is extremely complex. The benefits arising from the liberalization of markets can turn quickly in disadvantages, but we must admit that, at least during certain periods, the existence of these investment flows has proven beneficial.

There are no major differences between Romania's experience and that of other countries. Romania tried to attract, on a background of increasingly intense competition, foreign direct investments and other types of investments, and to maintain and develop these investment flows, in the hope they will provide the necessary funds to reduce the existing gaps.

Romania lost substantial flows of foreign direct investment, failing to remain an attractive destination for these types of capital flows. In these conditions, in the absence of investments, Romania was forced to find new solutions to finance the deficits, which led to the need to adopt radical solutions: cutting spending and foreign loans,

resulting in increased population poverty, reducing consumption, increasing the country's indebtedness and deepening the recession.

### Acknowledgment

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## Central Bank Accountability – Reevaluation and Perspectives

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### Abstract

*The economic literature regarding central banking and monetary policy suggest that the response of a standard monetary policy as a response to an inflationary bias, caused by a discretionary monetary policy represents the delegation of a monetary policy to an independent institution, which is directly linked and subsequent connected with the accountability concept. As we can notice, the accountability and responsibility terms are, ceteris paribus, supplementary. An individual person which is in charge of a task in his domain becomes, sequi, responsible for fulfilling it. An institution is responsible over the law for the fulfillment of a task and it's accountable in the situation in which she need's to justify it's actions. The central bank is entrusted with the monetary policy process, which, in the first place, becomes responsible, and, subsequent, becomes accountable for it's actions.*

**Key words:** central bank independence, monetary policy transmission mechanism, inflation expectations, ex ante control, communication process.

**J.E.L. Classification:** E50, E52, E58.

### 1. Introduction

In the literature regarding central banking and monetary policy the concept of central bank accountability emerged in different ways. Some authors identify in the agent – principal relationship a *de jure* accountability and a *de facto* accountability [1]. The *de jure* accountability represents the enrichment in

the law, especially central bank's statute, a formal contract between central bank and the executive branch. This definition requires, consequently, not just the objective accountability in the contract, but also the reports regarding the accountability evaluation, the central bank tasks reporting and the sanctions applied in case of failure.

Other authors made distinction between *ex ante* accountability and *ex post* accountability, in which the first one is defined as the act throughout the democratic government outlines the obligation over from which the delegated institution is accountable [2]; throughout this the authors refer to the objectives accuracy which is attributed to the central bank.

The concept of central bank accountability has three major dimensions: (i) the decisions regarding the monetary policy final objectives; (ii) the current monetary policy transparency; (iii) the authority which holds the final responsibility regarding monetary policy [3].

*Central bank transparency represents the second essential characteristic for central bank transparency, this being part of accountability because, without the public disclosure of the information by the central bank, the wide public, the civil society and the mass-media won't be able to evaluate the monetary policy performances.*

Accountability suppose that the central bank need's to explain and justify the monetary policy actions, as well as the undertaken actions in exercising it's responsibilities [4]. Regardless the existence or not of some arrangements regarding the democratic accountability, it can be noticed their limited purpose, in the lack of

transparency, because the information *vis – á – vis* the central bank behaviour is crucial for the evaluation of it’s performances [5]. In the *core* of a democratic society, all the public policies must have a high degree of openness with the exception in the situation in which such a forum does not impede the primary function designated to an institution [6].

According to other author, the accountability concept must be divided into three categories [7]:

- *accountability upon objectives* – the clarity and precision in which the monetary policy objectives are enriched and/or communicated;

- *procedural accountability* – the degree and forms of communication of the monetary policy strategies and decisions for the fulfilment of the statutory objectives;

- *informal accountability* – the situation in which the central bank is required to respond over the past decisions, the form of these decisions, the entity nature from which the central bank Governor is accountable.

## **2. The trade of between central bank accountability and central bank responsibility**

National Bank of Romania is the romanian central bank entrusted with legal power and an independent public institution of which the price stability objective is the fundamental objective of monetary policy [8]. This suggest that central bank independence is an important feature in modern central banking and modern monetary policy but it is the problem between the optimal trade of central bank accountability and independence.

Regarding the central bank responsibility we can suggest that because of the multiple subjects of the monetary policy delegation, with a special focusing on the whole society, occurs a problem regarding the definition of the objectives, because of the authority which will decide upon the final objectives of the monetary policy.

On one hand, we can remark the Parliament, the most democratic institution, and on the other hand, we can remark the central bank (especially the Board), institution which is chosen in an indirect manner (through the delegation process) over the society representation, i.e. Parliament.

The first one takes decision in compliance with the society desires, while the second one can deviate from the direct interest of the society. The responsibilities delegation process, implies, *stricto sensu*, the conflict resolution between the democratic deficit, in case in which the central bank establish the final objective of monetary policy, and the central bank transformation in an executor of the government’s will and preferences.

Regarding the central bank accountability we can suggest that it’s importance derive upon the individual and collective costs attached to the choice of the delegation process, process that can confer the central bank’s officials which needs to have different preferences from the rest of the society.

Being aware of these generated costs in a formal requirement of responsibility, some authors sustained that: responsibility is an essential and constituent element of the democratic order of politics. In this order, the institutions and the entities which hold the influence power of the welfare and living standard of the community must constitute the subject of a scrutiny by the constituents or their representatives [9].

This fact is, especially, relevant in some monetary policy domains – like central banking – in which the decisions are systematically removed by the *political arena* daily influences. However, accountability requires, *ceteris paribus*, the existence beyond the *political arena* of a moral and civil inherent obligation, but indirect corelated with the so-called *economical order*.

An additional aspect of accountability represents the relationship between the expected results and the curent results. If it is supposed that in the monetary policy formulation process of the monetary policy objectives are designated in the paretian sense, some efficient targets, using all the available information at the moment; in this sense, the central bank’s performances can be evaluated by comparing the expected targets with the curent one – this operational framework will be very important for the central bank. As it can be noticed, some monetary policy frameworks promotes, inherent, a high level of central bank accountability: for example, in case of *inflation targeting*, the target level, the level from which are evaluated the central bank’s economical performances is well known by

the society. In exchange, in other monetary policy frameworks didn't realise this fact, being very difficult the identification of some adequate targets for monetary policy.

### 3. Accountability – reputation

Some of the problems created by central bank accountability is the situation in which the public's opinions and preferences coincided with those of the entities from which they are responsible. Conformity is the cognitive decision taking process, because it allows the people to engage in the argumentation process, and engaging in a cognitive effort to generate a defensive position.

The evaluable audiences will prefer those who are agreed one with another and less the disagreement one's with their preferences, evaluating those which are agreed to be more intelligent and preferable [10]. Moreover, the decision-making entity will be congratulated and rewarded by those persons from which they are accountable. Indeed, in case in which the judging audiences hypothesis are known before people must express their opinions, these will present, usually, a higher conformity level [11].

These reactions of the conformity occur because of two reasons, which are corresponding to the classical distinction between *normative influence*, in which people express public their position for maximizing the group rewarding and minimizing the group punishments, and *informal influence*, in which people expresses privately their positions, because of the modifications in their beliefs regarding the correct solution. The strategic opinion occurs, frequently, because of such dispatches, since people modify their perceptions in the approval, acceptance of the audience, and other rewards, as well as the promotions and payments increases. Some normative modifications are adopted in a conscious manner, and, sometimes, even in a conscious manner.

Most of the time, these modifications seem to be the non-conscious, occurred as a response to social pressures [12], [13], [14], [15]. Such normative pressures generates a behavioral modification as well as the decisional organisms anticipate the explaining necessity of their preferences

before the audience. However, if accountability is canceled in the last minute, for example – in case of an anticipated reunion which cannot be held without audience – the people often recourse at their's original attitudes upon the problem, excluding the conformity effect.

People can modify their position because of informational motives, due to the fact that the audience can induce to them a modification in the way of surprising the fact as a whole. The audience can make the people to change, promptly, their perceptions regarding several problems – the preferences of an audience can make people:

- *engage in a bifocalisation of information* – disproportional bifocalisation upon information sustained the conclusion of the preferred audience;
- *modifying the modality in which they perceive and define the problem* – modelates the framework which is congruent with the audience hypothesis and objectives;
- *modifying the evaluation standards for using the results evaluation* – overestimation of the standards and the audience objectives.

These results suggest that accountability will lead to an increase in the objective importance of living in good conditions with those persons from which we are accountable. People focalized their attention upon the way in which the decisions are perceived and explained, conforming to the action course which they consider to be accepted by others. Although the mutual understanding objective with each other is extremely important, nowadays, it is the only objective that guides the people's behaviour.

### 4. Central bank accountability – some empirical evidence

In this section we started to measure central bank accountability in 20 developed and 20 emerging countries in the period 1990-2009. In order to measure central bank accountability we have taken into account Dumiter (2009) index and methodology [15].

The accountability and transparency index measured by the authors' has taken into consideration the following central bank characteristics:

- the formal statutory of the objective/objectives with an explicit prioritisation in case of multiple objectives;
- quantification of the primary objective;
- public availability of the economical data;
- the existence of explicit contracts beneath some arrangements between government and central bank;
- public availability of the central bank’s macroeconomic model(s);
- regular publication of the own macroeconomic projections;
- the promptly announcement of the monetary policy decisions;
- auditing central bank financial activities by independent auditors;
- explaining and justifying the monetary policy decisions;
- central bank’s Governor accountability;
- quarterly evidence of the explicit direction of monetary policy;
- regular evaluation of monetary policy;
- results evaluation over the macroeconomic objectives;
- regular information upon the main macroeconomic disturbances which affect the monetary policy transmission mechanism.

Table 1 reveals the results of measuring central bank accountability and transparency in twenty developed countries. As we can notice, at the top of the hierarchy are: Canada, Greece, New Zealand and Sweden with maximum points because of some features as: explicit statutory objective of price stability, public availability of the quarterly time series and macroeconomic models, presenting and explaining the monetary policy actions, decisions and measures adopted or which need to be adopted in the future.

Other countries with a high degree of central bank accountability and transparency in the developed country group are: France, Germany, Ireland, Ireland, United Kingdom, Norway, Spain (9.64 points), Belgium, Switzerland, Israel, Malta (9.29 points), Austria, Denmark and Luxemburg (8.93 points). These countries practice a transparent and accountable monetary policy, offering to the wide public several means of perceivind and understanding the monetary policy transmission mechanism.

At the bottom of the hierarchy are countries as: Iceland (8.57 points), United

States (8.21 points) and Japan (5.71 points). We can observe that Japan has the lowest score as a consequence of avoiding the communication with the wide public, avoiding the presentation of the curent and future monetary policy actions, and the lack of the public availability of the quarterly time series and macroeconomic models.

*Table 1 Central bank accountability and transparency in developed countries*

<b>Country</b>	<b>Central bank Accountability And Transparency</b>	<b>Country Ranking</b>
Austria	8.93	4
Belgium	9.29	3
Canada	10	1
Denmark	8.93	4
Switzerland	9.29	3
France	9.64	2
Germany	9.64	2
Greece	10	1
Ireland	9.64	2
Iceland	8.57	5
Israel	9.29	3
Japan	5.71	7
Luxemburg	8.93	4
Malta	9.29	3
United Kingdom	9.64	2
Norway	9.64	2
New Zealand	10	1
Spain	9.64	2
United States	8.21	6
Sweden	10	1

Source: Measuring central bank accountability and transparency was made by analyzing central bank websites, central bank statutes, different norms and regulations, reglementations and publications available on the central bank websites, as well as the real practices of the central banks’ from the developed country group in the period 1990-2009.

Table 2 reveals the measuring of central bank accountability and transparency in the emerging country group. At the top of the hierarchy are countries as: Serbia and Turkey (9.64 points), Slovakia and Turkey (9.33 points), Albania, Armenia, Moldova, Poland, Czech Republic, Romania (8.93 points) and Russia (8.57 points). Most of these countries exhibit the inflation targeting strategy which has lead to a great responsabilisation of monetary policy, a better communication process with the public and financial markets, publishing and presenting the projections and forecasts of inflation and

output, and the public availability of the quarterly time series for the main macroeconomic indicators.

*Table 2 Central bank accountability and transparency in emerging countries*

<b>Country</b>	<b>Central bank Accountability And Transparency</b>	<b>Country Ranking</b>
Albania	8.93	3
Armenia	8.93	3
Belarus	7.14	6
Bosnia – Herzegovina	5.36	8
Bulgaria	6.79	7
Croatia	4.64	9
Estonia	6.79	7
Latvia	5.36	8
Lithuania	4.64	9
Macedonia	7.50	5
Moldova	8.93	3
Poland	8.93	3
Czech Republic	8.93	3
Romania	8.93	3
Russia	8.57	4
Serbia	9.64	1
Slovakia	9.29	2
Turkey	9.29	2
Ukraine	4.64	9
Hungary	9.64	1

Source: Measuring central bank accountability and transparency was made by analyzing central bank websites, central bank statutes, different norms and regulations, reglementations and publications available on the central bank websites, as well as the real practices of the central banks' from the emerging country group, in the period 1990-2009.

At the bottom of the hierarchy in the emerging country group are: Macedonia (7.50 points), Belarus (7.14 points), Bulgaria and Estonia (7 points), Bosnia – Herzegovina and Lithuania (5.36 points), Croatia, Latvia and Ukraine (4.64 points). All these countries are characterized by a monetary policy whose parameters are not available for the wide public, it can be observed the lack of publishing the main macroeconomic models used for policy analyses, a low communication process with the mass-media, wide public and financial markets and the lack of explication and justification of the monetary policy actions and decisions.

## 5. Conclusion

Central bank accountability represents the responsibility of the monetary authority for the undertaken decisions. Being accountable, the central bank will become, *mutadis mutandis*, the subject of a failure subject, in the purpose of maintaining it's final responsibilities. From this point of view, accountability implies, throughout definition, some compromises regarding central bank independence. However, we consider that accountability represents an important way in assuring that the central bank operates in such manner that is in compliance with democratic ideas, as well as that the central bank operates under the auspices of it's legislative mandate regarding the monetary policy area. On the other hand, the ways in which it could be increased the central bank transparency, will create opportunities for producing some political interferences.

Another source of conferring a high degree of central bank accountability represents the five year or even less tenures of the central bank Governor, especially in cases in which the Governor and other Board members can be reappointed by several additional procedures, than it may throughout this appointment procedure to be established a more rigorous control upon the central bank's activities, and the Board members to be more responsible over the undertaken monetary policy. This fact can be seen as an unequivocal example of the *trade off* between central bank independence (facilitated by the existence of long-run tenures of the central bank officials without any potential reappointment procedures) and central bank accountability (facilitated by the short-run opportunities generated by the possibility of the reappointment of the central bank's officials).

## 6. Acknowledgment

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## How is the Future for the Internal Auditing?

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### Abstract

*Today's internal audit activity provides assurance that internal controls in place are adequate to mitigate the risks, governance processes are effective and efficient, and organizational goals and objectives are met.*

*As technology, globalization, organizational governance, and such trends as mergers and acquisitions have evolved, so has the internal audit profession. Higher expectations for increased accountability, more transparency, greater due diligence, and enhanced oversight have all contributed to growing professional opportunities in internal auditing. There is an overall movement toward solid organizational governance, to which internal auditing is essential.*

*One of this profession's challenges is clarifying for all stakeholders the internal auditors' roles, responsibilities, and true value. In actuality, they serve as management's and the board's safety net. The internal auditors provide assurance that policies and procedures are being followed. They monitor the ethical environment, corporate culture, and “tone at the top.”*

**Key words:** internal auditing, risks, internal controls, governance, objectives

**J.E.L. classification:** M42

### 1. Introduction

Definition of internal auditing says: the function as an independent, objective assurance and consulting activity designed to add value and improve an organization's

operations. In June 1999, the Institute of Internal Auditors (IIA) officially adopted a new definition of the internal auditing function. The new definition was developed by the Guidance Task Force (GTF) and defines the internal audit function as: internal auditing means an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

This definition shifts the focus of the internal audit function from one of assurance to that of value added and attempts to move the profession toward a standards-driven approach with a heightened identity. The IIA Research Foundation (IARF) is working every day to gauge best practices, business cultures, governmental activities, and other forces that shape the global profession and environment in which internal auditors practice. All of them research to date has resulted in guidance that helps internal audit practitioners learn from others and become more proficient, efficient, and effective.

### 2. IIA around the world

The IIA represents more than 120,000 professionals around the world. With 246 affiliates in 90 countries, this professional body works to bring together internal auditors from all around the world to share information and experiences. The challenge is not only to communicate the new information gained, but also to share

collective wisdom, overcoming the barrier of language, culture, and geography.

The IIA has set some clear priorities, including a greater emphasis on the importance of a balanced scope of work. Over time, the pendulum of focus has swung from financial to operational, and back to financial. The IIA, though, understands how important it is to utilize the internal auditors' expertise across the entire organization so that all risks, not just those with financial repercussions be assessed. This requires management and the audit committee to have serious discussions about the resources that will be devoted to internal auditing.

Professional internal auditors practice in accordance with *the Code of Ethics* and *International Standards for the Professional Practice of Internal Auditing* and obtain the Certified Internal Auditor (CIA) designation, which demonstrates internal audit knowledge and competency, personal character and integrity, education, and experience; implement and maintain a quality assurance and improvement program; and participate in professional development opportunities for enhancing expertise.

### **3. Internal auditing is at a cross-road**

The profession of internal auditing is at a critical and exciting cross-road. Never have the challenges been greater or the stakes higher. The way that the profession respond to the opportunities on the horizon will determine the overall destiny for years to come.

The 21st century presents unprecedented growth opportunities for the internal audit profession. Advances in technology, the confluence of the Information and the Internet Age, and the sheer speed and expansion of communications capabilities have significantly accelerated the pace of globalization.

Governance, risk, controls, and compliance processes within organizations have undergone significant change to manage the increasing complexity and sophistication of global business operations. All of these developments offer a huge opportunity for internal audit functions, whether in-sourced, co-sourced, or outsourced, including the potential to add even greater value to their respective organizations.

To ensure that a body of knowledge is systematically built up, developments in practice in a dynamically changing environment must be carefully monitored and continually analyzed to reveal critically important insights. Key lessons learned from the experience of the profession must constitute part of the historical record and be transmitted to current and future generations of internal audit professionals for optimal outcomes. Not only must we strive to secure a robust portrayal of the current state of the profession, but encourage practice-relevant research to inform and push the boundaries of practice.

The IIA Research Foundation undertakes large-scale studies of the global internal audit profession. The inaugural Common Body of Knowledge (CBOK) survey under William Taylor's leadership occurred in 2006 and for this moment there is an another second iteration. Based on the responses from The IIA's Global Internal Audit Survey from 2006 and second in 2010, it is possible to compare results and perform high-level trending.

Five reports cover the full spectrum of a wide range of the survey questions (carefully designed to allow for comparison between the 2006 and 2010 survey data). These reports cover topical content from characteristics of an internal audit activity to implications for charting the future trajectory of the profession. The cooperation and sharing among the five report-writing teams representing the Americas, Asia, Europe, and the Middle East have made this project a truly global and collaborative effort.

This collection of reports describing the expected influence of major themes about, and developments in, the profession as extracted from the survey will provide a comprehensive snapshot of the profession globally, offer helpful insights and actionable intelligence, and point the way forward to maintaining the profession's continued relevance and value-added contributions.

### **4. What's next for internal auditing?**

The 2010 IIA Global Internal Audit Survey is the most comprehensive study ever to capture the current perspectives and opinions from a large cross-section of practicing internal auditors, internal audit

service providers, and academics about the nature and scope of assurance and consulting activities on the profession’s status worldwide. This initiative is part of an ongoing global research program funded by The Institute of Internal Auditors Research Foundation (IIARF) through the William G. Bishop III, CIA, Memorial Fund to broaden the understanding of how internal auditing is practiced throughout the world.

A comprehensive database was developed, including more than 13,500 useable responses from respondents in more than 107 countries. The five reports derived from analysis of the survey responses provide useful information to internal audit practitioners, chief audit executives (CAEs), academics, and others to enhance the decision-making process involving staffing, training, career development, compliance with The IIA’s *International Standards for the Professional Practice of Internal Auditing (Standards)*, competencies, and the emerging roles of the internal audit activity.

**Characteristics of an Internal Audit Activity (Report I)** examines the characteristics of the internal audit activity, including demographics, staffing levels, and reporting relationships.

**Core Competencies for Today’s Internal Auditor (Report II)** identifies and discusses the most important competencies for internal auditors. It also addresses the adequacy, use, and compliance with The IIA’s *Standards*.

**Measuring Internal Auditing’s Value (Report III)** focuses on measuring the value of internal auditing to the organization.

**What’s Next for Internal Auditing? (Report IV)** provides forward-looking insight identifying perceived changes in the roles of the internal audit activity over the next five years.

**Imperatives for Change: The IIA’s Global Internal Audit Survey in Action (Report V)** contains conclusions, observations, and recommendations for the internal audit activity to anticipate and match organizations’ fast-changing needs to strategically position the profession for the long term.

The 2010 survey builds upon the baseline established in prior Common Body of Knowledge (CBOK) studies (i.e., 2006), allowing for comparison, analysis, and trends

as well as a baseline for comparison when The IIA’s Global Internal Audit Survey is repeated in the future.

## 5. Benefits to the Profession

Maximizing the internal audit function is imperative to meet the challenges of today’s business environment. Globalization and the rapid pace of change have in many ways altered the critical skill framework necessary for success at various levels of the internal audit function. Internal auditing’s value will be measured by its ability to drive positive change and improvement. It is imperative for internal auditing to examine current trends within the profession and thus be able to make recommendations for changes within the internal audit activity. This should help internal auditing to:

- Anticipate and meet organizations’ needs
- Strategically position the profession for the long term
- Deliver the greatest value to its organization.

## 6. Expected evolution of the roles of the Internal Audit activity

The role of the internal audit activity in risk management and governance will continue to increase to become accepted from the perspective of internal audit practitioners as the two most important cornerstones of the profession.

Respondents expect an increase in the next years in the role of the internal audit activity in:

- An advisory role in strategy development.
- An education role for the organization’s personnel.
- Training audit committee members.

The proportion of CAEs and managers that expect increases in involvement in strategy development and training to audit committee members is higher than in the other groups of respondents.

Respondents indicate that adopting a more intensive role in risk management and governance necessitates the allocation of additional resources to the internal audit activity (i.e., increase in staff size, audit tools, and techniques).

The top five activities that respondents’ internal audit activities performed in 2010 were:

- An education role for the organization’s personnel.
- Operational auditing (89 percent of respondents).
- Audits of compliance with regulatory code (including privacy) requirements (75 percent of respondents).
- Auditing of financial risks (72 percent of respondents).
- Investigations of fraud and irregularities (71 percent of respondents).
- Evaluating the effectiveness of control frameworks (i.e., using COSO and COBIT) (69 percent of respondents).

The top seven activities that respondents expect to be performed in the next years are:

- Corporate governance reviews (23 percent of respondents).
- Audits of the enterprise risk management process (ERM) (20 percent of respondents).
- Reviews addressing linkage of strategy and company performance (e.g., balanced scorecard —20 percent of respondents).
- Ethics audits (19 percent of respondents).
- Social and sustainability audits (19 percent of respondents).
- Migration to International Financial Reporting Standards (IFRS) (19 percent of respondents).
- Disaster recovery testing and support (18 percent of respondents).

## 7. Audit tools and techniques

The top five audit tools and techniques that are predicted to be used more in the next years are:

- Computer-assisted audit techniques (CAATs) (63 percent of respondents).
- Electronic workpapers (55 percent of respondents).
- Continuous/real-time auditing (54 percent of respondents).
- Data mining (52 percent of respondents).
- Risk-based audit planning (52 percent of respondents).

The top five responses indicate an expected trend to improve the efficiency of internal audit work consistent with the

growing importance of risk management as one of the two cornerstones of the profession. In line with the need to optimize internal audit resources, those internal audit activities that expect an increase in their staff size in the next five years also expect the highest increase in the use of all five tools and techniques. This report provides a portrait of emerging trends in the internal audit profession by understanding the functions internal auditors perform today and expectations for the future.

By shaping the perceptions of internal auditing its purpose, its intended focus, its differentiation from other professions we will demonstrate where we can add the most value. Because we are involved in all areas of the organization, we understand the employees, their processes and their objectives. Internal auditing brings to the table a composite of not only good business sense, but also in-depth knowledge of good internal controls and risk assessment. It is critical to effective operations, a proactive approach to problem-solving, and achieving organizational goals and to build a broad understanding of this, indeed, is an ongoing educational challenge. The good news is that, today, management and boards and other stakeholder are more aware of internal auditing's value than ever.

## 8. Conclusions

The role of the Internal Audit function evolving towards an active Management Advisor, participating in the organization, the Internal Auditors will perform a traditional audit, but with a better and more thorough risk analysis and this allows the Internal Auditor to free up some time and effort to assist management in making the audit recommendations happen, also will be expect an increased focus on the assurance function of Internal Audit, paying attention to monitoring, detecting and reporting.

Especially operational audits will become more important in the future, as well in IT as in non-IT processes. On average, no extra focus is expected on the financial processes. This view corresponds with the one of the Internal Auditor him/herself. For quite some people, IT has always been harder to grasp. This is clearly reflected in the answer of the organization’s Audit Committee members.

They expect much more focus on IT. This is also triggered by the fact that IT is often experienced as a black box and often the related issues in these areas are brought to their attention in a complex or technical language. The organization’s Board members recognize the increasing importance of IT and wants to be better informed. In addition, contrary to the organization’s Executive Management members who seem better informed by their (own) Finance department, the organization’s Audit Committee members expect more focus by Internal Audit on the financial processes, potentially driven by the current financial and economic crisis, with an increased focus on the financials (costs, expenses, revenues...).

The one skill the Internal Auditor should focus more on in the future is business insight. All parties, including the Internal Auditors, recognize this. Real business insight is still found to be lacking. This is the most important framework the Internal Auditor should benchmark his observations/recommendations against (next to the Internal Audit standards of course). Communication skills (orally and written) in terms of final reporting (to Executive Management and Audit Committee) but also during the project/audit (to convince and gain respect from operational management) and focus on a limited number of real business risks, is something Executive Management and Audit Committee members consider very important and should get more attention towards the future. Finally, more focus on IT skills (whether or not outsourced) is a common view of all included parties. The added value of the Internal Audit function in 2015 will more and more be determined by its ‘impact’ on the organization, which is amongst others reflected in the increasing importance of the number of action plans implemented and of focused and actionable audit results.

The role of the Internal Audit function can take on different appearances, going from an independent assurance function to a real management advisor. The future Internal Audit function will need to find an equilibrium between both roles, respecting the expectations from the different stakeholders. Independently of which role is selected, the ability to have impact within the organization will be important for every

future Internal Audit function. More added value at minimum cost.

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# The Impact of Family Policy Expenditures on Fertility in European Countries

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## Abstract

*The paper intends to check if there is a long-term equilibrium relationship between family and childcare support public expenditure and the total fertility rate, using a sample of 30 European countries, and to evaluate its magnitude.*

*The results obtained using recent techniques for panel data analysis confirm the theoretical predictions that family and childcare public spending has a positive long-term effect on total fertility rate.*

**Keywords:** Social Security, Fertility, Panel Cointegration

**JEL Codes:** H55, J13, J18, C23

## 1. Introduction

In the past decades, the low level and the downward trend of the total fertility rate have been a serious concern both for researchers and policy makers. There are two reasons for these concerns.

First, in most countries fertility reached such low levels which are far below the necessary replacement levels. Coupled with an ageing population, such demographic dynamic could have significant negative implications for countries with PAYG public social security systems, affecting the future sustainability of the welfare state [11], [14], [15]. Higher imbalances in public social security system due to the increasing dependency ratio translate either in crowding out of other desired public expenditure either in higher public debt [7]. These possible outcomes affect both the assumed purposes and financial soundness of the welfare state.

Either way, government intervention through pro-natalist policies is needed. Also, the resulting reduction in labour supply of young skilled workers could affect economic

growth if a corresponding increase in productivity does not offset it [2].

Second, another problematic issue related to observed low-level fertility is that is smaller than the ideal fertility desired by the population. The latest Eurobarometer [6] on this issue showed that, for most European countries, the two child norm is still in place. In a paternalistic approach, this could lead to the idea that government authorities should intervene, putting in place policies aimed at removing the barriers to childbearing and child rearing perceived by the population. In European countries, population replacement is achieved by a total fertility rate a little higher than two children per woman. In this context, only Nordic countries (Denmark, Sweden, Norway, Finland and Iceland), non-continental Anglo-Saxon countries (United Kingdom and Ireland) and France experienced in the past decade fertility levels close to the ones required for population replacement.

The population replacement could be a serious problem especially for Southern European countries (Italy, Spain, Portugal, Greece, Cyprus and Malta) and for Central and Eastern European countries (Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia and Slovakia) which experienced a total fertility rate with more than 0.5 lower than the required level for population replacement.

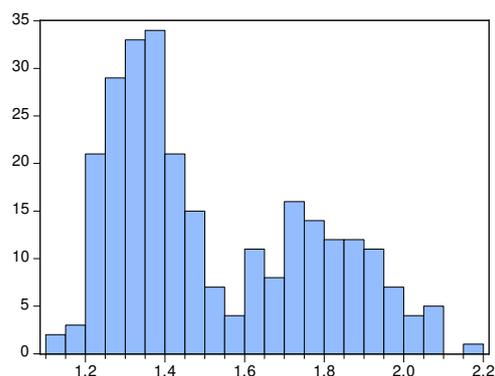
Having a look at current available data, one could observe for most of the European countries an upward trend in total fertility rate [8].

Histogram for the whole sample of 30 European countries, for the 2000-2008 period, is given in figure 1.

A consistent part of this cross-national variation in European countries fertility rates has often been explained in terms of family and childcare support policy. For instance, Adsera [1] showed that a combination of

public employment and generous maternity benefits boosted young Scandinavian women fertility. Bonoli [3] highlights the importance of childcare and the level of family benefits as determinants of fertility rates. D’Addio and d’Ercole [5] emphasizes the role of wider childcare availability, lower direct costs of children, higher part-time availability and longer maternity leaves for a boost of fertility in OECD countries.

Figure 1 Total Fertility Rate Histogram for 30 European Countries for 2000-2008 period



This paper provides new empirical evidence regarding the existing relation between family and childcare policies and fertility. It will introduce new estimates of the impact of family and childcare public expenditure on fertility for a sample of 30 European countries and it will answer the basic empirical question of whether higher family and childcare public expenditures are associated with increasing total fertility rate.

## 2. Methodology and Results

In this context, the paper intends to test the validity of the following hypothesis:

H0: Family and childcare support public expenditures (FCSPE) have a positive impact on the total fertility rate (TFR)

In order to test this hypothesis, we built a panel (N=30, T=9), using as variables:

- The total fertility rate (TFR)– the average number of children born by a woman during her entire life;
- Family and childcare support public expenditures (FCSPE) – as a percentage of GDP.

The sample used was composed by 30 European countries (the 27 EU member states along with Iceland, Norway and

Switzerland). The available time-span for the data used was 2000-2008. The source of the data used is Eurostat statistical database.

Descriptive statistics for both variables is given in Table 1:

Table 1 Descriptive Statistics

	TFR	FCSPE
Mean	1.519037	1.974061
Median	1.420000	1.685404
Maximum	2.150000	3.970579
Minimum	1.140000	0.216419
Std. Dev.	0.252177	0.844279
Skewness	0.581172	0.478928
Kurtosis	2.073765	2.192719
Jarque-Bera	24.85076	17.65339
Probability	0.000004	0.000147
Sum	410.1400	532.9964
Sum Sq. Dev.	17.10655	191.7451
Observations	270	270

The chosen research methodology is represented by recent panel data analysis methods, and was applied in three steps.

First, we run some unit root tests in panel: LLC test [12], IPS test [9] and two Fisher-type tests which use ADF and PP tests [13], [4].

All the four test employed have as a null hypothesis the existence of a unit root. But, only the LLC test uses the null hypothesis of a common unit root for all the cross-section of the panel, while the IPS, ADF-Fisher and PP-Fisher tests drop this homogeneity hypothesis.

Empirical specification for the unit root tests was chosen having in mind that both variables have only non-negative values and also have a natural upper bound.

The number of children born by a woman during her entire life is a finite, low number, constrained by biological and time factors.

The amount of family and childcare support public expenditures is also limited, given the public budget constraint. In this context, no trend was included in the empirical specification used for all panel unit root tests.

To account for country heterogeneity individual effects were included in the specification:

$$\Delta y_{it} = \alpha_i + \rho y_{it-1} + \varepsilon_{it} \quad (1)$$

LLC test impose a homogenous autoregressive root for all cross sections of the panel ( $\rho_i = \rho_j = \rho$  for  $\forall i, j$ ).

This homogeneity limitation is overcome by IPS test which drops this hypothesis, allowing for auto-regressive root heterogeneity ( $\rho_i \neq \rho_j$  for  $\forall i, j$ ).

ADF-Fisher and PP-Fisher tests are non-parametric Fisher-type tests based on a combination of significance levels given by p-values of individual unit root tests for all the panel cross-sections.

To start, we run the panel unit root tests for the time-series of both variables in levels.

Table 2 Panel Unit Root Tests – Variables in Levels

Test	TFR	FCSPE
LLC t*	1.16	-3.47***
IPS W-stat	3.66	0.57
ADF-Fisher $\chi^2$	48.14	61.00
PP-Fisher $\chi^2$	50.26	86.12**

(\*\*\*), (\*\*) and (\*) denotes rejection of the unit root hypothesis at the 1%, 5% and 10% levels, respectively

The results show that time series for both variables are not-stationary in levels. Nevertheless, it should be mentioned that for family and childcare support public expenditures variable, two out of four unit root tests were unable to reject the null hypothesis of a unit root. Given that in panels with short time dimension as in our case (T=9) panel unit root test have low power, we accepted the non-stationarity of family and childcare support public expenditures variable in levels.

Next, we re-run all the unit root tests for the first difference time series for the two variables.

Table 3 Panel Unit Root Tests – Variables in First Differences

Test	$\Delta$ TFR	$\Delta$ FCSPE
LLC t*	-13.01***	-7.28***
IPS W-stat	-3.44***	-1.64*
ADF-Fisher $\chi^2$	116.17***	83.50**
PP-Fisher $\chi^2$	183.64***	121.21***

(\*\*\*), (\*\*) and (\*) denotes rejection of the unit root hypothesis at the 1%, 5% and 10% levels, respectively

The results show that the first differences

series for both variables are stationary (i.e. are I(1) processes).

Next, we ran panel cointegration test developed by Pedroni ([16], [17]), in order to check if there is a long-term relation between total fertility rate and family and childcare support public expenditures.

To derive the test statistics, the following long-term relation is estimated:

$$TFR_{it} = \alpha_i + \delta_i t + \beta_i FCSPE_{it} + \varepsilon_{it} \quad (2)$$

where:  $i = 1 \div 30$ ,  $t = 1 \div 9$ .

The residuals from previous regression are used to estimate the following relation:

$$\varepsilon_{it} = \rho_i \varepsilon_{it-1} + u_{it} \quad (3)$$

Pedroni proposed seven tests, four based on the within dimension and three on the between dimension. For all seven tests, the null hypothesis is no intra-individual cointegration ( $\rho_i = 1$  for  $\forall i$ ). Under the alternative hypothesis the existence of a different cointegration relation for each cross-section is considered. For the four tests based on within dimension, the alternative hypothesis is given by  $\rho_i = \rho < 1$  for  $\forall i$ . For the three tests based on between dimension, the alternative hypothesis is given by  $\rho_i < 1$  for  $\forall i$ .

The Pedroni test (see Table 4) validates the existence of a cointegration relation between the fertility rate (TFR) and family and childcare support public expenditures (FCSPE) in the situation in which this relation includes a constant and a trend (four out of the seven test reject the null hypothesis of no cointegration between the two variables). More, Pedroni [16] indicates that in small sized samples (T<20), as it is in our case, the Group ADF Statistic test, followed by the Panel v-Statistic test are the most relevant. Both of these tests reject the null hypothesis of no cointegration between the two variables.

Table 4 Pedroni Test for Panel Cointegration

Test	H1	H2	H3
Panel v	1.08	5.65***	-3.51
Panel rho	1.70	1.82	-0.45

Test	H1	H2	H3
Panel PP	1.75	-4.48***	-1.98**
Panel ADF	2.37	1.35	-2.41***
Group rho	2.92	3.60	3.68
Group PP	0.07	-7.64***	-0.67
Group ADF	2.14	-2.74***	-3.29***

H1 - Constant and no trend ( $\delta_i = 0 \forall i$ ); H2 - Constant and trend; H3 - No constant and no trend ( $\alpha_i = 0, \delta_i = 0 \forall i$ ).

(\*\*\*), (\*\*) and (\*) denotes rejection of the no cointegration hypothesis at the 1%, 5% and 10% levels, respectively

Finally, in order to estimate the intensity and the sign of the relation between the total fertility rate and the family and childcare support public expenditure, we employed the panel Dynamic OLS (DOLS) estimation procedure. In a study of finite sample properties of OLS, FMOLS and DOLS estimators, Kao and Chiang [10] showed that DOLS estimator is superior to both OLS and FMOLS.

Assuming complete homogeneity of the cointegration vectors, the following regression is estimated:

$$TFR_{it} = \alpha_i + \beta FCSPE_{it} + \sum_{j=-k_1}^{k_2} \gamma_{ij} \Delta FCSPE_{it-j} + \varepsilon_{it} \quad (4)$$

where:  $k_1$  is the number of lags and  $k_2$  is the number of leads.

In order to determine the appropriate number of lags ( $k_1$ ) an iterative procedure was employed. First, the regression was initially run with  $n$  lags. If the  $n$ -th lag was found to be insignificant, than the lag was deleted and the regression was run again. The procedure was repeated until the last lag was found to be significant. The same procedure was used to determine the appropriate number of leads ( $k_2$ ). In our regression two lags and two leads were used.

The estimation result for the relation between family and childcare public expenditures and total fertility rate confirms the existence of a direct long-run equilibrium relation between the two variables, in accord

with the theoretical predictions.

The coefficients of the first difference variables are of no economic interest and therefore are not listed in Table 5.

Table 5 Panel DOLS

Variable	Coefficient
FCSPE	0.18***
$R^2$	0.90
Wald $\chi^2$	7.38***

(\*\*\*), (\*\*) and (\*) denotes statistical significance at the 1%, 5% and 10% levels, respectively.

The results show that an increase of 1% of gross domestic product in family policy expenditures could lead to an increase with 0.18 of the number of children born by a woman during her entire life.

### 3. Conclusions

The hypothesis tested has been confirmed for the sample of 30 European countries, for the period 200-2008.

Family and childcare support public expenditure have a positive long-term effect on the fertility rate ( $\beta=0.18$ ).

This result indicates the fact that in the sample European countries, the public authorities' policies for family and childcare support are efficient and contribute to increasing fertility rate. This is a very significant result for countries with a low fertility rate. In order to boost fertility, government authorities could increase the share in gross domestic product of public expenditures targeted at families and childcare support.

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## Risk Typology in Foreign Investment

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### Abstract

*The paper highlights the main categories of risks that transnational companies can face when implementing foreign investment. These risks affect the company's performance and therefore they must be properly managed. Risk factors, risk categories and risk control measures are analyzed here. We also propose a conceptual model of risk measurement that can effectively establish to which specific class of risk belongs the national economy.*

**Key words:** risk, foreign investment, conceptual model, indicators

**Jel classification:** F21, G30

### 1. Introduction

In today's economy, the risk is an ever present element with profound implications at the micro and macroeconomic level. For multinational companies, risk analysis is an indispensable factor in the investment analysis. Any company will perform risk analysis regardless of its typology. The detailed knowledge of the risks that the company is exposed to allows it to adopt decisions that can lead to risk elimination, reduction and effective management. When making an investment, the multinational company will must take into consideration a multifactorial analysis directed to three dominant aspects: the size of the investment, the size of the profit generated by the investment and the risk associated with the investment. The investment return deadline and the investment cost get to a second importance as there is no question of payback unless the investment generates the profit expected by the investors or the risks involved are so large that they cannot be

quantified or managed, damaging thus the return on investment and the profits generated by it. Knowing the typology of risk in foreign investment, of risk factors, of the methods of identification, quantification and management will enable the company to easily adopt investment decisions, based on the deep knowledge of the environment in which the investment is made.

### 2. Risk and foreign investment – literature review

The theories about risk and its implications were developed at the beginning of the twentieth century, when the economic and financial relations started to develop at an accelerated pace, and economists and other categories of professionals involved in the economic and technological process began to raise questions regarding the possibilities of accomplishing precisely planned activities. The first theories about risk as it is currently defined were elaborated by Frank Knight [1], who talked about the association between the probability theory with risk. Two different meanings of risk, a subjective and an objective approach, are highlighted. According to Knight, the term risk designates in a subjective approach the possibility of measuring uncertainty.

Subsequently, the theories about the risk have taken new values, much more complex. Risk analysis and risk management started to be the concern of more and more specialists in various fields. Investment portfolio management gets a new dimension along with portfolio theory developed by Harry Markowitz [2]. Although Markowitz does not strictly define risk, his theory explicitly exposes the investors' decisions and their perception of risk. It makes the connection between the return on investment and its risk.

Risk complexity and its multiple meanings are also highlighted by Glyn Halton [3] who makes an insight of the literature. The findings reveal the complex nature of risk, the multiple ways of approaching different authors and the various perceptions of risk depending on the individual and situation. In spite of all this, two keywords are found in most approaches: probability and uncertainty. The varied meanings of risk are also noticed by Ilan Kelman [4] who makes a presentation of risk definitions. Thus, for Blong [5] risk implies the existence of three elements which are found in a simplified form, while for Crichton [6] or Granger [7] it represents hazard, vulnerability and exposure or elements at risk, which may be expressed or quantified mathematically. According to Sayers [7], risk is probability x consequence.

The American authors [8] define risk: “the possibility of suffering harm of loss, or a course involving uncertain danger or hazard.”

In another sense, the Romanian authors [9], define risk as being “*a possible prognosticable and partially quantifiable phenomenon that can affect the entity’s activities*”. Depending on the type of work and form of risk, the authors mentioned above identify eight major categories of risks that a company can face:

- The operational risk – reflects the company’s incapacity to earn income to cover expenses. Basically there is no correlation between the workload and the structure of costs in a variable business environment.
- The financial risk – characterizes the variability of the indicators under the company’s financial structure.
- The risk of bankruptcy - involves the assessment of the company’s ability to adjust its financial obligations in due time. Basically it analyzes and verifies the company’s solvency that means the capacity to cope with the overdue obligations arising either from the previously contracted commitments or from the current operations whose performance is a condition to continue the activity, or from compulsory sampling.
- The technical risk - adequately appreciated for the operating probabilities of the technical and

technological system components.

- The social risk – generated by the appearance of some inadvertences regarding the personnel or the labor force.
- The cultural risk - caused by the changes in company culture and the impact it creates on its economic system.
- The country risk - provides a snapshot of the way in which the national economic climate is perceived by the international environment.
- The investment risk - generated by the investment made and its ability to cover the investment costs, its depreciation and the profit expected by the investor.

In terms of foreign direct investment we should follow the motivations and the determinants that the investment decision is based on. In what motivations are regarded, Dunning J. [10] makes the best identification of the resorts that represent the basis of the investment decision of multinational companies in this regard. Thus, firms make direct foreign investment:

- to procure the resources necessary to develop their activity. In this respect material resources (minerals and fuels) are particularly sought.
- to be able to spread their products on other markets. The expansion on other markets has the effect of increasing sales and counteracts competition.
- to increase efficiency. Increasing efficiency practically means making a larger gap between the selling price of products and the production cost.
- to acquire strategic assets. This operation aims to expand the production capacity and to locate it on new markets or counteract competition.
- for other reasons such as: the identification of the countries with permissive laws from some points of view (escape investments), parent company support through various activities and products produced abroad (support investments).

The determinants of FDI reveal some aspects regarding the conditions that favor foreign direct investment, conditions that attract a certain host country. The categories of determinants and their aspects are

highlighted by Sanjaya Lall [11] who speaks of three major categories of determinants: the economic conditions generated by the market characteristics, resources and competitiveness found in the host country, the host country policies that include: the macroeconomic policies, the private sector policies, trade and industry as well as the policies of foreign direct investment, and the third category, the transnational corporate strategies including risk and its perception and the multiple strategies adopted by these companies. Besides these categories of factors, we can add a new one, namely that of the factors particularly related to behavior and habits: corruption, nepotism.

The knowledge of the motivations and the determinants of FDI is very important in risk analysis as each category is associated with one or more risks or risk categories.

### 3. Typology of risk for foreign investment

At company level, the investment strategy is elaborated and fundamented by the company experts, who analyze all the aspects regarding: the identification of the best business opportunities, the implementation and evaluation of the investment project, the analysis of the project cost and its profitability, the identification and selection of financing sources, the analysis and management of possible risks. Each of these components is bearing risks that must be analyzed and managed.

*The identification of the best business opportunities* – the panel of business opportunities is not properly identified. The analysis and the selection of the best business has not been made in the best parameters. An analysis of the business environment in the country where the investment will be has not been properly conducted. *The implementation and evaluation of the investment project* - the project has not been properly evaluated from the technical, financial point of view and regarding its resources, time of execution and commissioning service.

*The analysis of the project cost and profitability* – the improper fundamentation of costs (lower costs or higher than the real ones). The profitability rates differ from those initially planned, threatening the payback times or the estimated profits.

*The identification and selection of financing sources* – the selected financing sources are not the best for the company (cost, extensions, and repayment terms).

*Identification, analysis and management of potential risks* - not all risks are identified for the investment and the methods of analysis and management of potential risks are not established.

These issues concern risks that regard the company’s internal strategy. We can consider them internal risks. Besides these potential internal risks, in the investment or investment operation process, multinational companies also face a number of risks that are not strictly related to the internal strategy of the company, they are external risks.

The specialized literature[8] classified the risk of foreign investments into three categories: firm-specific risk (micro-risk), country-specific risk in which the investment is made (macro-risk) and global-specific risk (mondo-risk).

The firm-specific risk category includes: business risk - sales, costs, profits, foreign exchange risk - transaction exposure, operating exposure, accounting exposure, governance risk - goal conflict, ownership structure, human resource.

The host country-specific risk category includes: transfer risk - blocked funds, macroeconomic disequilibrium, economic infrastructure, sovereign credit risk, war and ethnic strife, cultural differences, ownership structures, human resource Norms, Religion, Corruption and nepotism, intellectual property rights; protectionism - defense industry, agriculture, the infant industry.

The global-risk includes: terrorism - potential terrorist attack generated by the host country’s foreign policies, e.g. the U.S.A., the U.K., anti-globalization movement; environment concerns; cyber attacks; poverty. The American authors mentioned above also suggest a number of risk combating strategies. (Table. No. 1)

Table no. 1  
*Strategies of combating risk*

Sensitivity analysis	Minimize assets at risk
<ul style="list-style-type: none"> <li>• simulating business plan</li> <li>• adjusting</li> </ul>	<ul style="list-style-type: none"> <li>• minimize equity in subsidiary</li> <li>• borrow</li> </ul>

discount rate • adjusting cash flows	locally
Diversification	Insurance
• plant location • source of debt and equity • currency of denomination • supply source • sales location	• hedging currency risk • risk sharing agreement • country investment agreements • investment guarantees

source: (Moffet, Stonehill, Eiteman, 2003)

One may observe that these strategies cover a range of distinct methods through which risks are reduced. Sensitivity analysis involves interventions that are particularly linked to the way in which the investment strategy is conceived (rates, revenues, expenses, cash flow). Assets are managed in such ways that especially aim at their size and control. Diversification is, in our view, a much more complex and expensive strategy than others. If the strategy proves to be wrong, the risks are much higher. The method of reducing risk through various insurance forms is increasingly used at international level.

#### 4. A conceptual model of risk analysis in foreign investments

The model that reflects the way in which the risk for foreign investment is perceived involves several steps such as:

1. identification of the relevant risk-related elements
2. realization of a model to quantify risk
3. creating a system of risk interpretation.

According to our opinion, the significant elements that belong to the risk analysis of FDI are:

- a. The indicators of macroeconomic performance. This category includes: the rate of inflation, the rate of gross domestic product, the rate of public

debt and budget deficit.

- b. The economic freedom offers a valuable starting place from which to reflect on the fundamental principles of the free-market system and the lasting value of economic freedom. The index is formed on the basis of ten indicators representative for a free market: the corruption level, property rights, governmental and fiscal and public expenditure policies, the monetary policy, the labor force policy, the freedom to make business, trade, investment policies, and financial policies.
- c. The country risk classifications are meant to reflect the country risk. Under the participants’ system, country risk is composed of transfer and convertibility risk (i.e. the risk a government imposes capital or exchange controls that prevent an entity from converting local currency into foreign currency and/or transferring funds to creditors located outside the country) and cases of force majeure (e.g. war, expropriation, revolution, civil disturbance, floods, earthquakes). The country risk classifications are not sovereign risk classifications and should not, therefore, be compared with the sovereign risk classifications of private credit rating agencies (CRAs). Conceptually, they are more similar to the “country ceilings” that are produced by some of the major CRAs. The Participants’ country risk classification system uses a scale of eight risk categories (0-7).
- d. The global competitiveness index allows assessing and comparing a country’s economic performance. The composition is a composite index which includes 12 components: the institutional environment, infrastructure, macroeconomic environment, higher education and training, goods market efficiency, technological readiness, labor market efficiency, financial market development, market size, business sophistication, innovation, health and primary education.

The proposed theoretical model is based

on the arithmetic average of the indicators that are part of the model.

$$Y = \frac{\sum_{i=1}^4 Indi}{4}$$

where:

Indi = indicators that are part of the model  
and I = 1- 4 represents the number of indicators

The classification of Y (the phenomenon) between certain parameters allows its qualitative characterization. The economic theory captures either the intervals with limit  $Y \in (k, z)$  or intervals with upper or lower limit  $Y \leq K$  or  $Y \geq K$ .

In our case the equation becomes:

$$Ir = (PE + EF + CR + CG)/4$$

where: Ir – risk index; PE – macroeconomic performance, EF – economic freedom, CR- country risk, CG- global competitiveness.

The methodology for calculating the indicators is similar to the methodology used by PNUD in calculating the human development index (HDI).

Thus the indicators are calculated as follows:

$$V_{ind.I} = \frac{V_i - V_{i \min}}{V_{i \max} - V_{i \min}}, \text{ where:}$$

$V_i$  – value of the “I” indicator at the country level

$V_{imin}$  – minimum value of the “I” indicator at the level of the countries that are evaluated with this indicator.

$V_{imax}$  –maximum value of the “I” indicator at the level of the countries that are evaluated with this indicator.

For inflation and public debt we use the following formula:

$$V_{ind.I} = (1 - \frac{V_i - V_{i \min}}{V_{i \max} - V_{i \min}}) \times 100$$

For the criteria where there are differences between the maximum and minimum values, the values are converted into logarithms.

According to the methodology, all values can have a position in the interval 0-100. The values that go towards zero indicate a very low risk, while the values going to 100 indicate a high risk.

To facilitate classification with a particular area, we offer the following classes of risk:

Table no. 2  
Classes of risk

Class	Scoring	Risk category	Recommendation
A	0 - 20	Very low risk	Recommended for investments
B	21 - 40	Low risk	
C	41 - 60	Medium risk	Caution
D	61 - 80	High risk	Not recommended for investments
E	81 - 100	Very high risk	

Source: made by the authors

The classes from A to E reflect the economic position towards risk. At the same time, it indicates, as a recommendation, the position towards risk. The indicator presented in this form can be a very useful tool and easy to interpret for the companies that want to invest in a particular country.

## 5. Conclusions

Risk is a possible element that we can encounter in any activity. Knowing the risk, its analysis and interpretation, the adoption of some measures of prevention and control represent key-elements to risk management at company level. The study highlights the presence of three major categories of risks that a company can face when deciding to make an investment in a different country than the country of origin. The proposed indicator together with the presented classes of risks constitutes various risk analysis tools that can be used and developed by any company.

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# The Foreign Direct Investment - Investment Environment Relationship

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## Abstract

*This paper aims to identify the relationship between foreign direct investment and the investment environment. The major investment environment variables are highlighted, the strength and correlation between them. The scientific approach highlights the main motivations of international companies to invest in different countries' economies, other than the origin ones, as well as the elements specific to the investment environment found in the acceptance of various international organisations and institutions. The model build is based on a multiple regression function and four variables that characterise the investment environment. The regression equation obtained, as well as the statistical analysis highlight how foreign direct investments are influenced by the model's variables.*

**Key words:** variables, model, foreign investment, investment environment

**JEL Classification:** C30,G 30

## 1. Introduction

Attracting foreign direct investment has been and continues to be a central concern of any government due to the many implications that this type of investment generates within an economy. Investment theories put foreign direct investment motivations and determinants in the spotlight, but without putting special emphasis on the relationship between investment and the investment environment. However, the above mentioned theories, capture, without explaining, a series of elements constituting the investment environment variables. The investor is undoubtedly concerned with the investment – efficiency relationship. He will be guided according to the organisation's specific needs

to those locations which enable business growth and profit maximisation. The choice of the investment location requires a double analysis: identifying the internal motivations underlying the business expansion and the investment environment specific to the host country. Most often, the investment decision involves creating a matrix showing the advantages and disadvantages arising from the host country's policies, freedom of action, tax system, property right or other elements related to the firm's external environment, more or less controllable elements.

## 2. Theories specific to foreign investment and investment environment

The theories on foreign direct investment have diversified over time, as financial relations have developed, national companies have become transnational corporations and global economy has entered the age of globalisation.

Over time important authors have expressed their views on foreign investment, on their role, on the business internationalisation stages. Among the most important theories there are: production cycle theory [1], market imperfections theory [2], Porter's competitive advantage theory [3] if we refer to the representatives of the North American continent; but also Anglo-Saxon theories, such as the representatives of the oligopoly theory [4] or the eclectic theory [5] – a theory very present in the scientific community today. According to Vernon, the internationalisation of business involves four stages: 1. consolidation in the country of origin; 2. export to the country of destination (which will become the location for investment); 3. localisation of production in the host country; 4. export from the host country. Hymer identifies among the motivations at the basis of business internationalisation the benefits achieved by

the market (fiscal policy, ratio between profitability and cost, access to resources). He is the first author who includes among motivations the variables of the investment environment. The “Porter Diamond” shows which are the factors at the basis of the competitive advantage: the companies’ strategy, the state of the factors, the demand parameters, and the nature of related industries. The oligopoly theory highlights the advantages multinational companies can benefit from due to the oligopolistic characteristics that can develop or generate them as a result of localisation in a particular country.

The OLI paradigm developed by J. Dunning is the current dominant opinion today. There are three essential aspects of the foreign investment theory that are highlighted: the investor’s benefits, the advantages of the location and the internationalisation benefits. Dunning also identifies five categories of motivations behind transnational corporations’ investment decision. Thus, transnational companies are turning to natural resource-rich countries or to countries where they can get an advantage due to cheap and relatively qualified labour. Thus, they direct towards the poor countries which have ores and fuels or towards emerging countries whose labour is paid less than the workforce in the country of origin. This can create a significant gap between the production cost and the selling price, a gap representing a major advantage for the company over the competitors.

Selling to other markets is a way to maximise the turnover and therefore the profit. The markets from the developed countries that have a high absorption rate are targeted, the products offered being special in terms of quality, but also the markets from the developing countries, which have great potential and which generally absorb products that are not really state-of-the-art.

Transnational companies seeking to increase efficiency are based on three major objectives: rationalisation of production, extended economies and risk diversification. Efficiency is measured as the optimal ratio between the company’s income and expenditure.

The acquisition of strategic assets involves the extension of the production capacity in the host country to produce for the local

market at lower costs, thus achieving a closer relation with the customers on the one hand, and a cost saving on the other. Another objective at the basis of strategic assets acquisition is counteracting competition, to stop its expansion.

In terms of motivations generated by the permissive legislation or by the parent company’s support, the scope of these motivations can be generated precisely by a number of variables specific to the friendlier investment environment than at home or in other countries that could become locations for investment.

The analysis of these motivations allows the identification of the internal scope of the multinational company that decides to make an investment in a certain country that becomes the host country. But the investment decision does not only involve exploring the internal motivations. The investment environment is a landmark of great importance in the investment analysis. We can say that an investment decision, respectively the achievement of the investment involves the exploration and analysis of the needs generated by the motivations specific to the company that we call internal motivations, but also by the conditions encountered in the host country that we call external motivations generated by the investment environment conditions specific to the host country.

Regarding the investment climate the World Bank states: *“the investment climate represents the economic and financial conditions in a country that affect both the country’s population and the investors”* [6]. This climate should provide business opportunities for all businesses regardless of their size. *The investment climate contributes significantly to the economic growth and to poverty reduction* [6]

There are concerns about creating an attractive investment climate in the European Union as well to enable the achievement of sustainable investment designed to pull Europe out of recession. In this respect the European Commission states: *“the setting up and development of an enterprise is not only an exciting adventure, but also a real challenge. To help entrepreneurs meet this challenge, it is necessary to create a favourable business environment. Facilitating the access to financing, clearer and more*

*effective legislation, development of an entrepreneurial culture and business support networks are all essential for the setting up and development of enterprises. However, creating a favourable business environment does not only mean improving the companies' growth potential. It also means making Europe an advantageous place to invest and work. Thus, promoting corporate social responsibility contributes to increasing the attractiveness of European business. Small and medium enterprises (SMEs) represent 99% of European companies. Their small size makes them very sensitive to the changes in industry and in the operating environment. It is therefore extremely important to pay special political attention to their welfare” [7]*

There are five courses of action mentioned that will lead to a favourable investment environment: 1. Small and medium enterprises – because they represent 99% of European companies; 2. Entrepreneurship; 3. Business support; 4. *Improvement of the business environment*; 5. Social responsibility of the enterprise.

### **3. Analysis of the business environment – foreign direct investment relationship**

The analysis of the relationship between foreign direct investment and the business environment involves identifying a model and the specific variables allowing the quantification of the relationship between the two components analysed.

The elements targeted by various organisations or financial institutions to characterise the investment environment differ in most cases, but there are also common elements.

In the case of the World Bank the following elements are targeted and analysed: stability and security, regulation and taxation, finance and infrastructure, labour market (WDR 2005).

International Finance Corporation characterises the investment environment of a country using the following elements: business environment, infrastructure, regulations, taxes and licenses, corruption, crime, finance, innovation and employment.

International Bank for Reconstruction and Development (IBRD) in the annual reports – Doing Business – uses the following

attributes in determining the ranking of a country's investment/business environment: ease of business start-up, permits, employment terms, company and property registration, getting credit, taxes, international trade, enforcing contracts, closing business.

As it can be seen there are certain different elements that are targeted and which compose differently the investment climate. It may be noted that the above mentioned institutions and organisations do not use macroeconomic performance indicators in characterising a country's investment climate. We consider it imperative that these macroeconomic performance indicators be part of the model characterising the relationship between the investment climate and foreign direct investment.

In this context the model that captures the relationship foreign direct investment – investment environment is written as follows:

$$FDI = (\text{investment climate variables}) \\ \text{is extended to} \\ FDI = (RL, LG, RE, OM)$$

where *the investment climate variables* consist of: **Rule of law** (property rights, freedom from corruption); **Limited government** (fiscal freedom, government spending); **Regulatory efficiency** (business freedom, labour freedom, monetary freedom); **Open markets** (trade freedom, investment freedom, financial freedom).

In this context one can use a multiple regression function to characterise the phenomenon.

$$Y_t = a_0 + a_1X_{1t} + a_2X_{2t} + \dots + a_kX_{kt} + e_t, \quad t = 1, 2, \dots, n$$

where:  $a_0$  – is the constant value,  $a_1 - a_k$  equation parameters, and  $x_{1t} - x_{kt}$  variables of the function,  $e_t$  – standard error.

In our case the function is written:

$$FDI = a_0 + a_1(RL) + a_2(LG) + a_3(RE) + a_4(OM) + e_t$$

Where:

RL = rule of law containing property rights and freedom from corruption.

This indicator is calculated as average of the two indicators that compose it.

LG = limited government includes fiscal freedom, government spending. The indicator is calculated as average of the two indicators that compose it.

Table no. 2

RE = regulatory efficiency includes business freedom, labour freedom, monetary freedom. The indicator is calculated as average of the three indicators that compose it.

OM = open markets includes trade freedom, investment freedom and financial freedom. The indicator is calculated as average of the three indicators that compose it.

The statistics used in the model are presented in Tables no. 1 and 2 as follows:

Table no. 1

The FDI value and the indicators that characterise the business environment

Year	Foreign direct investment (mil. euro)	Rule of law	Limited government	Regulatory efficiency	Open markets
2011	1917	39	72,2	69,06	72,53
2010	2220	39	72,8	68,73	70,83
2009	3488	36	78,5	69	65,26
2008	9496	30,5	78,2	67,9	65,33
2007	7250	30	78,45	66,96	64,66
2006	9059	29,5	78,2	66,23	56,13
2005	5213	29	69,5	57,7	50,13
2004	5183	28	72,35	55,9	45,86

Source: [www.bmr.ro](http://www.bmr.ro).

<http://www.heritage.org/index/explore> and processing of the author

Due to the very large differences in value between foreign direct investment and business environment indicators it was needed to find the logarithms of these values.

The statistical analysis shows a very slight standard deviation located between 0.02 and 0.27 for limited government and 0.27 for FDI. In terms of skewness analysis, it shows their distribution to the median. Thus, the positive values indicate a distribution concentrated on the left while the negative values indicate a distribution concentrated on the right. Statistically, one can notice “the length of the series tail” and its orientation. In the case of the analysis of the variables within the model presented, one can notice that only the rule of law has a positive value indicating a left-oriented distribution, while foreign investment, limited government, regulatory efficiency and open markets have negative values, thus a right-oriented distribution.

The logarithmic values of the indicators presented in Table no. 1

Year	Foreign direct investment (mil. euro)	Rule of law	Limited government	Regulatory efficiency	Open markets
2011	9,282622	1,391065	1,858537	1,839227	1,860518
2010	9,346353	1,391065	1,862131	1,837146	1,850217
2009	9,542576	1,356303	1,89487	1,838849	1,814647
2008	9,977541	1,4843	1,893207	1,83187	1,815113
2007	9,860338	1,477121	1,894593	1,825815	1,810636
2006	9,957080	1,469822	1,893207	1,821055	1,749195
2005	9,717088	1,462398	1,841985	1,761176	1,700098
2004	9,714581	1,447158	1,859439	1,747412	1,661434

Source: processing of the author

Table no. 3

*Descriptive statistics*

	FDI	RL	LG	RE	OM
Mean	9.668251	1.509904	1.874746	1.812819	1.782732
Median	9.715834	1.480711	1.877669	1.828843	1.812641
Maximum	9.977541	1.591065	1.894870	1.839227	1.860518
Minimum	9.230449	1.447158	1.841985	1.747412	1.661434
Std. Dev.	0.275576	0.059591	0.021414	0.036862	0.071830
Skewness	-0.425211	0.504075	-0.256077	-1.089820	-0.626563
Kurtosis	1.845926	1.504094	1.438447	2.376517	1.989928
Jarque-Bera	0.685034	1.084700	0.900250	1.713186	0.863522
Probability	0.709981	0.581380	0.637549	0.424606	0.649364
Sum	77.34601	12.07923	14.99797	14.50255	14.26186
Sum Sq. Dev.	0.531594	0.024658	0.003210	0.009512	0.036117
Observations	8	8	8	8	8

Source: processing of the author

The relationship between the variables is highlighted by the Correlation Matrix. This highlights the strength of the links between variables. The standard values are included in the [- 1, 1] range. If the values tend towards - 1 or + 1, then the correlation is strong. On the other hand, for the values that tend towards zero we consider a weak correlation and for the zero value the variables are independent. In Table no. 4 we notice the intensity of the links between the variables. Regarding foreign direct investment we find out that they are strongly correlated with rule of law and averagely correlated with limited government and open market. Surprisingly, the correlation is weak with regulatory efficiency.

Table no. 4  
Correlation Matrix

	FDI	RL	LG	RE	OM
FDI	1.000000	-0.856951	0.512554	-0.245383	-0.460124
RL	-0.856951	1.000000	-0.084190	0.691897	0.814607
LG	0.512554	-0.084190	1.000000	0.587037	0.336815
RE	-0.245383	0.691897	0.587037	1.000000	0.940474
OM	-0.460124	0.814607	0.336815	0.940474	1.000000

Source: processing of the author

In terms of the equation resulting from the application the model is the following:

$$FDI = -5,848673RL - 0,237419LG + 6,373131RE - 0,864731OM + 8,932540$$

Table no.5  
Equation

Variable	Coefficient	Std. Error	t-Statistic	Prob.
RL	-5.848673	1.199431	-4.876205	0.0165
LG	-0.237419	3.557490	-0.066738	0.9510
RE	6.373131	4.661623	1.367149	0.2650
OM	-0.864731	1.847348	-0.468093	0.6716
C	8.932540	3.537073	2.525404	0.0858

R-squared	0.968877	Mean dependent var	9.668251
Adjusted R-squared	0.927380	S.D. dependent var	0.275576
S.E. of regression	0.074262	Akaike info criterion	-2.093254
Sum squared resid	0.016545	Schwarz criterion	-2.043604
Log likelihood	13.37302	F-statistic	23.34811
Durbin-Watson stat	2.364278	Prob(F-statistic)	0.013470

Source: processing of the author

For this equation R – squared is 0.968877 very close to the standard value 1, and adjusted R – squared is 0.927380, a value very close to R – squared. In these circumstances we can validate the model; moreover, it shows strong links between components.

#### 4. Conclusions

Between the foreign investment and the investment environment there is a direct and stronger link. The investment environment in a country together with the transnational company’s internal motivations is at the basis of the investment decision in a particular location. The investment climate variables characterise the economic environment

specific to the host country: ownership, corruption, fiscal and monetary policy, trade freedom, government spending, regulations on investment, labour market all are the pros and cons of investing. The model presented allows identifying the relationship between foreign direct investment and the business components, the intensity and correlation of these links.

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# Importance of Assessing and Managing Credit Risk in Banking Institutions

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## Abstract

*Credit market is in a continuous and complex process of adaptation of offered products and services, due to the competition between banks, competition generated also by the globalization effects of economic activities.*

*In these terms, the banks are obligated to consolidate their position on the market by identification the ratio between risk and profit, so that it can be assured business continuity.*

*For the banks to be able to maintain on the market it is necessary that they comply with the standards and the regulations on credit risk assessment and management.*

*A performance banking strategy should include clearly defined programs and measures for assessing and managing credit risk, measures that have to minimize potential exposure to bank risk and maximizing the profits.*

**Keywords:** credit risk, identification of risk, assessing the risk, managing the risk, banking performance.

**JEL classification:** G21, G32.

## 1. Introduction

Evaluation and management of credit risk is a complex process involving major resources and knowledge. The success of these assessment activities and credit risk management in banking institutions is dependent on managers' ability to correctly identify the potential risks they face when they decide a company credit.

This stage is actually initiating the risk assessment process, after establishing the right context in which the company will work in the future.

If a banking institution assesses a request for funding companies it will try to identify in advance all the threats that could affect both the activity of the bank and the company that require funding.

Credit risk is a challenge for every financial institution in that it can not be eliminated entirely from lending activities. This risk is assumed by the difference of each banking institution based on behavior and different attitudes from risk.

## 2. The need and the role of assessment and management of credit risk

It is known that a banking strategy should include both program performance and clear procedures for assessing and managing credit risk, which aim to minimize the likelihood of such risks and potentially expose the bank. The main objective of these programs and procedures is to minimize the additional costs incurred by the bank.

In some cases the bank's strategy may involve more risk taking or risk us. In this case the decision must be made considering the additional costs necessary to ensure greater protection.

As a general principle, the main objectives of assessment and managing credit risk are:

- maximizing profitability;
- minimize exposure;
- compliance with banking regulations in force both internal and external.

Often the importance of assessing and managing credit risk is not limited to minimize costs. The constant preoccupation of bank management or top management, to minimize exposure to risk has positive effects on the behavior of bank employees who become more rigorous and conscientious in fulfilling their duties. [9]

Assessment and effective management of credit risk and its toll on the public image of

the bank. Customers want a secure bank and shareholders alike.

By monitoring risk in lending and exposures by industry, banking companies aim to maintain a constant balance between its objective of risk dispersion and the interest which aims to develop the national economy as a whole, with the support of sectors considered priority strategic or competitive potential domestic and foreign. [2]

With the assessment and management of credit risk for the banks lending has become an issue of growing importance and also more pressing. In this time of economic crisis and financial instability, commercial banks in Romania have to bear higher credit risks under the fierce competition erodes their profit margins high. In these conditions, increased vulnerability to negative shocks successive banks, leading for mismanagement of credit risk in bank failure. To survive these conditions and to thrive and policy banks need new models of assessment and credit risk management, credit market conditions always adapted. In these circumstances, bank management, implementation of appropriate policies assessment and risk management becomes a necessity, as well as assimilating the employees of some new techniques and tools for risk management.

Romanian banking sector growth has become an essential attribute of banking performance. It is not an end in itself but is imposed by the profitability of investments in new technologies, possible only in conditions of effective assessment and management of credit risk.

Economic and financial environment in which they operate both banks and their clients (companies) generate new business opportunities for both sides, involving also the most complex and diversified risks, which represents a new challenge to traditional approaches to assessment and management of credit risk that banks must manage it as adequate to survive competition and to support its overall national economy.

Risks are well administrate when they can be understood, measured and controlled and when the bank is able to resist their negative impact. [8]

Credit risks are a source of unexpected expenses, assessment and appropriate

management can stabilize their income while having as a shock absorber. All banks should improve their understanding and practice of assessment and credit risk management to be able to successfully manage the diverse range of products it promotes.

A performance evaluation and risk management results in obtaining a bank as profitability. Profitability is one of the essential objectives of a banking company, for which in all cases will be like a maximization of profit, as achieving a high return on equity. [6]

Banks will be able to successfully assess and manage risk in lending, if they recognize and understand the strategic role of assessment and risk management to increase efficiency, if they adopt specific measures to adapt to risk and performance if they create mechanisms according to risk reporting.

If credit is one of the "principal products of the financial institution, the organizational structure and management systems of all product components should reflect this. A bank can quickly become unprofitable or insolvent as a result of poor decisions on loans, resulting in non-performing assets. [5]

### **3.Corelation between assessment and management of credit risk**

Bank risk management problem is approached from a narrow perspective, the types of risks. This is because banks are diverse and complex risks. Among the most important risk is credit risk, but should not overlook the fact that all risks, the bank's exposure is more risk and also are in interdependence. Global management of these risks in entering and credit risk a necessity and be organized at the plant each bank. An appropriate credit risk management should ensure the bank's ability to identify, assess, eliminate, prevent and finance risks.

All these steps to identify, assess, eliminate, risk avoidance and financing are part of the management of credit risk.

Often risk is an economic category complex, difficult to assess and manage, especially since it is conducted in the banking operations. [3]

In the evaluation phase of credit risk priorities that should be taken into account are: anticipating losses, establishment, transfer any credit risk.

Integration of credit risk assessment process both credit risk management in strategic planning and ensure efficient management of bank credit risk and risk profiling current and future. To integrate the identification and risk assessment process both bank risk management and planning process, the bank has to first identify the main business lines, business lines including internal lending standards and procedures regarding employee duties involved in this process and tasks associated ancillary activities.

Identification and management of banking risks is both a philosophical problem and a problem running the banks. Philosophical problem is the attitude of banks towards risk and strategies adopted in relation to risk. Malfunction as it is risk identification, risk classification and the methods and procedures used for measuring, monitoring and control. The two approaches are not independent of each other. Attitude to risk is creating guidelines for monitoring, measuring and controlling risk. [7]

The credit risk management begins with determining the risk profile for each product type loan that the bank that wants to promote. The risk profile should be compared with the bank's risk profile. To identify and assess the risk of a credit bank product type, managers must identify all situations that can cause significant financial loss for the bank.

Misidentified risk can not be intelligently managed. However a risk was identified and quantified with precision, its treatment program is quite natural. [4]

Methodologies for identification and risk assessment can provide an estimate of the risk profile for both bank branches and agencies and the entire bank. In the absence of clear risk assessment methodology, a bank has not Niciu a means to reduce expenses related to credit risk through rigorous control and a more appropriate risk financing.

It is generally difficult to manage risk, if he was not identified, assessed and properly quantified. Credit risk as any risk can be eliminated by removing the cause that produces it.

When credit risk is identified and assessed in time, managers can redesign products and activities that generate credit risk by product and associated activities in order to minimize credit risk identified initially.

Eliminate and prevent credit risks on time can have an effect on cost reduction totate the bank if the bank has correctly assessed the risks associated costs and revenues adjusted for credit risk associated with each product separately.

Risk assessment is the process of comparing the results of risk analysis with risk criteria to determine if the risk is acceptable or tolerable. [11].

Credit risk assessment involves comparing the level of both risk tolerance criteria, and determine priorities for the initial treatment phase ulteriora risk.

Risk treatment is the application of policies and methods to influence and control credit risk.

At this stage follows: [11]

- avoid risk by deciding not to initiate or continue resulting in increased risk;
- looking for an opportunity by deciding not to initiate or continue to create or increase risk;
- relocation of risk source;
- change the probability of risk;
- change consequences;
- distribution, transfer or separation of risk in many parts;
- withholding or stopping credit risk through the use of choice.

When risk assessment is carried out improperly and recorded negative consequences, it follows:

- reduction or risk reduction;
- eliminate the risk;
- preventing the risk;
- management, suppression or managing risk;
- correction of risk.

All these are measures to control or change in credit risk.

If we consider that most bank assets take the form of loans, credit decision is a very important banking function.

In terms of financing through a loan of economic entities of the most important analysis is the primary risk analysis. Dynamic efficiency of banks can be reduced, if the bank is not organized to deal with immediate risk in the event of irregularities on lending.

Credit risk assessment takes into account the six "C" of credit and includes: [1]

- Character (willingness to pay)
- Capacity (ability to pay)

- cash
- Collateral (insurance if necessary)
- Foreign and economic conditions;
- control and audit, preparation of documentation according to internal regulations of bank credit.

Character - in customer credit analysis, bank wants to convince the good intentions in the loan and its repayment.

Capacity - the bank must verify the client's legal ability to request credit, if legally competent to request a loan and offer legal status of his signature on a credit agreement.

Cash - refers to the client which can generate enough cash (cash) in the form of income or cash flows to repay the loan.

There are three sources of funds that a trader can use to reimburse a loan:

- cash flow;
- sale of fixed assets;
- issuance of equity or credit;

Any of these sources of liquidity can provide sufficient funds to repay a bank loan. Banks prefer a loan repayment source to be cash flow from current activity, because the sale of fixed assets may jeopardize current client activity and a new loan may be less secure position as a creditor bank.

Collateral - To assess collateral, the bank must consider the client assets, not only to assess the feasibility of possible guarantees that the client will provide in exchange for credit, but also to estimate the capacity of these assets continue to support client activity.

Conditions - The bank customer evaluation must consider:

- Client's position in the industry and market that covers;
- Economic and financial performance compared to firms the same activity;
- On labor market conditions, environmental factors and the policies;

Control and audit - the last essential factor in assessing client. Control involves ensuring that the bank loan to meet standards and the regulatory authorities in terms of credit quality, and express an audit opinion on the accuracy of financial reports.

#### 4. Conclusions

Avoiding credit risk require thorough analysis and multilateral banks to the debtor (solvency, liquidity, profitability, human

competence, economic situation and internal and external financial, etc.), but also to ensure adequate safeguards. [10]

Credit risk management in terms of commercial banks is identifying and assessing all accounting procedures and methods of bank credit risk management in order to limit, division and their financing, and mitigate risk exposure of each bank.

In this context, credit risk should be assessed in comparison with the benefit that the bank is expecting to obtain the loans, the most important function is the management of credit analysis and credit risk assessment because poor credit is the main cause of bank failures.

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# The New Approach of Qualitative Characteristics of Accounting Information in Financial Reporting

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## Abstract

*The qualitative characteristics are those features that give utility and value to the information presented in the financial statements. They are features derived from the normalization of a conceptual framework and a chart of accounts. These qualities, which are supposed to be general for all accounting data, connect the objectives of the financial reporting and the requirements from accounting standards, by separating the useful information from the unnecessary ones, information which are going to be presented in the financial statements.*

*In this paper, we will conduct a research in order to find out the useful characteristics of accounting information presented in the financial statements. The research will be conducted by analyzing and comparing the information in diverse accounting framework, especially the American and the international one, both before the changes brought by the Conceptual Frameworks in 2010 and at the present time.*

**Keywords:** fundamental qualitative characteristics, the relevance, the faithful representation, enhancing qualitative characteristics, comparability

**JEL Classification:** M40, M41

## 1. Introduction

The American referential, FASB, and the international one, IASB, work together to develop a common financial reporting framework.

Therefore, FASB and IASB launched the first phase of the project on 28 September 2010, as result, the International Conceptual Framework and the American one (SFAC no. 8/2011), issued by January 2011 regarding the “Qualitative characteristics of the

information presented in the financial statements” agreed on the competency, definition, hierarchy of the qualitative characteristics, but also agreed on the restrictions necessary in order for information to be considered useful.

Thus, *the relevance* and *faithful representation* are considered **fundamental qualitative characteristics**.

**Enhancing qualitative characteristics** are considered the following: *comparability, verification, opportunity, intelligibility*, who amplifying, helps to improve the fundamental characteristics.

## 2. The fundamental qualitative characteristics

If not so long ago we considered the relevance and the credibility as core qualitative characteristics, presently the accounting frameworks IASB and FASB tend to agree upon a common denominator, by keeping the relevance and replacing the credibility with the exact representation.

### ■ The information relevance

Is the essential quality of accounting information because it refers to the ability of influencing the decisions of investors, creditors and other users of financial statements.

A relevant information also helps the users to evaluate the past, present and future events and to correct eventual mistakes from the past.

The relevance must be evaluated taking into account not only the principal objective of the financial situations, namely to help the users make decisions, but also has to consider the context in which the financial statements were elaborated.

Regardless of the conceptual framework used, the relevance of information is

influenced by *the nature of the information and its threshold of significance*.

*The nature of the information* – refers to the descriptive aspect of the information (for example the re-evaluation of a new sector of activity of an enterprise, or of an tangible/intangible asset) and *the threshold of significance* refers to the size, value of the information (the value obtained by the new sector of activity, the value of the tangible/intangible asset). The two factors can together or separately ensure the relevance of information.

If until the revision from 2010, the American framework presented separate the threshold of significance from the qualitative characteristics, more precisely *as restriction* of them for establishing the utility of information, with the new changes brought by the convergence process, the threshold of significance is presented *as a feature of relevance*. The conceptual frameworks consider that the relevance plays a double role in its relation with the users.

First, *has a predictive value* – for example the current and even the past information regarding the level and structure of the owned capitals - which guides the investors in their forecast of the enterprise’s reaction capacity to avoid unfavorable situations.

Second, *a confirmation value* which compares the effects of decisions taken based on the forecasted financial situations, and those based on the present financial situations.

The two values of financial information are connected.

### ■ The accurate representation

The conceptual frameworks consider that in order to be useful, the accounting information must *represent with accuracy the respective events*.

The accurate representation has three features: the information must be **complete**, **neutral** and **without errors**.

In the previous version of the conceptual framework, *the complete* and *neutral* features of accounting information were aspects of credibility, characteristic that is not known anymore under this name.

However, we notice that the credibility’s features (defined in the previous conceptual frameworks), namely the accounting

information mustn’t contain errors, omissions or elements which might lead to wrong interpretation – are founded in the explication given by the new version of the conceptual framework **“without errors”**, which completes the accurate representation.

The second feature of the accurate representation is that the information presented in the financial situations must be **complete**.

We observe that in the previous version, the American conceptual framework not clearly defined this feature through SFAC2, that IASB conceptual framework however this feature could be understood. In the new version, this drawback is eliminated through *SFAC 8 Qualitative Characteristics of useful Financial Information*.

A complete description of the phenomenon must include all the information necessary in order for the user to understand the event. For some elements, this description must be completed with explanations regarding the significant facts on the quality and nature of the elements, factors and circumstances which might affect their quality and nature.

Nevertheless, the accurate representation of the information presented in the financial statements must be done in the reasonable limits ensured by the conceptual frameworks, limits which refers to the cost/benefit report, but also in the limits imposed by the inaccuracy of the estimation, the professional reasoning of the specialists, the limits of the evaluation bases etc. (IASB and FASB consider the cost as the unique restriction of the financial reporting, **cost** which must be justified by the **benefits** of the reported financial information).

**The neutrality** - is another characteristic which according to the accounting conceptual framework completes the accurate representation, where that accuracy is provided when the selection and the presentation of the information from the financial statements does not influence the decisions that lead to a predetermined result. Additionally, the information must be equally used by all categories of users, without giving advantages to some and to other being harmful.

### 3. The qualitative characteristics which amplifies the information

If previous versions of the conceptual frameworks of International and American had different views to present qualitative characteristics, meaning that the international referential consider the relevance, credibility (reliability), comparability, intelligence as all the main, and the American referential are distinguished by their hierarchy first two being the main and the last two secondary, currently the two conceptual frameworks have the same view: the present the hierarchy of *fundamental characteristics* which were described above and *features which amplifiers*, meaning they aimed at improving, enhancing the usefulness of relevant information and accurate representation.

In this category of secondary features, the following are included: comparability, verifiability, opportunity and intelligibility.

#### ▣ Comparability

The static information of the financial reporting related to a given year, most often are not relevant and do not influence the economic decisions of users, but they may be seen by comparing the same enterprises in different context; this is when its valences regarding the usefulness are achieved. **Therefore**, *comparability of accounting information is a necessary feature in order for it to be considered useful.*

We consider that the necessity to subscribe the financial reporting to a conceptual framework, completed with international standards, is best highlighted by the characteristic comparability for accounting information.

Regardless of the conceptual framework, we noticed the same details for comparability, namely it allows users to identify and understand similarities and differences between elements. But, the comparability *is not to be confused with consistency*, the latter only helps to improve the comparability. Consistency refers to using the same methods, accounting policies as far as possible without distorting the accounting information for the same elements, to ensure comparability from period to period for the same company, or for the same period but for different companies.

Also, the comparability must *not be confused with the uniformity*, and for

ensuring the comparability of the information, similar aspects must be similarly presented, and different aspects must be differently presented.

#### ▣ Verifiability

If in the previous American accounting framework, the verifiability was defined as a feature of credibility, aspect which is more deducted in the international referential, both frameworks define and present this secondary characteristic the same way. The purpose of the verifiability is to ensure the users that the information presented in the financial situations represent accurately the economic phenomenon. These assurances are given by independent evaluators, by confirming the correspondence between the image presented and the intended purpose of events and transactions carried out.

After the measurements done by the independent evaluators, it is easy to agree on the value of liquidities, but more difficult in case of stocks and depreciable assets because of the multiple assessment methods, and much more difficult for provisions, especially those for litigation.

#### ▣ Opportunity

Both, the current international and American conceptual framework define *opportunity* as a feature that enhances the usefulness of accounting information relevant and accurate representation.

In previous versions of conceptual frameworks, in *the international* one the opportunity *was classified as restriction* (limit) of the qualitative characteristics with a certain balance between the need of quality, fair representation and an advantage of cost - benefits, and in *the American* was presented as a feature *that complete the relevance* of accounting information.

Regardless of its hierarchy and framing, its significance remains the same, namely that the information is available when decisions are supposed to be made. Delays in producing them may result in loss of relevance, but at the same time a fast presentation can affect its accurate representation.

The following intervals influence the opportunity: the period between the date of

recognition, measurement and presentation in the financial statements and the date by which information is considered and the moment when the financial statements are published, but also the period elapsed between their publication and the use of information when decisions are made.

#### ☐ **Intelligibility**

Another feature that can enhance the qualities of relevance and the accurate representation is *intelligibility*, whose purpose is to understand the information provided by the financial statements.

The conceptual frameworks, American and International ones believe that information should be presented as understandable as possible, classified and described in a clear and concise manner. **This feature relates the information generated by the financial statements and the user’s need for this information.**

The conceptual frameworks specify that the financial reports are prepared for those users who have sufficient knowledge on economic and business activities, although sometimes they may need the help of an expert to understand information about complex economic phenomena.

**We believe that, the intelligibility must be considered by the accounting referential as a link point between the quality of the information provided through the financial situations and the level of training and understanding of the decision makers, by sustaining a common language between those who prepare the financial statements and those who use them, and not address firstly to that category of users (investors, shareholders, creditors) who have the financial power.**

Therefore, it is important to find equilibrium through language. To support this aspect both the conceptual frameworks and the standards have a section which defines the terms. Finding the most efficient method to define the terms, sustains the intelligibility as a characteristic of the financial situations, but also broadens their usefulness.

#### **4. Qualitative characteristics of accounting information in the Romanian referential**

In the national accounting regulations - **OMPF 3055/2009 for approval of accounting regulations harmonized with European directives**, the usefulness of the accounting information is explained by the following features of qualitative characteristics: understandability, relevance, reliability and comparability, with all four compulsory. We observe that the definitions, characteristics and limits (restrictions) related to these qualitative features are just like those internationally treated by IASB, but prior to its amendments (September 2010) regarding the convergence with FASB.

**We believe** it is time that Romanian accounting regulations also should align to the last amendments of IASB in terms of qualitative characteristics of accounting information, especially from 2012 as the international reference system (IASB conceptual framework and IAS / IFRS) becomes predominant basis for banking, insurance-reinsurance in individual financial statements.

We conclude that the conceptual framework defines and characterizes each quality of accounting information, **but what is important is that it does not indicate how these features should be used.**

This influences the activity of company’s management, because when they need to make a decision, they must identify every opportunity available, and then consider which option is most useful, in this way comparing the qualitative characteristics. This analysis is a matter of professional judgment, which discusses the importance of comparing the qualitative characteristics.

#### **5. Conclusions:**

We are witnessing a rearrangement of the characteristics at conceptual level, with IASB and FASB having as objective a common base for the qualitative characteristics of the information presented in the financial statements.

Thus, they agreed on the components, definition, hierarchy of the qualitative characteristics, but also on the restrictions that must be respected in order for the characteristics to be considered useful.

We consider that the hierarchy of the fundamental characteristics is not justified, and even more, the comparability and

intelligibility should not be considered secondary characteristic, especially the comparability.

The relevance of information is linked to their comparability, and also everything that IASB and FASB have done to accomplish a convergence process is connected to the comparability of information, which makes us wonder why it has not been included in the fundamental category of characteristics.

Another aspect which must be necessary mentioned refers to the fact that, even with all the changes brought to the qualitative characteristics in their definition, hierarchy, components, the way they must be used is not specified at all. This represents an obstacle for the company's management; especially when it has to make a decision, and identify all the opportunities, analyze the useful alternative, by comparing some qualitative characteristics with others, which might lead to a subjective evaluation.

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\*\*\* The Finance Order no. 3055/2009 regarding the Approval of the Accounting Regulations according to the European Directives.

# The Present Requirements on Bank Prudence. Publicity Requirements and Sanctions

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## Abstract

*Requirements on banking activity impose regulation of specific issues concerning both the authorisation and the operation, and also ceasing the bank activity. This enforcement originates from the objectives pursued by the National Bank of Romania as own policy, but also as a separate member of the European financial structures. The analysis aims to identify, without exhaustive study, the intrinsic correlations of essential notions for banking field - prudence, prudential supervision, international publishing and sanctions, quartered obviously in risk area. We mention that risk, as related to surveillance and caution, represents the possibility of potential, expected or unexpected events to have a negative impact on bank capital or bank revenue.*

**Key words:** bank, requirements, bank prudence, publicity, sanctions

**J.E.L. Classification:** K29

## 1. Introduction

Commercial banks are autonomous entities that carry out an activity for profit within the laws of the country. Unlike other types of banking business, banks are entrusted with money resources by other companies and by population, so regulations for banks is more severe, more rigorous, but apply the general principles governing the market economy. Requirements on banking activity impose regulation of specific issues concerning both the establishment and the operation and ceasing the bank activity. This enforcement originates from the objectives pursued by the National Bank of Romania as own policy, but also as a separate member of the European financial structures. The analysis aims to identify, without exhaustive

study, the intrinsic correlations of essential notions for banking field - prudence, prudential supervision, international publishing and sanctions, quartered obviously in risk area. We mention that risk, as related to surveillance and caution, represents the possibility of potential, expected or unexpected events to have a negative impact on bank capital or bank revenue. We will not use the notion of control, which seems included in that broader surveillance, but we remind that a prudential supervision aims at preventing internal or external risk at a credit institution level, and avoiding their spread. Macroeconomic prudential supervision is an internal management activity, given the evolution of constraints that come from outside, the change of activity place or re-defining prudential rules at national and international level. The Central Bank remains the supreme authority in banking supervision, performing this activity through Supervision Committee and the Department of Surveillance of National Bank of Romania. This is the case of the supervision of central banks, along with supervision performed by each bank at internal level. The Supervision Committee is a permanent structure, deliberative and decision-making nature composed of ten members and led by the Governor of the National Bank of Romania. His duties and powers aim at monitoring and evaluating the credit institutions' activities of functioning in terms of asset quality, financial performance and their classification in the regulated level of bank prudence indicators, but also ensuring regulatory base, according to specific legislation and international practices in the field.

## 2. Measures on Bank Prudence

With the beginning of reform, the National Bank has developed a set of rules necessary

for establishing prudence in banking filed, regulations that relate to capital adequacy, large exposures, currency exposure, a bank ownership, ownership of non-banking companies, classification of loans according to risk, general reserves, large loans, training and professional experience of bank managers. The bank prudence, when there is no doctrinal definition, is imposed by measures and indicators that define it. Requirements on capital adequacy (solvency) require that the own funds of a banking company, consisting of capital and additional capital, to represent at least 8% of total assets and the, elements outside the balance sheet, weighted depending on their degree of risk. Then the bank will keep the large exposures, which means that the granting of loans towards a single debtor can not exceed, cumulatively, 20% of the bank's own funds. In accordance with the Regulation on lending to borrowers who are in special relationships with banks, loans to these persons may not exceed, in total, 20% of the bank's own funds. At the end of each working day, the currency exposure will be so that the total currency position may not exceed 10% of the bank's own funds. The *participation* of a banking company in the capital of non-banking companies may not exceed 20% of the capital of an entity that is not related to banking, and participation of a banking company in the capital of another bank will be up to maximum 5% of capital, with the condition of participation of a banking company, a foreign juristic person or an international financial institution. We add to this list of legal requirements *criteria for classification* of granted loans (loans). Thus, depending on their risk, loans are highlights of the five categories: *standard, under observation, substandard, doubtful and loss*. Bank *insurance* needs against risks of loans are covered by general reserves for credit risk and specific risk provisions. And finally, *liable persons* to run a credit institution which takes the form of a bank shall be subject to the rules on training and professional experience necessary to ensure quality and effective business leaders of the bank. In another form, we can speak of prudential indicators that Member States of the European Union measure the bank prudence: bank solvency, high risk factor, the adaptation rate to market

risk, the minimum capital, the financial participations.

### **2.1. Prudence in the stage of bank function**

The supervision performed by the National Bank of Romania can take different ways: a) through periodic reports that banks have to submit in accordance with relevant regulations; b) on the occasion of the presentation of changes in the bank status in order to be authorized; c) by inspections that specialized personnel of the Central Bank perform at the bank and in secondary offices, both in the general topics applicable to all entities in the system, and the periods known for verification of how the regulations practically are applied in matters by the supervised bank. Prudential rules governing the authorization of banks and their supervision are imposed by the need to avoid panic, crisis and reflects the concern for security of the public savings deposited in these banks. Although the bank supervision is the concern about the financial safety and health of the banking institutions, taken individually, the main reason of prudential regulation of banks is the concern for the security of the banking system as a whole and, ultimately, the national economy. National Bank provides prudential supervision of credit institutions, Romanian legal persons, including their branches established in other Member States or in third countries, by establishing prudential rules and indicators and monitoring their compliance and other requirements of law and regulations, both individually and on a level consolidated or not, as appropriate, to prevent and limit the risks of bank activity. Monitoring the compliance of credit institutions, Romanian legal persons, of prudential requirements and other requirements provided by Government Emergency Ordinance no.99/2006 on credit institutions and capital adequacy, is made by the National Bank of Romania through the reports submitted by credit institutions and checks carried out at the credit institutions and their branches in the country and abroad.

To establish and facilitate an effective supervision, the Central Bank, as the authority responsible for consolidated and / or individual supervision, signs written

agreements on coordination and cooperation with competent authorities in other states.

## **2.2 Prudence in the stage of bank function**

The supervision performed by the National Bank of Romania can take different ways: a) through periodic reports that banks have to submit in accordance with relevant regulations; b) on the occasion of the presentation of changes in the bank status in order to be authorized; c) by inspections that specialized personnel of the Central Bank perform at the bank and in secondary offices, both in the general topics applicable to all entities in the system, and the periods known for verification of how the regulations practically are applied in matters by the supervised bank. Prudential rules governing the authorization of banks and their supervision are imposed by the need to avoid panic, crisis and reflects the concern for security of the public savings deposited in these banks. Although the bank supervision is the concern about the financial safety and health of the banking institutions, taken individually, the main reason of prudential regulation of banks is the concern for the security of the banking system as a whole and, ultimately, the national economy. National Bank provides prudential supervision of credit institutions, Romanian legal persons, including their branches established in other Member States or in third countries, by establishing prudential rules and indicators and monitoring their compliance and other requirements of law and regulations, both individually and on a level consolidated or not, as appropriate, to prevent and limit the risks of bank activity. Monitoring the compliance of credit institutions, Romanian legal persons, of prudential requirements and other requirements provided by Government Emergency Ordinance no.99/2006 on credit institutions and capital adequacy, is made by the National Bank of Romania through the reports submitted by credit institutions and checks carried out at the credit institutions and their branches in the country and abroad. To establish and facilitate an effective supervision, the Central Bank, as the authority responsible for consolidated and /or individual supervision, signs written

agreements on coordination and cooperation with competent authorities in other states.

## **3.Publication.Publicationrequirements**

To ensure uniformity and comparability of published information, the European Committee of Banking Supervisors, CEBS has developed a web structure standardized disclosure requirements, addressed to the supervisory authorities of Member States, and published general instructions necessary to implement this common approach (CEBS Guidelines on Supervisory Disclosure). From January 1, 2011, the European Banking Authority, EBA, established by Regulation (EC) nr.1093/2010 of the European Parliament and the Council from 24 November 2010, took over all responsibilities of the Committee of European Banking Supervisors. Thus, the important role of prudential supervision transparency was emphasized both by the Basel Committee on Banking Supervision and the provisions of the new European legislation (Directive on the taking up and pursuit of credit institutions - 2006/48/EC and Directive on capital adequacy of investment firms and credit institutions 2006/49/EC). Article 144 of Directive 2006/48/EC stipulates explicit disclosure requirements for supervisory authorities of Member States.

The legal instruments that ensure bank prudence in publication are contained in the following regulations:

- Laws and regulations that ensure adoption of the provisions of Basel II in Romania, gathered in Directives 2006/48/EC and 2006/49/EC. These documents present the legislative and regulatory in the prudential field, subject to prudential supervision of credit institutions in Romania.
- Specifications and instructions issued to establish a unitary application of new legal provisions by the supervised institutions.
- Guidelines that include explicit requirements of transparency provided by the two directives, and detailing the application and compliance with new legal provisions.
- Reporting requirements that include information on key issues of implementation of financial reporting (FINREP) and prudential reporting system (COREP)

In addition, Directives 2006/48/EC and 2006/49/EC contain a significant number of

options (to the supervisory authorities or institutions subject to supervision in a Member State) the exercise of which depends on each country. Central Bank shows how to exercise, in the national regulators frame, of national options under Directives 2006/48/EC and 2006/49/EC and cases of mutual recognition of various treatments related to the exercise by the other Member States, of these options. In addition, the supervisory authority provides tools for performing the prudential supervisory, the general criteria and methodologies used in Romania, in the process of verification and evaluation (SREP), minimum requirements for the internal processes for assessing capital adequacy to risks (ICAAP s) that must be held by the supervised institutions and policies on supervisory measures for certain situations and / or institutions. The obligation to publish the bank will be made through reporting statistical data. They refer to aggregate statistical data on the implementation of prudential regulatory framework in Romania. Tables to be published will include information on Romania's banking sector, credit risk, operational risk, market risk and brief information on actions and measures taken by supervisory authorities. BNR reserves the right to omit certain items from publication if it they are private or confidential.

#### **4. Prudence and International sanctions**

National Bank has the following powers in relation to international sanctions, the financial-banking incidents:

- supervises the implementation of international sanctions, in accordance with Article 17. paragraph (1) of the Emergency Government no.202/2008 on the implementation of international sanctions, approved by Law no. 217/2009;
- publicizes documents which establish binding international sanctions in Romania, in accordance with article 5. paragraph (1) of GEO nr.202/2008;
- adopts specific regulations for monitoring the implementation of international sanctions;
- provides specific measures and penalties for non-compliance legislative incidents;

- participates, through appointed representatives, to the Inter-institutional Council working sessions, established under the provisions of Article 13 of Government Emergency Ordinance nr.202/2008 on the implementation of international sanctions

Sanctions to impose restrictive measures within the areas of activity are established by legal instruments adopted by the Security Council of United Nations (UN), the European Union (regulations and decisions), other international organizations or by unilateral decisions of Romania or other countries and aims, in blocking funds and economic resources, trade restrictions, restrictions on operations with products and technologies with dual travel restrictions, restrictions on transport and communications, diplomatic sanctions, or scientific and technical fields, cultural or sports. European regulations on institutions in the area of regulatory/oversight of the central bank have the regulating purpose of imposing restrictive measures against certain persons and entities under a state or not. Updated list of states, individuals, groups and entities subject to sanction regimes adopted both by UN and the EU is available on the Ministry of Foreign Affairs website. We exemplify by the following acts in the field: NBR Order no.340/2010 on the unitary model of reporting blocked funds and economic resources or Order no. 95/2011 of the President of the National Office for Preventing and Combating Money Laundering on approving the methodological norms for making notifications and processing requests for authorization to carry out financial transactions. The supervision activity of international banking groups, NBR cooperate with other supervisory authorities through working structures established at European level and relevant substructures within them. They are BSC - Banking Supervision Committee, established by the ECB European Central Bank, CEBS Committee of European Banking Supervisors, established by the European Commission under the Lamfalussy structure, Moneyval - Committee of Experts on-the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism established by the European Council. Banking supervision, in general, is the system used by the state to ensure financial

system stability. To have an effective banking supervision, it has to propose some well-defined goals, explained, that will determine economic policy, and those who directly perform banking supervision.

## 5. Conclusions

There are two tasks underlying all banking supervision systems: ensuring balance banking sector, to enhance and support the economic growth of the country, protecting the funds paid to the bank. Thus, prudential regulation (preventive) and surveillance remain essential elements of banking. Supervision, as monitoring activity of credit institutions and checking how banking regulations are respected and applied aims, through prudential regulation, to ensure efficient allocation of resources, minimize risks and ensure stability and financial health of each bank and banking system as a whole.

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# Does High Corporate Tax Rates Attract Foreign Direct Investment?

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## Abstract

*A part of the empirical literature seems to support the view that international differences in corporate taxation are important determinants of FDI location, while another part argue that FDI are attracted by the business environment, without taking into consideration any directly or indirectly influence of fiscal policy. In this context, the aim of the present paper is to analyze the relation between corporate tax rates competition and Foreign Direct Investment location and to offer conjectures as to the reasons behind. In this purpose the paper analyze the evolution of FDI in European Union, in the developed and emerging economies together with the national differences in corporate taxation, for the period 2005-2010. The study's results suggest that fiscal competition between governments for FDI is not necessarily a corporate tax rates competition, but a business environment one, which is determined primarily by fiscal policy.*

**Keywords:** Fiscal Policy, Fiscal Competition, Foreign Direct Investment, Business Environment.

**J.E.L. classification:** H32, F23, P45

## 1. Introduction

The contemporary reality demonstrates that most countries, irrespective of their stage of development, employ a wide variety of incentives to attract the foreign direct investments. As beyond World Trade Organization (WTO) and European Union (EU) rules, governments have lost many of the instruments traditionally used to promote local competitiveness in order to attract FDI,

the fiscal policy becomes an important instrument. The Role of the fiscal policy in attracting FDI is a very controversial issue both at scientific research and political level. The literature on the subject of corporate taxation in European Member States, as a determinant for Foreign Direct Investment (FDI) location, is centered on the question of tax harmonization vs. tax competition as a solution to the awkward state of asymmetric tax rates that currently exists in the European Union for creating a better business environment. The existing viewpoints run the gamut from entirely pro-harmonization to pure pro-competition stances as it is shown in the literature review. Moreover there are some opinions that fiscal policy does not influence the FDI, or its influences are rather small.

Based on the reality that FDI has positive effects on economic growth in both developed and developing countries, the present study is started from the need to understand and demonstrate the relation between corporate tax rates competition and Foreign Direct Investment location and to offer conjectures as to the reasons behind.

## 2. Literature review

The literature indicates the important role played in attracting FDI by elements such macro-economic stability (growth, inflation and exchange rate), institutional stability such as policies towards FDI, tax regimes, the transparency of legal regulations, the scale of corruption and political stability[1], [2], [3]. The political and economic factors, the form of the privatization process and the need to secure market access have been the determinants of allocation of FDI across the world [4], [5], [6], [7]. The determinants of

FDI inflows are very various: country risk, unit labor cost, host market size, private sector development, industrial development, the government balance, corruption, policies [5], [6], [8]. Some of researchers argue that policies matter for FDI inflows [9]. A predictable policy that promotes macroeconomic stability stimulates the FDI inflows [10], this is most often the case of trade policies and tax policies. Some work papers show that low tax rates attracts FDI inflows [11]. Other studies demonstrate that a simple tax system tend to be more attractive for FDI [12]. A large part of the empirical literature seems to support the view that international differences in corporate taxation are important determinants of FDI location [11], [13], [14], [15], [16].

Some researchers consider that FDI are attracted by the business environment, without taking into consideration any directly or indirectly influence of fiscal policy [17], [18]. In its 2000 Conference on Trade and Development, United Nations states that, as a factor in attracting FDI, fiscal policy is “secondary to more fundamental determinants, such as market size, access to raw materials and availability of skilled labor” [19]. Contrarily, other studies conclude that fiscal policy is an important tool [20], the central administration can utilize to influence the economy and attract FDI. Based on the fiscal policy, the government is able to control the macroeconomic variables [21], such as aggregate demand, disposable income and economic activity as a whole. Many studies are focused on the fiscal FDI incentives as exceptions to the general tax regime [22], [23], [24], [25], [26], very few been focused on general fiscal regime [24], [25], [9], [12].

Regarding the central question i.e. fiscal competition vs. tax harmonization as the best solution for a better business environment, the researchers’ points of view are very different. Some of researchers argue that tax competition will harm the efficient supply of public goods, and should therefore lead to tax regulation/harmonization. [27], [28], [29]. According to Mitchell [30] tax competition generates responsible tax policy. Lower tax burden of business subjects creates the fertile soil for higher economic growth. Without the tax competition the governments could behave as the monopoly, to levy the

excessive taxes. As the mention [30], the tax competition always results in decrease in the statutory tax rates. As quotes Smith, in case that the fiscal competition process would be stopped by the tax harmonization, the European Union would be less converged than ever before [31].

Despite serious study and debate, no optimal solution to the tax question has surfaced and the relation between corporate tax rates and the FDI location still remains controversial.

### **3. Hypotheses, research’s goal and methodology**

This study is based on the following assumptions:

- International differences in corporate taxation are important determinants of FDI location [11], [13], [14], [15], [16];
- In order to achieve the goals of Lisbon Strategy, Europe must improve European and national fiscal regulation. Although creating a better business environment is a priority for the European Commission, there are still ample possibilities to improve fiscal policies which vary in the European Union countries. The questions raised from such hypotheses are:

1. In which way the fiscal policy influence the FDI inflows, i.e. the FDI will be attracted mainly by the countries with lower overall tax ratios or contrarily or this aspect doesn’t matter?
2. Which are the countries characterised by significantly lower overall tax ratios, the developed countries or the emerging economies?
3. Which is the effect of tax competition on the business environment and on the EU market integration, in order to take full advantage of the single market?

In this context, the aim of this paper is to study and analyze the role of fiscal policy in determining the destination of Foreign Direct Investment in emergent and developed countries in European Union. For this purpose, the study use a pooled dataset consisting of annual observations over the period 2005-2010 for the actual EU Member States regarding the corporate tax rates and the FDI inflows. For comparing purposes the study analysis focuses on six actual European Union countries considered “Emerging

European Economies”, Bulgaria, Hungary, Latvia, Lithuania, Poland and Romania (BHLLPR).

The data sources are only official ones, i.e. Eurostat, governmental statistics for the fiscal policy, International Monetary Fund and World Bank for the foreign direct investment. As regards the FDI, it is important to note that practically all of UNCTAD and World Bank’s data have been presented in USD as it was converted from national currencies in the official statistics. Although the considered states for the present study are European Members states, we preferred to not denominate the FDI indicators in EUR terms for not reducing their accuracy by the possible effect of currency fluctuations, which is a very important issue in particular when analyzing time series for making comparisons across different countries.

The present paper includes further work based on our latest research, unveiling the fiscal policy as an important determinant for the Foreign Direct Investment, which directly or indirectly influences all the other factors that determine the investors behaviour [32], [33], [34], [35], [36].

Being focused on empirical, contextualized analysis, this study highlights the overall empirical relationship between FDI and fiscal policy and only offers conjectures as to the reasons behind this relationship. Future research will study the effects of specific categories of fiscal instruments on FDI as well as the channels and mechanisms through which these effects take place.

#### 4. Analyses and results

As it results from the table 1, in 2007 the FDI inflows exceed the level from 2005. The global economic crisis from 2008 temporarily stopped this trend. The developed economies have attracted almost seven times more foreign investment. As it can be seen in the table 1, foreign direct investment has been clearly more oriented to the developed countries than to the emerging countries. To note that in 2008, because of the global financial crisis, the decline was really high both for developed and emerging countries. The year 2010, still affected by the

global financial crisis, brought new decreases of the FDI inflows.

*Table 1. The Foreign Direct Investment Inflows between 2005- 2010 in the EU economies (billion dollars)*

Country	2005-2010 Years					
	2005	2006	2007	2008	2009	2010
BE	34.4	58.9	93.4	142	23.6	61.7
BG	3.9	7.8	12.4	9.9	3.4	2.2
CZ	11.7	5.5	10.4	6.5	2.9	6.8
DK	12.9	2.7	11.8	2.2	3.0	-1.8
DE	47.4	55.6	80.2	4.2	37.6	46.1
EE	2.9	1.8	2.7	1.7	1.8	1.5
IE	-32	-5.5	24.7	-17	26.0	26.3
ES	25.0	30.8	64.3	77.0	9.2	24.5
FR	84.9	71.8	96.2	64.2	34.0	33.9
IT	20.0	39.2	40.2	-11	20.1	9.5
CY	1.2	1.9	2.2	4.1	5.7	4.9
LV	0.7	1.7	2.3	1.3	0.1	0.4
LT	1.0	1.8	2.0	2.1	0.2	0.6
LU	6.6	31.8	-28	9.8	30.2	20.4
HU	7.7	6.8	4.0	7.4	2.1	2.4
MT	0.7	1.8	1.0	0.9	0.8	1.1
NL	39.1	14.0	119	3.6	34.5	-16
AT	10.8	7.9	31.2	6.7	7.0	6.6
PL	10.3	19.6	23.6	14.8	13.7	9.7
PT	3.9	10.9	3.1	4.7	2.7	1.5
RO	6.5	11.3	9.9	13.9	4.9	3.6
SI	0.6	0.6	1.5	2.0	-0.6	0.8
SK	2.4	4.7	3.6	4.7	-0.1	0.5
FI	4.7	7.7	12.5	-1.1	0.0	4.3
GR	0.6	5.4	2.11	4.5	2.5	2.2
SE	11.9	28.9	27.7	36.8	10.3	5.3
UK	176	156	197	91.5	71.1	45.9
FDI 1	18.4	21.6	31.5	18.1	12.8	11.3
FDI 2	5.0	8.2	9.0	8.2	4.0	3.1

Source: Made by authors based on the collected data [38] and on the author’s calculations

According to UNCTAD report, FDI inflows will continue to recover to the pre-crisis level in 2011. They are expected to rise again in 2012 and in 2013 to the record achieved in 2007. The multinational corporations’ liquidity, the restructuring of corporations and industry, the increasing stock value, established as support measures during the crisis, creates new investment opportunities for the worldwide companies [37]. However, in crisis times the business environment is doubtful. The risk factors such as the unpredictability of global economic governance, a potential crisis of

sovereign debt and the instability of financial and fiscal sectors in some developed and emerging economies, can slow down the recovery of FDI.

As it regards the evolution of foreign direct investment inflows during 2005-2010 in European Union the study reveals the following relation:

$$FDI1 > FDI2 \quad (1)$$

FDI1 represents the average FDI inflows at European Union level and FDI2 represents the average FDI inflows at BHLLPR group level.

The data suggest that the New Member States are generally characterised by low level of FDI inflows, most of FDI inflows being still oriented to the developed economies from the European Union.

A question raise from such a study: In which way the corporate tax system determine the investors decisions, i.e. the firms will choose to locate their investment in countries with lower taxes or contrarily?

In this respect, the Table 2 presents the average CTR at European Union (CTR1) level and the average CTR at BHLLPR (CTR2) group level during the entire analyzed period.

By comparing the two series of indicators for each year of the considered period, the study reveals the following relation:

$$CTR1 > CTR2 \quad (2)$$

Table 2. The Corporate Tax Rates (CTR) in UE Members States during 2005-2010 (%)

Country	2005-2010 Years					
	2005	2006	2007	2008	2009	2010
BE	34.0	34.0	34.0	34.0	34.0	34.0
BG	15.0	15.0	10.0	10.0	10.0	10.0
CZ	26.0	24.0	24.0	21.0	20.0	19.0
DK	28.0	28.0	28.0	25.0	25.0	25.0
DE	38.7	38.7	38.7	29.8	29.8	29.8
EE	24.0	23.0	22.0	21.0	21.0	21.0
IE	12.5	12.5	12.5	12.5	12.5	12.5
ES	35.0	35.0	32.5	30.0	30.0	30.0
FR	35.0	34.4	34.4	33.3	33.3	33.3
IT	37.3	37.3	37.3	31.4	31.4	31.4
CY	10.0	10.0	10.0	10.0	10.0	10.0
LV	15.0	15.0	15.0	15.0	15.0	15.0
LT	15.0	19.0	18.0	15.0	20.0	20.0
LU	30.4	29.6	29.6	29.6	28.6	28.6
HU	17.5	17.5	18.6	16.0	16.0	10.0
MT	35.0	35.0	35.0	35.0	35.0	35.0
NL	31.5	29.6	25.5	25.5	25.5	25.5
AT	25.0	25.0	25.0	25.0	25.0	25.0
PL	19.0	19.0	19.0	19.0	19.0	19.0
PT	27.5	27.5	26.5	26.5	26.5	26.5
RO	16.0	16.0	16.0	16.0	16.0	16.0
SI	25.0	25.0	23.0	21.0	21.0	21.0
SK	19.0	19.0	19.0	19.0	20.0	21.0
FI	26.0	26.0	26.0	26.0	26.0	26.0
GR	32.0	29.0	25.0	25.0	25.0	25.0
SE	28.0	28.0	28.0	28.3	26.3	26.3
UK	30.0	30.0	30.0	30.0	28.0	28.0
<b>CTR1</b>	<b>25.5</b>	<b>25.3</b>	<b>24.5</b>	<b>23.3</b>	<b>23.3</b>	<b>23.1</b>
<b>CTR2</b>	<b>16.3</b>	<b>16.3</b>	<b>16.1</b>	<b>15.2</b>	<b>16.0</b>	<b>15.0</b>

Source: Made by authors based on the collected data [38] and on the author's calculations.

The study suggest that the New Member States (including the analysed group) are generally characterised by significantly lower overall tax ratios. From such evidence we can conclude that most of FDI inflows are still oriented to the developed economies despite their higher level of taxation.

## 5. Conclusion

According to the present study, FDI is concentrated mainly in the developed economies compared with the emerging

economies, despite the higher level of taxation of the developed economies. In this way the present paper contradicts the studies according to which FDI are mainly attracted by the countries having low corporate tax rates. Moreover, based on the above presented researches which state that FDI are attracted by the business environment the present paper logically conclude that higher tax rates create better business environment.

Using data for 6 actual European Union countries considered “Emerging European Economies” i.e. Bulgaria, Hungary, Latvia, Lithuania, Poland and Romania, for the period 2005-2010 and by comparing it with the rest of European Union Member States, the results suggest that fiscal competition between governments for FDI is not necessarily a corporate tax rates competition, but a business environment one, which is determined primarily by fiscal policy. A low corporate tax rate will not attract the FDI if the fiscal policy generates an unfriendly business environment marked by unpredictability, lack of transparency, fiscal ambiguity, tax avoidance and tax fraud; a high corporate tax rate will stimulate the FDI flows if the revenue is used to provide public goods that improve the environment in which investors operate.

In our future research we intend to study the effects of specific categories of fiscal instruments on FDI as well as the channels and mechanisms through which these effects take place.

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# Romania's Economic Recovery Strategy in 10 Years

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## Abstract

*Globalization, by its proportions, changed the basis and the perspective of the economic life as a fundamental change in human history. Involving major implications, it determined redefining our possibilities and limits of acting at local action.*

*Globalization is a system where the objective function aims the whole in order to eliminate adversity and competition, to generate creative destruction.*

**Keywords:** Globalization, competition, international market prices, confrontation with reality, strategies

**J.E.L. Classification.:** G0, G24

## 1.Introduction

The increase in value of world exports (in current prices) is due to several causes: the increase in this period of the physical quantity of exports, increase of international market prices, profound changes in the structure of world economy mainly due to modern scientific and technological progress, deepening of global division of labor, changes produced in the world market price formation mechanism, the absence of great economic crisis as in the not too distant past.

In the dynamics of globalization there is faster growth of world trade compared to world output of goods and services, increasing the share of export or import that is of the coefficient of dependence of the economy of a nation on the world economy. Growing importance of foreign market for a nation inevitably requires states to adopt measures to liberalize bilateral trade.<sup>[1]</sup>

Transnational companies (STN) are now a key factor in globalization. They appeal to different mechanisms (transfer pricing, manipulation of international interest, influence of the exchange rate, autonomy of

tax setting that these companies pay states by transnational corporations and subsidiaries spread registration in different countries of the world with low taxes) affecting the economy of various countries or groups of states.<sup>[2]</sup>

## 2.Strategy for revival in 10 years

Economic globalization is an objective and necessary step that has several forms, from simple to most complex ones, including the organization of over - national integration tools. Creation of common institutions and international bodies such as global, regional and sub-regional ones, both public and private is an objective process that leads to globalization. An objective process is the adoption by States of international economic integration measures.<sup>[3]</sup>

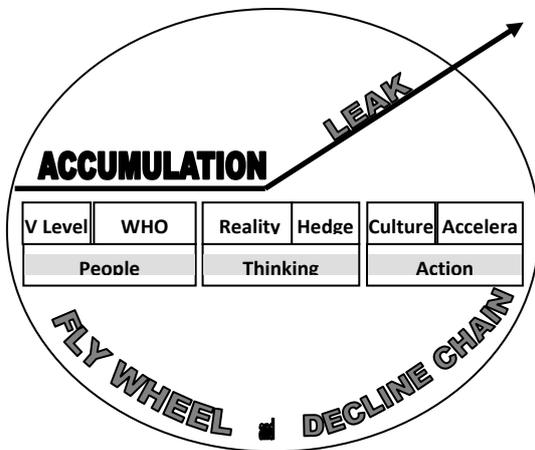
Characteristic of globalization is that it is carried out with unprecedented intensity and speed. The experience of recent years shows that the processes and critical phenomena in a given country quickly come to affect economic and social developments in different countries.<sup>[4]</sup> Some of these phenomena can have predictable causes and others not (e.g. financial crises). One such event occurred in the winter of 2008 when real estate housing crisis broke out in the United States and dramatically influenced the banking system, destabilizing it. The crisis has spread rapidly in Europe too, affecting all European countries, but mainly Greece (where social conflicts have been reported) and Spain. Romania is still affected by this process. Romania is currently going through a period marked by the onset of several crises to which it must find solutions for the lowest costs possible.

This paper proposed a strategy for revival in 10 years based on the principles of excellence in business, principles drafted by a team of researchers from the United States of America led by Jim Collins. In 1990-2000,

Jim Collins led a team of researchers to answer the question: "What are the measures that have allowed some prestigious American companies to increase their shareholder value significantly above the overall increase in capital market?"

In the book "Business Excellence" during the first 9 chapters, Jim Collins and his colleagues come to define a set of concepts and principles that have allowed the leap from good to excellent business. [5] In essence, these principles are presented in the figure below:

Fig.1 Principles which have allowed some American companies to make the leap from good to excellent business.



Source: IMF: Jim Collins, "Excellence in Business", Bucharest, 2009.

The meaning of key terms presented in the figure above is:

table no 1

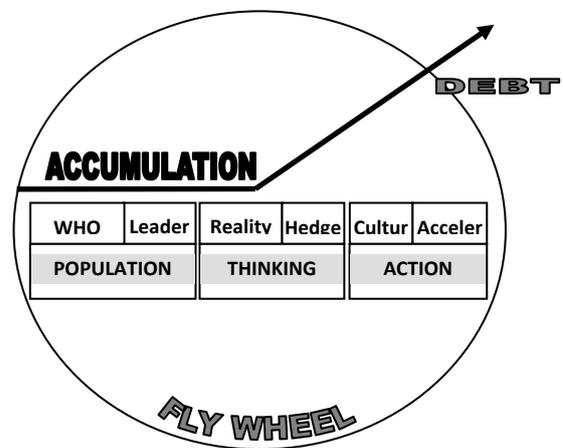
<b>1. Leader of level V</b>	there are leaders who have had outstanding results in the management of companies they lead, they are quiet, reserved, even shy, they are a paradoxical blend of personal humility and professional will.
<b>2. First</b>	In the management

<b>„who”then „what”</b>	of companies are chosen the right people for the job first and then determine "who" have done in the "what" conditions.
<b>3. Disciplined men</b>	Are those people who can maintain unwavering faith that they can and will eventually succeed against all odds.
<b>4. Confrontation with reality</b>	At the same time they have discipline to face the brutal facts of current reality, whatever it may be
<b>5. Concept of hedgehog</b>	To go from good to excellent, it is needed an understanding of three circles which intersect and lead to a simple clear and concrete concept.
<b>6. Disciplined thinking</b>	Positive education; thinking always in favor of the company, perceive what is good and bad.
<b>7. Culture of discipline</b>	All companies have a self culture and discipline. When a company has

	disciplined people, they do not need hierarchy and bureaucracy any more. They also do not need excessive control.
<b>8. Tehnologic accelerators</b>	Technology is never the main means of raising the performance transformation of society. In different companies, the role of technology is designed differently.
<b>9. Disciplined action</b>	– It is aware that the company's prosperity depends on activity, acting for the company, perceives when something brings negative consequences for society and strives to act or to report a wrong thing to a higher authority.
<b>10. Flywheel and the decline chain</b>	- leap to excellence never happens in a single shot. It takes perseverance to use centrifugal force of a flywheel. The people that trigger programs of dramatic change, revolutions and forced restructuring will not succeed to move to excellence.
<b>11.</b>	Sustainable

<b>Accumulation and breakthrough</b>	transformation follows a predictable pattern of accumulation and vulnerability. Pushing a giant heavy flywheel requires a huge effort to incite, but a persistent movement in a consistent direction over a long period of time, the flywheel creates momentum, eventually reaching the point of breakthrough.
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Fig. 2. Principles to enable the strategy to revive the Romanian economy in order to pay off IMF and significantly reduce the external debt in ten years



Source: processing by Jim Collins, op. cited, page 182.

The meaning of key terms presented in the figure above is:

Table no. 2

<b>1. First „who” then „what”</b>	It is set up the school "V level political leaders". Each recognized
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	party shall appoint a number of persons in proportion to votes obtained in the last campaign to attend school-level political leadership.
<b>2. Politic Leader of level V</b>	They are leaders who have left the school of political leaders with a "magna cum laude".
<b>3. Disciplined Population</b>	TVR1 program, will organize a set of programs that lead to increase people's knowledge in areas such as democracy, entrepreneurial culture, the management of NGOs.
<b>4. Confrontation with reality</b>	People need discipline to confront the brutal facts of current reality, whatever they might be
<b>5. Concept of hedgehog</b>	To go from good to excellent, it is needed an understanding of the three circles which intersect and lead to a simple,

	clear and concrete concept.
<b>6. Disciplined thinking</b>	Positive education, always thinking in favor of your company, perceive what is good and bad.
<b>7. Culture of discipline</b>	All companies have a self culture and discipline. When a company has disciplined people do not need hierarchy and bureaucracy any more. They also do not need excessive control.
<b>8. Technologic accelerators</b>	technology is never the main means of raising the performance transformation of society. In different companies, the role of technology is designed differently.
<b>9. disciplined action</b>	is aware that the company's prosperity depends on activity, acting for the company; perceives when something brings negative consequences for society and strives to act or to report a wrong thing to a

	higher authority.
<b>10. Flywheel</b>	The jump to excellence never happens in a single shot. It takes perseverance to use centrifugal force of a flywheel. The people that trigger programs of dramatic change, revolution and forced restructuring will not succeed to move to excellence.
<b>11. Payment of debts</b>	Economic conditions are created for the gradual payment of debt so that people do not feel this effort. It requires the cultivation of a specific education for an indebted country towards "feasible" sacrifice, acceptable to be better for us tomorrow

A main conclusion in the analysis of financial flows in the last two decades is that they have no money and therefore public sector funding stagnated and private funding and other sources increased.

External debt is fueled by financial resources resulting in market conditions, most of the loans represented by transnational banks. Without exception, all commercial banks to hedge against credit default risk, claim interest on the international market plus a margin calculated by rating the country.

IMF (International Monetary Fund) is an international organization which has 186 member countries, established to promote international monetary cooperation, exchange stability and systematic exchange agreements to boost economic growth and high levels of labor use and provide temporary financial assistance to member countries under the right conditions to help the balance of payments adjustment.

### 3. Conclusions

The article proposes a strategy for revival of Romanian economy in a period of ten years, based on the principles of business excellence, developed by a team of researchers led by Jim Collins.

The strategy also created, by default, the economic conditions for the gradual payment of debt, so that people are not severely affected by this effort. It is necessary to cultivate a specific education in the country indebted towards accepting the sacrifices to be better for us tomorrow.

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## Bank Deposits: Policies, Dynamics and Regulations

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### Abstract

*In Romania, the increase of the population's real incomes, of their trust in national currency and, generally speaking, the economy's stabilization during the first decade of the 21st century have made the saving process record a certain recovery. Furthermore, the inflation which had reduced saving in the 90's has slowed down and thus deposits' growth has started to enjoy positive dynamics.*

*From the economic perspective, saving's growth is the basis of sustainable development, a solution for the society progress that could rely on domestic resources, and it signifies the decrease of dependence on foreign funding.*

*The present paper aims at examining saving from the point of view of marketing, the evolution of such a phenomenon in Romania as well as certain applicable reporting standards.*

**Key words:** deposits, saving, interest, evolution, standards.

**J.E.L Classification.:** G21

### 1. Introduction

Saving is not only a concept emerging in macroeconomic policies, but also one of the permanent concerns of banks, as it is the foundation of banking operations' amount increase.

In order to raise saving, specialists recommend the diversification of saving products. The more the latter are, the more beneficiaries they may attract. Diversification

can take place by two main techniques, terms and prices.

During the years previous to the financial crisis in Romania, although present, the saving process did not reach the necessary level to support the funding of banks which had to resort to financial aids from mother banks (open-end credits). This aspect has become at times of crisis a factor of financial stress with the risk of fund outflows (namely the open-end credits previously granted by mother banks cannot be renewed) which might have augmented the pressures on foreign currency market leading to Leu value loss.

Since the crisis emerged, the reasons related to prudence, or the uncertainties for "tomorrow" have made the saving process improve and its dynamic, although not very high, is still encouraging.

### 2. Amount of deposits and quality-price ratio

Attracting resources from the population is one of the major goals of a bank, even if the reason is that they represent the cheapest of the funds used to support financial intermediaries [1].

If a bank maximized the price provided to its clients who are willing to acquire saving products (deposits), the additional funding sources would grow, but the profitability allowance would implicitly lessen. The same impact ensues from the increase in the quality of such products.

It is recommended that while setting the prices of saving products various variants of prices provided (interests) should be simulated, so that to attract the maximum

amount of resources. A high level of deposit prices (interests) granted to clients is not always the best thing a bank can do. This happens because a maximum price level brings about a number of low amount deposits whose costs may affect the overall bank profitability.

Moreover, it should be taken into account that a maximum price to each consumer can have different values. Thus, a maximum price can be compensated for high income retail clients by secondary services (counselling regarding investments, services to alert deposits' maturity, fixed interests on long terms etc.) and the quality of these products can be improved as this type of clients tend to appreciate secondary services rather than deposit interest maximization. On the contrary, the clients whose incomes are modest always appreciate a maximum interest and think secondary services are useless.

An optimal ratio between cost and quality of saving products can be achieved by cutting banks' operational costs. Operational costs are directly proportional to the number of deposits and inversely proportional with the amount of an average deposit. A way to cut operational costs can be the alternative distribution channels (ability to make deposits in ATM's or by I-banking or e-banking services).

The increase in banking culture level has made more and more clients concerned not only with the nominal value of the interests charged by banks, but also with other secondary aspects: commissions and fees paid for acquiring a product, facilities provided, and with factors related to the quality of banking products.

The commissions and fees paid for a product actually reduce the price received by a depositor. There are opinions that it would be better to display or communicate the interest real level to depositors, especially when these interests' taxation is higher and higher and many depositors do not know that [2].

Facilities provided. Many clients have began to pursue aspects such as: whether an interest is fixed or variable, whether interest bonuses are granted according to deposition term or deposit size, method of interest calculation, whether it is transferred into a deposit account or another account etc. It is

recommended the promotions for these products should attach various facilities to attract the clients segment which the respective product addresses to the interest level (which must necessarily be indicated).

More often than not, factors such as: account administrators' kindness, counters' number, place and schedule etc. may compensate the lower prices granted by financial intermediaries for saving instruments.

The brief enumeration above indicates that the price of saving instruments is one of the basic elements in their marketing, as this price largely generates the amount of deposits attracted by banks, therefore the resources the latter take their funds from.

### 3. Romanian evolutions in the field of bank deposits

Between 2000 and 2008, demand deposits and time deposits rose from 15 billion Lei (RON) to almost 220 billion Lei. In other words, they rose by about 16 times, yet it was a nominal increase because inflation was still high in the early 21st century [3].

*Table 1. Dynamic and structure of bank deposits in Romania*

Year	Available at demand	Time deposits			Financial enterprises' deposits
		Total	Of which:		
			Lei	Foreign currency	
Absolute values – billion Lei					
2000	2.1	13.4	6.2	7.2	1.5
2005	22.4	74.8	48.9	25.9	4
2008	67.3	151.5	98.8	52.7	9
2010	55.2	177.4	113.5	63.9	11
2012 Feb	55	188.6	126.8	61.8	11.6
Relative values					
2000	1.0	1.0	1.0	1.0	1.0
2005	10.7	5.6	7.9	3.6	2.7
2008	32.0	11.3	15.9	7.3	6.0
2010	26.3	13.2	18.3	8.9	7.3
2012	26.2	14.1	20.5	8.6	7.7

Feb					
Shares of GDP - %					
2000	2.6	16.7	7.7	9.0	1.9
2005	7.8	26.0	17.0	9.0	1.4
2008	13.1	29.4	19.2	10.2	1.7
2010	10.6	34.0	21.7	12.2	2.1
2012 Feb	10.0	34.4	23.1	11.3	2.1

Source: data taken from BNR Annual Bulletins, January 2000 – February 2012 and calculations of paper authors

A better evaluation of deposits' size is rendered by their share of GDP. Thus, the total of deposits rose between 2000 and 2008 from about 20% to 45%, namely they more than doubled in eight years. After 2008, the financial crisis, job losses, prudence-related reasons, uncertainties about the future have made time deposits rise by around 11 billion Lei (in just three years) whereas demand deposits have decreased their size (against a reduction of economy liquidity, optimization of liquidity capitalization, and demand deposits' taxation).

From the perspective of deposits' structure, the following remarks can be made:

- most deposits are in the form of time deposits (meaning a funding source of bank investments, including the loans they offer);
- about half of time deposits are made in foreign currency, with the specification the share of those in Lei is rising. This aspect shows that some Romanians do not trust national currency too much (although some change their opinions) and because of foreign financial pressures, to save foreign currency means an alternative to saving national Lei which relies on insecure economy and is dependent enough on foreign economies.

Table 2. Structure of population's and non-financial companies' deposits

Year	Total	Of which:	
		Lei	Foreign currency
a. Population's deposits			
Absolute values – billion Lei			
2000	6.8	4.3	2.5
2005	34.2	22	12.2
2008	82.9	52.4	30.5
2010	104.1	64.3	39.8

Year	Total	Of which:	
		Lei	Foreign currency
2012 Feb.	115.9	74.9	41
Shares of GDP - %			
2000	8.5	5.3	3.1
2005	11.9	7.6	4.2
2008	16.1	10.2	5.9
2010	19.9	12.3	7.6
2012 Feb.	21.1	13.6	7.5
b. Non-financial companies' deposits			
Absolute values – billion Lei			
2000	6.6	1.9	4.7
2005	35.6	23.6	12
2008	59.6	39.8	19.8
2010	62.3	41.5	20.8
2012 Feb.	61.1	43.1	18
Shares of GDP - %			
2000	8.2	2.4	5.8
2005	12.4	8.2	4.2
2008	11.6	7.7	3.8
2010	11.9	8.0	4.0
2012 Feb.	11.1	7.9	3.3

Source: data taken from BNR Annual Bulletins, January 2000 – February 2012 and calculations of paper authors

The analysis of deposits' structure in the two categories of depositors: population and non-financial companies indicates the following orientations:

- the saving process has been more pronounced as far as the population is concerned, according to the increase in their real incomes (which was felt until the crisis) and more obvious prudence behaviours (after the crisis began). Thus, the population's time deposits have a level that is almost close to that of the same deposit type as far as companies are concerned;
- non-financial time deposits had much more modest increases after the crisis beginning and even a decline after the year 2010, proven by the hardships they have faced over the last years and by the increase in their number as a consequence of insolvency and failure;

- whereas in 2000 time deposits denominated in foreign currency meant about 40% of all time deposits and 70% in the segment of non-financial companies, in the end of the period subject to analysis they were between 30% and 40%. Therefore, in terms of companies, the saving of foreign currency has reduced its proportions as a result of the full liberalization of foreign currency market, easier conditions for economic agents to access foreign currency. As a matter of fact, companies' time deposits in foreign currency have lessened since 2010, evolution confirming the difficulties they have been running;
- companies' time deposits stabilized after 2008 at 12% of GDP, of which about 8% were deposits in Lei and another 4% in foreign currency;
- population's time deposits continued their ascending trend after the crisis had started, that is they progressed from 16.1% of GDP in 2008 up to 21.1%, so they had a 5% increase. The increase mainly occurred for the component of Lei time deposits. Between 2010 and February 2012, the population's foreign currency time deposits recorded a slight decrease (in terms of their share of GDP), probably as an effect of decreasing transfers in foreign currency from family members working abroad.

From the accounting perspective and as a an approaching way, the deposits attracted by loan institutions are financial instruments. The recent regulation of loan institutions is worth emphasizing in its historical background. Order no.13 of 19 December was approved in 2008 agreeing upon accounting regulations in compliance with European directives applicable to loan institutions, non-banking financial institutions and the Fund for guaranteeing deposits in the banking system. This Order was later revoked by Romanian National Bank Order no.27/2010 for the approval of accounting regulations compliant with the International Standards of Financial Reporting applicable to loan institutions. International Standards of Financial Reporting also known as ISFR are standards adopted in accordance with the procedure provided by Article 6, second indent, of Regulation no.1.606/2002 of the European

Parliament and Council of 19 July 2002 concerning the application of international accounting [4].

Since the beginning of tax year 2012, loan institutions have been submitting an annual report drawn up according to the data in their accounting registers to the Ministry of Public Finance. When transposing the balances of accounting accounts in the trial balance made up for 31 December 2011 into the accounts opening tax year 2012, loan institutions must prepare statements including the differences between the values registered in the trial balance of 31 December 2011 and those registered in the accounts to begin tax year 2012, along with details about their nature and the method of amounts' transfer. Additionally, there should be the amendments of accounting policies generated by the transition to ISFR application.

The above explanations are needed to clearly define the regulations applicable to loan institutions and implicitly the way of evaluating and recognizing deposits in financial statements. However, loan institutions are familiar with this approach as they already prepare consolidated financial statements in compliance with ISFR (International Standards of Financial Reporting).

As far as the evaluation and recognition of financial debts are concerned regarding the deposits attracted from clients and the deposit interest-associated expenses for the financial statements made up for 2011, they used to be treated and registered according to European Directives as such:

- the deposits made, irrespective of their type (time, demand deposits etc.), were regarded as debts of an entity and evaluated at the nominal value these deposits had at the end of the tax year;

- the interest-related expenses were recognized and evaluated at the level of amounts regarding the deposits' interests paid or payable.

Since the beginning of tax year 2012, current accounts and clients' deposits have been recognized at depreciated costs and in addition, the deposits created and revenues/expenses associated with interest revenues and expenses have been registered in accounts of profit and losses for all the instruments evaluated at depreciated costs, by means of the effective interest method.

Interest-related revenues include the coupons of fixed-income securities, discounts and bonuses accumulated in treasury certificates.

Effective interest method is the method of calculation of the depreciated cost of a financial asset or financial liability and allocation of interest-associated incomes and expenses during a relevant period. Effective interest rate is the one that precisely updates future estimated cash payments or payments during the estimated existence of a financial instrument, or, if necessary, during a shorter period, at the net accounting value of a financial asset or financial liability.

For the calculation of effective interest rate, treasury flows are estimated taking account of all the contract circumstances of a financial instrument (for instance, payments made beforehand). In order to calculate a depreciated cost, first the real interest rate should be set taking account of all the cash flows associated with a deposit.

Example: in the end of a tax year, an institution must evaluate a two-year time deposit of 100,000 Lei, with a fixed interest rate of 5%/year, where the interest is entirely paid on maturity date.

The deposit is evaluated at its depreciated cost in the end of the tax year. In order to set the effective interest rate, the following equation is required:

$$100,000 = \frac{110,000}{(1 + R_{def})^2}$$

which leads to the effective interest rate = 4.881%.

Table 3. Setting a depreciated cost in the end of the first tax year

Year	Initial cost	Cash flow (interests paid)	Effective interest	Final depreciated cost	Difference to be entered
0	1	2	$3 = 1 * R_{def}$	$4 = 1 - 2 + 3$	$5 = 4 - 1$
1	100,000	0	4.881	104,881	+4881
2	104,881	10,000	5.119	100,000	-4881

Source: Authors' calculations

In the end of the first tax year, the deposit value to be included in financial statements according to ISFR is 104,881 Lei, whereas if

the old regulations compliant with European Directives had been applied, the deposit value would have been 100,000. In the authors' opinion, the end of 2012 shall bring great differences in loan institutions' financial statements regarding the evaluation method of financial instruments in compliance with the new regulations (ISFR) as compared to old rules.

In conclusion, it can be stated that there is a contradictory evolution of the bank saving process influenced by changes in the economic context and progress both at national and international level, and last but not least, by the policies promoted by the banks in our country. As far as the latter aspect is concerned, it should be added that Romanian banks' policies meant to attract resources have changed after 2008.

Thus, getting liquidities from mother banks was easy and inexpensive before the crisis (in the context of liquidity excess on foreign markets) whereas after 2008, restraining the liquidity on foreign financial markets has made Romanian banks raise their deposit interests in order to refund their loans granted and investments made, therefore the saving process has grown. Saving has also been encouraged in Romania after 2008 by the more obvious restrictive nature of the monetary policy of the Romanian National Bank which has increased monetary policy interest thus making banks resort to fewer deposits because they have lower costs [5].

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# The Economic Crisis and its Effects on the Evolution of Economic Performance

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## Abstract

*This paper attempts to provide an estimate of how the Romanian economy can develop in 2012. This prediction is made based on an analysis of the evolution of the market value of the main companies operating on the financial markets, in the industry, on the energy market, on the consumer market, in real estates, in agriculture. The conclusion is that there is no evidence of a trend and common to all sectors analyzed, but we can provide some answers to the question: Which of the economic sectors will have a positive trend this year?*

**Key words:** economic crisis, share value, economic sectors.

**J.E.L. Classification:** G3; G32; G34

## 1. Introduction

“This is a nightmare, which will pass away with the morning. For the resources of nature and men’s devices are just as fertile and productive as they were. The rate of our progress towards solving the material problems of life is not less rapid. We are as capable as before of affording for everyone a high standard of life—high, I mean, compared with, say, twenty years ago—and will soon learn to afford a standard higher still. But to-day we have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the working of which we do not understand. The result is that our possibilities of wealth may run to waste for a time—perhaps for a long time.” (John Maynard Keynes, *The Great Slump of 1930*).

Today, after 80 years of the Great Depression of the 1930s, most industrialized countries face a severe recession. Euphoria credits extended for a period of almost 50

years has led to excessive price increase, especially in the United States, and finally the situation turned into a contraction of the market. Economists believe that the current recession is even more severe than the Grand crisis of 1930 and are concerned that the end of it is not in the near future, but sometimes after 2012.[1]

The signs of the economic crisis are:

- A sharp decline in industrial production in countries that rely on export;
- Unemployment, especially in constructions, real estates and financial services;
- High degree of market volatility;
- The crisis in financial markets emphasized by significant decreases in the share value;
- The decline in business travel - hotels respond to this situation by reducing prices, making more special offers etc.
- Political instability – as can be seen in the violent protests in Greece, the protests of thousands of people in France and the Great Britain, all aimed against the economic policies.
- Overall, we can notice that the current global recession forces all investors to revise their business plans and also constrains the consumers to cut on their expenses.

It is obvious that Romania is affected by the current economic crisis. Whether faster or slower, all economic sectors have been affected. This paper portrays the evolution of stock prices for the major companies on the market, broken down by sector of activity, according to statistics provided by BSE.

## 2. Data regarding the evolution of companies share value

We have analyzed the evolution of the following economic sectors:

**Financial market** – its evolution was studied based on an analysis of the changes in the share value for some of the most representative companies belonging to sectors such as banking, insurance, brokerage, mutual funds. The study included a total of nine companies and the results are as follows:

Company Name	Share Value May 2008	Share Value May 2011	Share Value Evolution
BRD	22	14,91	-32,22%
Banca Transilvania	4,3	1,57	-63,48%
Erste Group Bank AG	160	141	-11,87%
Banca Comerciala Carpatica	0,2	0,07	-60,00%
SIF 2	2,5	1,56	-62,66%
SIF 5	3	1,56	-48,00%
SIF 3	1,5	0,58	-61,33%
SIF 4	1,7	0,85	-50,00%
SIF 1	2,7	1,27	-52,96%

**Energy** – this area of economic activity was analyzed in terms of developments in the oil, natural gas and electricity production market.[6]

The results provided by the five companies are shown in the table below:

Company Name	Share Value May 2008	Share Value May 2011	Share Value Evolution
Transgaz	240	255	06,00%
Transelectrica – Transporting electrical energy	27,2	21,00	-22,79%
Romp petrol – crude oil products	0,6	0,37	38,33%
Petrom – petroleum extractions	0,43	0,43	0,00%
Dafora – petroleum and natural	0,3	0,12	-60,00%

gas extraction			
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**Industrie** – the existing data in this area were numerous, but we selected as representative the data from 21 different companies belonging to the manufacturing industry, metallurgy, furniture industry, pharmaceutical and chemical industry, textile industry etc.

The results were as follows:

Company Name	Share Value May 2008	Share Value May 2011	Share Value Evolution
Zim tub S.A. – producing steel tubes	4	1,35	-66,25%
Biofarm S.A. – pharmaceutical products	0,3	0,20	-33,33%
Azomures S.A. – producing fertilizers	0,2	0,68	240%
Alro S.A. – aluminum processing	7,6	1,66	-78,16%
Teraplast S.A.- plastic processing	0,83	0,51	-38,55%
Altur S.A. – producing vehicle pieces and accessories	0,06	0,04	-33,33%
Zentiva S.A. – pharmaceutical products	0,6	1,5	50,00%
Amonil S.A. – producing fertilizers	0,06	0,01	-83,33%
Turbomecanica	0,4	0,08	-80,00%
Antibiotice S.A – pharmaceutical products	1,4	0,57	-59,28%
Oltchim S.A. – chemical products	0,8	0,41	-48,75%

Alumil – aluminum processing	5,7	1,38	-75,78%
Arrom – producing steel tubes	12	1,4	-88,33%
SNO – naval constructions	10	4,5	-55,00%
Siretul Pascani – textiles	0,06	0,2	233,33%
Aerostar – aircraft constructions	1,4	1,01	-27,85%
Electroputere	0,8	0,07	-91,25%
Statusmob – mobile	0,1	0,04	-60,00%
Mobam-furniture	4	2,8	-30,00%
Faimar – ceramic products	0,25	0,04	-84,00%
Pantex – textiles	30	6,1	-79,67%

**Constructions** – the construction economic sector was studied by means of changes in the share values of real estate developers, construction firms and construction and real estate brokers.[1]

The results are as follows:

Company Name	Share Value May 2008	Share Value May 2011	Share Value Evolution
Condmag	0,8	0,36	-55,00%
Impact Developer – Real Estate Developer	2,5	0,4	-84,00%
Transilvania Constructii	350	36,5	-89,57%
Edil Constructii	0,8	0,05	-93,75%
SCT SA	24	4,6	-80,83%
Forconcid SA	150	60	-60,00%
Cocor SA	400	299	-25,25%

**Retail** - Consumer goods market has been analyzed based on changes of the value of shares belonging to companies representative of the electrical trade, alcoholic beverages,

pharmaceuticals, auto parts trade.

Company Name	Share Value May 2008	Share Value May 2011	Share Value Evolution
Flamingo	0,3	0,04	-86,67%
Bermas	1,7	0,81	-52,35%
Farmaceutica	0,35	0,17	-51,43%
Automobile Craiova	25	14,5	-42,00%
Medimfarm	0,35	0,3	-14,29%
Dorolux	0,16	0,7	337%
Uzinexport	0,6	0,5	-16,67%
Petrom Aviation	0,14	0,25	78,57%
Centrofarm	8,5	5	-41,18%

**Services** – The tertiary sector is represented in this paper by the evolution of the share value in the tourism sector (hotels, travel agencies) and by the market developments in passenger and freight transport.

Company Name	Share Value May 2008	Share Value May 2011	Share Value Evolution
Turism Felix	0,6	0,17	-71,66%
Casa de Bucovina	0,2	0,05	-75,00%
Durau SA	0,3	0,65	116,67%
Bucuresti Turism	20	3,5	-82,50%
Bat Medias	0,6	0,49	-18,33%
Trameco	30	8	-73,33%
Dorna Turism	6	2,7	-55,00%
Tusi Prahova	0,2	0,11	-45,00%
Intercontinental	0,18	0,07	-61,11%
Mondotrans	0,8	0,84	5,00%
Herculesc	0,4	0,4	0,00%

**Agriculture** – The evolution of the agricultural sector is presented based on the way in which the share value has evolved for companies dealing with selling cereal, for those in the meat, dairy and bakery industry.

Company Name	Share Value May 2008	Share Value May 2011	Share Value Evolution
Titan	0,35	0,37	5,71%
Comcereal	35	15	-57,14%
Graul SA	0,25	0,19	-24,00%
Coreal	10	5,4	-46,00%
Avicola Buzau	0,07	0,02	-71,43%
Unisem	0,07	0,03	-57,14%
Albalact	0,5	0,22	-60,00%

Summarizing the data obtained, we will now present the growth rate for the period between May 2008 - May 2011, for each of the economic sectors considered, based on the average value of shares evolution in the companies that we considered representative for the areas that we took into account.[4]

Economic Sector	Average value of the evolution	Standard Deviation
Financial Market	-67,21%	0,17
Industry	-52,05%	0,68
Energy	-61,23%	0,16
Constructions	-73,59%	0,24
Retail	-23,67%	0,51
Services	-36,84%	0,58
Agriculture	-44,29%	0,26

From the data herein presented we can conclude the following:

- All economic sectors registered a fall in the market value their shares;
- The narrowing of the market is significant (only three of the sectors analyzed presented a decrease below 50% - services, retail and agriculture), thus excluding the hypothesis of a conjunctural negative situation and creating all the prerequisites for a similar development on the long term;
- The most affected of the economic sectors considered is the construction sector, a situation mainly caused by stopping the funding for such investments;
- The least affected sector is the consumer goods market, situation which may be generally explained by the fact that

products are generally low-cost, are products of prime necessity, some of them less elastic depending on the income;

- The development of services, analyzed, as we have already mentioned, mainly in terms of tourism services, can be considered less than relevant because the analysis involves a period affected by the economic crisis, less favorable to the demand for tourism services.

We will further present the consequences that we forecast, as a result of the national economy previously outlined.

**The financial market**, which is the second, according to our analysis regarding the rate at which the value of shares decreases, is in turn divided into: banking, insurance, the leasing, brokerage houses. The expected evolution for this economic segment is characterized by certain relevant aspects, as follows:

- A consolidation of the market position of the strongest banks based on mergers and acquisitions and not based on competitors going bankrupt;
- A slowing down of the expansion of banking networks and of the addition of bank assets;
- A deceleration of both the contracting and the lending of credits, for the population and for the companies alike;
- An orientation for loans in lei;
- A decrease in the spread of interests;
- The insurance market will suffer losses due to the fact that, in these times, companies mainly wanting to save will reduce the budgets allocated for purchasing insurance products;
- The collapse of stock prices and of the trading volume will drastically affect the profits of brokerage houses, which in turn will have negative effects on wages and employment in this market segment;
- On the leasing market also we can also assume there will be a stagnation in the increase of profits and wages.

**The industry**, with a decrease in share value during the period between 2008 - 2009 of about 50%, is a very heterogeneous sector, which makes a global assessment less relevant or important than as a trend. Therefore, this sector should be carefully analyzed, taking into account the sectors it is made up of.

*The steel and metallurgical sector* will be subject to different pressures. On the one hand it is expected that the export demand will fall, on the other hand, in times of economic crisis, infrastructure projects, which would increase the domestic demand, are initiated.

*The manufacturing sector*, itself a heterogeneous sector, will be characterized by significant variations in terms of turnover, profits and wages according to the markets analyzed. There are market segments that benefit from EU funding (such as those related to irrigation equipment, sewage, etc.), but there are also market segments such as the shipyards which, due to restricted activities of the ship-owners, will see significant cutting down of their activity.

As far as the *furniture market* is concerned, expectations are related to the fact that there will be no market growth recorded and that low price segments will be preferred. As a result of the decrease in the demand for furniture one can expect lowered prices for furniture.

*The automotive industry* is one of the most affected by the current economic circumstances. While there's a significant decrease in the number of cars produced, there will also be a decrease of profits and wages. In response to this situation companies that operate on this market segment will focus on after sales services.

*The pharmaceutical industry* has a more special situation because this market, unlike others, is characterized on the one hand by lower elasticity towards income, on the other hand is a regulated market as far as price is concerned. Although it is doubtful that it will have a development parallel with the economic crisis, impact will be one generated indirectly by the government's health policy which regards, among others, the modality of calculating the price of drugs.

*The chemical industry*, respectively the chemical fertilizers market will be largely dependent on the agricultural policy measures adopted. Specialists think however that there will not be significant increases in the market, while wages and profits will remain constant,

Regarding the *light industry* one can say that it will be one of the most affected sectors, to the extent that this downward trend had begun before prior to this period,

respectively since 2005. Specifically this will translate in a significant decrease in the market, lay-offs of at least 20% of the employees, lack of demand, bankruptcies, lower prices.

**Energy**, namely the petroleum natural gas and electricity market, decreased by about 60% in value of the shares for the period analyzed. The main players in this market appreciate that the evolution will be characterized by the following:

- Stagnation or even contraction of the market, both in quantity and in value;
- Maintaining the same level of the salaries or even lowering them by 5%;
- Lay offs;
- Maintaining the profits or reducing them in a small proportion.[6]

**Construction**, the sector most affected by the economic crisis characterized by aspects specific to the segment that they make reference to. Thus we can talk about a fall in homes prices - but to a greater extent for old houses, the rents for commercial spaces, land prices especially in non-central areas and about keeping rents for office accommodation at a stable level. Concomitantly, a slow down in earnings of about 10% is expected, as well as a comparable reduction in profits, the bankruptcy of small businesses, difficulties for construction firms in contracting new clients, decreasing the growth rate on the construction materials market. Ultimately, the evolution of this market will be influenced by the extent to which funding can be obtained, mainly for infrastructure works, by the credit-worthiness of customers and by the banks' lending policies.

The effects of the economic crisis on the **consumer goods market** will be reflected especially in the changing of the consumer habits. It's about consumer becoming oriented towards commodities which are basic and cheap, which will increase the market share of discounters. It is also appreciated that there will be a significant decrease in the market for consumer electronics, otherwise there will be no significant reductions (non-food consumer goods) or we might even record some increases (cosmetics, alcoholic beverages and soft drinks). As far as wages are concerned, we cannot talk about significant increases, in a context where the same number of

employees will be maintained or the layoffs are less relevant than in other sectors.[3]

**The tertiary sector**, one of the most flexible to incomes and prices, will be one of the most affected. The hotel services are expected to register an increase in the demand for average-quality services to the expense of five stars services, in search of a smaller price, reduced lengths of tourists sojourns, lower occupancy, maintaining relatively constant profits and wages. A similar trend will be recorded for the restaurant market. Customers will migrate from the top restaurants to those that fall within the medium-economy class. This level is also expected to have an increase in sales of up to 20%, which will determine a profit raise of about 10% and wages which are 6-7% higher. Structural changes are also expected in transportation. As there will be less demand for freight and passenger transportation, it is expected that road and air transportation will be preferred to the rail one. Overall we can expect a slight increase in sales and profits and a stagnation of the wages.[2]

The evolution of the agricultural sector will be largely dependent on state intervention and on the extent to which farmers will have access to funding. As far as the food industry is concerned we expect stagnation or a slow growth in sales, a constant level of profits, customer orientation to cheap and basic products, an increase of prices for raw materials and even the bankruptcy of small businesses.

### 3. Conclusions

Making an estimate of the economic development in the near future is a big challenge given that, as it can be seen, apart from the general trend of lower share prices, we cannot talk about a specific evolution on various markets. However, from all of the above we may conclude that we can expect stagnation of wages and profits, especially in banking, sales decreases, notably on the auto market, electronics and brokerage houses, a reducing of the rate of economic growth and foreign investments, deflation, larger unemployment, bankruptcies on one hand, and consolidation of the already powerful companies on the other hand, increased macroeconomic imbalances and a general

decrease of the confidence in the Romanian economy.

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## Bank Credit in Romania, between Marketing and Risk

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### Abstract

*In Romania, in recent years, bank credit has seen explosive growth, which has not been left without consequences. On one hand, credit growth has meant economic growth, raise of quality of life and living standards. But on the other hand, the same phenomenon has meant an increase in risks facing the Romanian economy and banks in our country. This communication aims to analyze bank lending in Romania, seen as a marketing element, and its developments and the risks that it determines.*

**Keywords:** credit, interest, commission, structure, risks.

**J.E.L. Classification:** G21

### 1. Introduction

Bank credit was and is one of the controversial issues in the analysis of Romania's progress in the last decade. Thus, on the one hand, it is quite obvious its contribution to economic growth in the first decade after 2000 or in terms of raising the quality of life and living standards of many Romanians.

On the other hand, bank credit, but also its strong increase within the period 2005-2008 was one of the channels through which economic and financial crisis broke in Romania and additionally amplified the risks facing the economy, businesses and population.

### 2. Marketing of bank credit

Although at first glance, it seems that the typology of bank loans would be the same, there are a number of features, due to the economic environment, geographic areas in which banks operate, the standard of living of applicants, banking culture etc. Also, in

many countries such credit products are related to other products such as savings instruments, making it difficult to separate credit analysis services that are dependent. Credit is considered as a product in strategic marketing of financial-banking services. Credit is a strategic product because [1]:

- it allows the sale of other financial and banking products. Thus, often the bank will make a loan provided that the debtor is to transfer the salary into an account at the bank or credit card account. Furthermore, the existence of these accounts makes it possible to pay utilities, telephone bills through the bank or ATMs, so on and so forth;
- it allows the sale by banks of packages of products and services. So far most banks when granting a loan to maximize sales, attach also a card (with which they can use the credit), insurance products (nearly every bank has as subsidiary an insurance company, where they conclude insurance policies or, if it does not have one, it acts as a broker in selling insurance policies of companies in the field), payment of credit purchases to be made through bank accounts, property valuation services by guaranteeing loans made by bank staff etc;
- as bank loans require a detailed analysis of the applicant, they can be used in developing complex databases of clients, which, in turn, may find use in the marketing process, to monitor population needs and behaviors;
- in some cases, credit may be a byproduct of other bank services. It is recommended in order to increase sales and bank income (as loans bring some of the largest bank revenues), to try the distribution of credit type products, even when the client is at the bank for another product. It is exemplified by overdraft facilities to debit

cards as banks offer to credit card depositors, which are guaranteed by collateral of deposit accounts.

In the bank marketing, credit costs play a very important role, so it is necessary to examine the elements that determine it.

Interest is the essential element of credit cost and at the same time, the main characteristic of a comparative analysis that customers make when purchasing such a product. However, due to competition, which caused an equalization of the levels of interest, the importance of this element began to decline significantly.

Hidden costs (a series of maintenance fees, insurance, management, etc.) are those that recently customize loans from bank to bank. Banks, faced with lower interest income in recent years have tried to counter this situation, by attaching to credit type products a series of commissions, justified by covering all costs that were made when granting a loan. Since the levels of interest were becoming smaller and smaller and hidden costs increasingly larger and to enable customers to make fair comparisons, taking into account both interest rates and hidden costs, regulators in many states have imposed financial intermediaries to calculate the full cost of credits (a sort of compound interest annually, as is in Romania the effective annual interest). Imposing publication of these annual effective interest was generated by the market entry of non-bank intermediaries on the financial products market, or even traders, who, in trying to win the important parts of the market carried extensive promotional campaign about the "0% interest" practiced. In fact they sold goods at increased prices that represented exactly the amount of the interest and other commissions. As seems to be true the idea that publication of the annual effective interest was a fair measure to protect customers by ensuring the transparency of operations, given that for many consumers financial services terminology of the elements (flat, free, etc..) or techniques for calculating interest or maturities, due to reduced banking culture had no relevance. In addition, the annual percentage rates had the advantage of increasing competition in financial markets and banking.

Undoubtedly, these types of interest influence very much interest on loans.

Consumers of financial-banking services, insufficiently clear on the mechanisms underlying interest, consider that any fall in the first category of interest, should also determine reduced lending rates. In reality, any bank, when reducing interest on loans, do so not from a cyclical influence or imitation of competition, but after analyzing a variety of environmental factors, some internal and external of the bank and, not least, due to the evaluation of the impact which generate amplification in volume of bank operations.

Risk [2] is another element that affects the interest rate on loans. In principle, if the analysis made by the bank at granting the loan is casual, (see slogans "credit with ID only", or based on the certificate of employee), the higher the interest, because it can interfere with many uncertainties for banks. Conversely, a long term loan, mortgage or real estate like, with guarantees and insurance, with a thorough analysis of the creditworthiness of the applicant, will have a much lower risk and therefore will have less interest. Loans in foreign currency, in principle, have higher levels of interest in relation to the reference rate in the country issuing the currency, because it is dependent on the volatility of currency markets, on the international financial market creditworthiness of the bank to attract resources, on one hand, and gives credit on the other hand.

Reserve requirements are another element that "raises" the interest on loans. The fact that for any resource of bank financing, except equity category, they must restrain some accounts the central bank, while the cost of attracting and involving not only make very small income, they must be supported by the interest charged by banks on loans. Studies in Romania indicate that approximately 30-35% of the interest margin charged by banks is the cost of minimum reserves held at the National Bank of Romania.

A portion of bank loans (small - approx. 3% - for loans to individuals and higher for business loans - about. 5-7%) do not return to the bank, borrowers entering default. These banks have incurred losses for the banks and the amounts they are spending on their own account, meaning on account provisions that do nothing but increase the interest on loans.

Distribution cost loans. Levels of interest

on loans to retail customers is higher than the interest on loans to corporations and that the first volumes were much lower than those for businesses and therefore the fixed costs of lending (usually commissions) distributed over much smaller amounts. In addition, most loans to individuals are distributed through the network of counters, which is a relatively expensive means of distribution. In recent years, banks, just to avoid these costs and therefore to reduce the level of interest for credits, prefer to allow credits of small volumes, for individuals, in the revolving system and through the cards.

We notice that many of the factors that determine the cost of credit are not one-off factors, but rather structural, which banks often have no way to control, in order to reduce the levels of interest on loans. Therefore, to balance their level it is recommended, in terms of marketing, emphasizing secondary services such as facilities provided (payment terms, grace periods, the fact that the interest rate is fixed, when there appears a trend of increase or variability on the market, when the trend is downward, has no specific destination, early repayment is allowed, rates can be paid at any counter or through any channel, etc.), service quality is high, response time credit application is short (see the slogan "credit in an hour"), the product can be contracted through alternative channels (call centers) etc.

### 3. Romanian developments in credit and related risks

Non-government credit (for population and business) has registered an explosive increase, in 12 years, it grew almost 30 times. However, in its evolution there are two distinct periods (table no. 1):

- one prior to the crisis in Romania, 2001-2008 (but especially, between 2005-2008, in which the non-government credit rises strongly, from about 7.5 billion lei (RON), to 194 billion lei (RON). Accelerated dynamics of the non-government credit in this period can best be captured by the ratio of it and the gross domestic product of Romania, indicator which from 9%, as it was in 2000, reaches 38% in 2008;
- the second beginning with the year 2009, after the crisis struck, in which the increase fades, and in some parts of the

credit we can even speak of decreases. Thus, non-government loan, as a share of GDP, evolves in this period from 38% to 40%, provided that this increase is due to foreign currency component, namely the process of currency depreciation of the leu (against the euro, dollar or other currencies in which the loans were denominated) recorded in relation to 2008 (table no. 2).

Table 1. Credit dynamics in Romania

Year	Government credit		Non-government credit	
	billion lei	% of GDP	billion lei	% of GDP
2000	3,4	4,2	7,5	9,3
2001	2,5	2,1	14,4	12,3
2005	3,3	1,1	60,6	21,0
2006	3,5	1,0	93,3	27,3
2007	9,6	2,3	144,4	34,7
2008	17,2	3,3	194,0	37,7
2009	47,0	9,4	196,4	39,2
2010	61,0	11,7	209,0	40,0
2011	70,1	12,8	219,8	40,0
2012 feb	77,1	14,0	218,9	39,9

Source: NBR monthly data from January 2000 Bulletins - February 2012 and author's calculations

Non-government credit growth, theoretically, should have beneficial results for the economy, but the dynamics that this process took place in Romania and a very short period of time that has happened is rather risky and unfavorable: amplification of inflation, of the real estate prices, amplifying the current account deficit, excessive debt [3] etc.

Table 2. Currency structure of credit

Year	Non-government credit			
	RON		in currency	
	billion lei	% of GDP	billion lei	% of GDP
2000	3	3,7	4,5	5,6
2001	4,7	4,0	9,7	8,3
2005	27,9	9,7	32,7	11,4
2006	49,5	14,5	43,8	12,8
2007	66,2	15,9	78,2	18,8
2008	82	15,9	112	21,7
2009	78,1	15,6	118,3	23,6
2010	77	14,8	132	25,3
2011	79,8	14,5	140	25,5
2012 feb	78,4	14,3	140,5	25,6

Source: NBR monthly data from January

2000 Bulletins - February 2012 and author's calculations

It should be noted that non-government credit growth stop since 2008, is accompanied by a rapid expansion of government credit (for state authorities), which from a value of 9.6 billion lei at the end of 2007, reaches 77.1 billion in February 2012, so an increase of almost 9 times in four years, or as a share of GDP from 2.3% to 12.8%. This last point explains the fact that reducing lending rates in recent years, despite efforts of the central bank to reduce policy rate, is a slow process: demand for loans for people and businesses is at historical minimal, the state credit appetite is very high.

Table 3. By debtor credit

Year	Non-government credit			
	business		for the population	
	billion lei	% of GDP	billion lei	% of GDP
2000	7,1	8,8	0,4	0,5
2001	13,4	11,5	1	0,9
2005	31,4	10,9	29,2	10,1
2006	54	15,8	39,3	11,5
2007	72,9	17,5	71,5	17,2
2008	94,6	18,4	99,3	19,3
2009	96,1	19,2	100,3	20,0
2010	105	20,1	104	19,9
2011	115,6	21,1	104,2	19,0
2012 feb	114,5	20,9	104,5	19,0

Source: NBR monthly data from January 2000 Bulletins - February 2012 and author's calculations

An analysis of loans by currency of denomination (table no. 2) indicate a prevalence of Romanians and Romanian companies to borrow in foreign currency, it fully justified given that interest rates on foreign currency loans were significantly lower than for loans in lei (although by the financial crisis monetary authority - NBR - tried, without much success, to discourage the loans in foreign currency). Statistics indicate an increase from 3 billion lei to 82 billion lei for loans in lei (or as a share of GDP from 3.7% to 15.9%) in 2008, after which a slow decline to 78 billion lei in February 2012. Regarding the currency component, it increased throughout the period under review, the increase being over 135 billion, noting that the phenomenon undergoes the biggest development prior to the crisis (115 billion), due to new loans and slower growth

after 2008 (22 billion lei), explained, mostly, as I said earlier, more through the depreciation of the leu against foreign currencies in which denominated loans that were already granted.

As a share of GDP non-government credit in currency represented about 25% of GDP and it must be said that it introduces a strong risk in the economy, any depreciation of the currency increases the borrowers debt and in the conditions of income restrictions the risk of insolvency increases of the borrowers, which through propagation strikes even the creditor banks. Is to note that most of foreign currency loans granted by banks were a source of credit lines granted by foreign parent banks or financing from international financial markets, these adding to the foreign currency deposits of non-residents, because savings in foreign currency is relatively low [4].

Table 4. Term structure of credit

Year	Non-government credit		
	Short-term	Mid-term	Long-term
Business			
2000	5,3	1,3	0,5
2001	10,7	2	0,7
2005	12,6	12,2	6,6
2006	26,9	15	12,1
2007	30,4	21,8	20,7
2008	39,6	27,4	27,6
2009	39,4	26,6	30,1
2010	40	30	35
2011	45,4	32,1	38,1
2012 feb	47,3	30,1	37,1
For population			
2000	0,1	0,2	0,1
2001	0,4	0,4	0,2
2005	10,1	10,1	9
2006	4,6	10,7	24
2007	3,9	11,7	55,9
2008	5	13	81,3
2009	5,4	12,2	82,7
2010	6	12	86
2011	6,3	10,8	87,1
2012 feb	5	12,1	87,4

Source: NBR monthly data from January 2000 Bulletins - February 2012

The analysis of loans structure by borrower (table no. 3) indicates a greater progression of credit to households. Thus, if at the beginning of the period analyzed credit for businesses was overwhelming, and that

for population was of insignificant size, it comes that in 2008 the one for population to surpass the one for companies (credit for the population grew from 0.4 billion lei in 2000 to 99.3 billion lei in 2008, and the one for companies grew from 7, 1 billion lei to 94.6 billion lei). Since 2009, we are witnessing a change, that population loans increase more slowly in relation to the business loans, the latter amounting to 10% higher compared to the first. At the end of the period under review the credit for the population represented 19% of GDP and the one for companies 21%. Risks induced by such a structure of the credit relate to its purpose. Thus, if loans to companies lead to economic growth, which are used mostly to increase operating parameters and investment activity, those for the population are intended to finance consumption (table no. 5.), in other words they do not contribute to create new value.

The structure of non-government loans by maturity indicates new risks in banking (table no. 4).

*Table 5. Purpose of credit to households*

Year	consumption	housing	more
2007	55,1	14,2	2,2
2008	73,7	20,9	4,6
2009	72,8	24,2	3,2
2010	65	29	10
2011	62	33,4	8,9
2012 feb	70,9	33,5	-

Source: NBR monthly data from January 2000 Bulletins - February 2012

Thus loans granted to companies show a concentration towards short term granting (up to a year), because at the end of the range, medium-term loan amount (between 1 and 5 years) and the long term (over 5 years) to be higher than short-term (in February 2012 those being of 47 billion lei in the short term, medium term 30 billion lei, 37.1 billion long term). However, for individuals, loans with terms longer than one year were always higher compared to the short term, the last with very low values compared with the medium and long term (in February 2012 those being of: 5 billion lei in the short term, medium term 12 billion lei, 87 billion lei for long term). Risks that arise from the term structure origin from the origins of sources of finance from which lending banks finance the

loans. Thus the dominant sources of financing the Romanian banks are term deposits up to one year and credit lines obtained short term and, hence, a mismatch in terms of the two categories: the sources attracted from short term loans are funded medium and long term loans. Additionally the maturity structure of loans to households induce additional risk meaning that the loans to this category, given the majority consumption (table no. 5), results that individuals are indebted medium and long term time to acquire goods that are morally and physically worn in a short period of time. At the enterprise level, the prevalence of medium and long term loans can be good, equivalent to financing investments of smaller or larger scale, which eventually lead to economic growth.

Table no. 5 provides an overview of the destination of loans granted to households. Observation is that throughout the period analyzed the destination of this type of loans was consumption, those for real estate (housing), being much smaller. As I said earlier risks assumed to this structure have funded in a smaller rate less durable goods, being financed mainly consumer goods with short-life, rapidly depreciating.

#### 4. Conclusions

Romanian government credit granted by banks was one of the channels through which the bank has become an active presence in the lives of our citizens, a simple marketing tool that they have increased your profits.

At the same time, credit, and more specifically, its rapid expansion has meant less economic and more risk and uncertainty for millions of Romanian. Unfortunately, what I consider as having a greater negative impact that the credit is increased governmental and global risks that affect the economy in general and all the inhabitants, not only those who have taken this loan.

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# The Financial System, the Direct Foreign Investments and the Economic Growth

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## Abstract

*This paper aims to synthesize the debates concerning the development of the financial systems and the direct foreign investments in promoting the economic growth.*

*The present work wants establish a connection between the development of the financial systems and the economic growth. Recent studies have marked out the correlation between the financial system, the catalyst factor, and the economic growth.*

*The actual stage of the financial system from Romania, as well as the connection with the banking system and the financial institutions are also taken into account. The most recent structural changes of the financial system from Romania after the adherence to the European Union, as well as the evolution of the direct foreign investments are also presented.*

**Key words:** financial system, direct foreign investments, economic growth, impact

**JEL Classification:** E20,G32

## 1. Introduction

Theoretical approaches regarding the financial system and its impact on the economic growth are found as early as the 19<sup>th</sup> century and they target, through for and against arguments, debates that want to elucidate if the financial system, and implicitly its structure, really leads to the durable development of a country.

There are also approaches according to which the structure of the financial system does not induce effects on the economic development in the specialty literature. It is author's J. Robinson's opinion that considers that the financial system doesn't have an impact on the economic growth, because finances either follow, either reflect the

economic amplitude, the investors anticipating the evolution of the economy.

Impact effects on the evolution of the economic system in its whole can also be attributed to the financial system implicitly in the actual context in which the finances are recognized for the specific function to stabilize the economy and implicitly their demotor role in boosting the economy .

## 2. Approaches regarding the impact of the financial system on the economic growth

In 1969 J. Hicks considers that the economic system played an important role in the industrialization on Great Britain, acknowledging itself as capital mobilization factor. J. Schumpeter marked out the positive impact of efficient banking activity on the financial innovation, in the same context, at the beginning of the 19<sup>th</sup> century. The banks only finance the profitable projects, with positive effect on the canalization of capitals towards the investments that contribute through innovation and to the economic growth by choosing the investors.

The economic literature most often identifies 2 main sources of the economic growth, and that is the technological progress, as propelling factor of the economic growth on one hand, and the innovation which induces effects including on the first factor, extending the frontier of the technologies, implicitly of the financial-banking ones, as objective basis in amplifying the real ones, on the other hand. The durable development appears as a result of the technological progress, approached as exogenous factor, in this context

The role of the financial system, and, implicitly of the finances, in the economic growth is ignored in some authors' opinion. Moreover, neither the neoclassical theory of the economic growth brings the financial

system into discussion, but it appears as being justified, because the money fulfill a neutral role within it. Also, the financial-monetary elements from the financial system are exogenous and without influencing capacity of the real actives, so they do not concur to the economic growth, also in the context of the classical liberal doctrine.

A series of economists consider that the possible connection between the financial system and the economic growth is not relevant. R. Lucas synthesizes that some economists exaggerate the role of the finances and of the financial system as basis of the economic growth, while others ignore the possibility of influencing the development in the basis of financial factors.

Most of the theoretical studies, but also the conducted statistical studies mark out a strong positive connection between the development of the financial system, the quality of the financial services and the economic growth as author R. Levine also synthesized .

### **3. Interrelations between the direct foreign investments, the financial system and the economic growth**

The contribution of direct foreign investments to the economic growth is deeply debated upon in the economic literature, the emphasis being on the transmission channels of the effects on the countries in which these investments are realized. It is considered that the direct foreign investments can lead to the introduction of new technologies, new knowledge and they lead to the creation of new production capacities that will amplify the economic development.

A series of authors consider that the impact of the direct foreign investments is strongly dependant on the development of the financial system of the country that receives the considered financial resources. The literature that tackles the economic growth mark out the importance of the new technologies, the growth degrees from the less developed countries proving to be strongly dependant on their adoption and implementation. The new technologies together with more performing production capacities and the managerial techniques initially used only by foreign multinational corporations that invest, are considered to be

subsequently adopted also by inland companies, being a factor that propels the economy.

The development degree of the financial system as factor with a strong influence is approached more and more often, together with a series of other factors amongst which the development of retail sale markets, of the training of the workforce, of the education level. A strong financial system determines the success chances of the inland firms, influencing the efficient allotment of the financial resources towards trustworthy investments projects. The development degree of the banking system and of the financial market becomes relevant in this background, the capacity of the financial intermediates and of the specialized actors to reduce the risks associated with these investments being of the utmost importance.

So, it can be considered that the direct foreign investments, the financial markets, the banking system and the financial system in general are complementary elements in the implementation and new technologies dispersion process, as basis for the economic growth.

### **4. The financial system, the direct foreign investments and the economic growth in Romania**

Romania's adhesion to the European Union encouraged the credit development and the foreign investments in the financial sector. The structure of the financial intermediary sector indicates an orientation towards the banking system, while the investments on the capital market hold a reduced weight. The capital market can only take over the role of sponsor of the real economy in the case of some imbalances of the banking sector in a limited measure. The societies of services au financial investments have a significant role as far as the intermediation on the stock exchange market. The insurance societies registered a positive evolution in the last years, but the life insurances component, oriented towards the long term investments, is reduced.

Table 1. The number of active financial institution from Romania

	2008	2009	2010
Credit institutions	43	42	42
Insurance companies	44	45	43
Insurance brokers	459	510	567
Private pensions funds	23	25	22
Open investments funds	54	52	58
Close investment funds	-	15	18
Financial investment companies ( Rom.: SIF)	5	5	5
Financial investment service companies	66	64	55
Non-banking financial institutions (General Registry)	238	228	207
Non-banking financial institutions (Record Registry)	4513	4802	5009

Source: BNR, CNVM, CSA, CSSPP

The financial societies activated on the market of non-banking financial institutions and on that of insurances intermediaries and of investments in real estate values, indicating a high competition level, but also a significant dispersal of the actives. The other components of the financial system registered a more reduced number of investments because of the nature of the activities that impose a substantive volume of capital. An increased interest of the financial institutions aiming at the access on the financial market from Romania was determined, many of them receiving favorable notification from the surveillance authorities in the basis of the unique European passport.

The degree of financial intermediation slightly restrained in 2010 because of decreasing economic activity and of the tensions from the international financial markets. The credit institutions represent the main component of the financial sector, and their exposures to the banking institutions from Romania, as well as the resources attracted from these financial institutions are

limited and do not present a significant direct contagion risk within the financial system.

The weight in the Gross Domestic Product of the actives detained and administered by the financial institutions that represent an evaluating coefficient of the degree of financial intermediation in economy slightly decreased in 2010, the increasing evolution from the previous years being broken by the decreasing economic activity and by the tensions from the international financial markets.

As far as the structure of the financial system is concerned, a decrease of the weight of the non-banking financial institutions in the period 2008-2010 is observed because the high degree of the non-payment risk associated to their portfolio lead to the restrain of the credit activity in this sector and implicitly to the reduction of balance sheet actives. This evolution was accompanied by increases of the weights of the other segments of the financial sector. The most important advance was that of credit institutions (the main component of the financial system) and the open-end investment funds; the private pensions funds continued to extend their value of the administered actives, reaching the level of 0,9% from the Gross Domestic Product at the end of 2010.

The risk of internal contagion, evaluated both by the exposures of the credit institutions towards the financial institutions from Romania, and by the resources attracted by these from financial institutions from Romania is low. A decrease of the weight of exposures and of the attracted resources from the financial institutions from Romania during 2010 is noticed analyzing the balance sheet of the credit institutions. They are monitored in order to identify some potential risk sources, the implementation of some retrieval measures not being necessary. The analyses regarding the intersectoral exposures did not identify risks that could affect the stability of the financial system. The financial regulation does not fully solve the problem of the internal contagion. Still, the sectoral regulations foresee limits of the exposures to reduce intersectoral exposures.

The evolution of the number of financial institutions during 2010 does not mark out important changes in the case of the institutions that administrate the greatest part

of the actives from the financial system. The significant slow down of the decrease of the economic activity allowed the deployment of the activity of financial intermediation without a high volume of Mergers & Acquisitions, the risks being administrated within the financial institutions or within the financial groups that they are part of. An increase of the insurance brokers and open-end investment funds, but also a restrain of the number of societies of financial investments services are noticed. Although the capital market suffered important corrections in the period 2008-2010, mainly determined by the international financial crisis, the recovery of the stock exchange quotations from the last period increased the investors' interest for placements in investment funds.

The evolution of the economic growth in the last years, approached by the evolution of the Gross Domestic Product is reflected in the following table:

Table 2. The economic growth in Romania (the modulation Gross Domestic Product – USD millions)

Year	2006	2007	2008	2009	2010
PIB (GDP Value)	122696	170617	204339	161109	159338

Source: UNCTAD

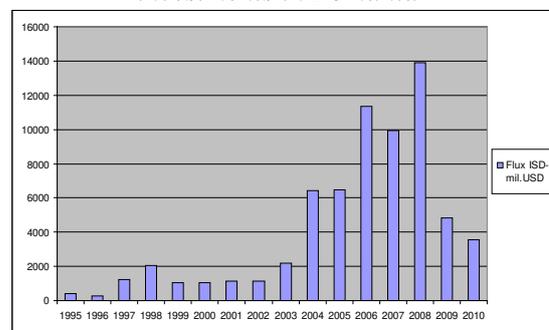
A series of factors have to be taken into account for the development of the financial system in the context of the economic growth:

- the strengthening of intellectual property rights because it encourages the productive investments;
- the strengthening of the legal system – a system that clearly contours the rights and respectively the contractual statements and that guarantees the property right leads to an increase of investments;
- the reduction of corruption – it is considered that it appears as an inhibitor factor for the economic development;
- the implementation of prudential or supervision or regulation rules in the banking system – a good canalization of the financial resources through credit leads to economic growth;

- the improvement of the corporate government – being considered that a more efficient management leads to positive results including in the real production plan, but also increases the interest to acquire the issued financial titles.

The evolution of foreign investments in 2010 was characterized as being disappointing and significant changes are not expected next year because of the uncertainties that are characteristic to an elective year and because of the fact that the international markets will probably continue to be tense.

Figure 1. The evolution of direct foreign investments in Romania



Source: UNCTAD 2010

On medium term, respectively the period 2012-2014, the prognosis scenario foresees the acceleration of the economic growth with rhythms between 4,0-4,7% to recover from the decreases from the years 2009-2010 due to the economic-financial crisis and to assure the reductions of the gaps towards the more developed countries of the European Union (*catching-up*). The scenario is based on the improvement of the activity in all economy sectors, especially in the industrial branches with high export potential, as well as in the construction sector that can capitalize the required infrastructure that exists in all domains.

The main risks that Romania will face in 2012 refer to the stint of the access to finances and those regarding the autumn elections. The failures concerning the attraction of structural funds can have a negative perception amidst the business people, a thing that should be avoided. The surveys show that the direct foreign investments will decrease by 20% in 2012, whereas the exports dynamics will be

decelerated to an increase of approximately 10%.

The main external vulnerabilities of Romania's economy at the moment of the crisis start tempered considerably. Firstly, the current account deficit continued to maintain itself at a moderate and sustainable level (4,1% of the Gross Domestic Product in the year 2010, the prognosis for the 2011-2012 period being under 5%, in comparison to the level of 11,6% registered at the end of the year 2008), and the exports performed above the region medium. The keeping of the sustainability of the current account deficit also in the context of the reprise durable economic growth asks for the continuation of the fiscal consolidation and for the correlation of the income policies with the evolution of the work productivity. The external debt on short term, another important vulnerability existent in the previous years, decreased its negative potential on the financial stability.

The companies with external debt have an installment of un-performing credits inferior to the system medium.

The vulnerabilities linked to the Romania's potential of economic growth had mixed evolutions. On one hand, the absorption degree of the structural and cohesion funds (calculated on the basis of the reimbursements received from the European Commission) remained reduced, and the innovation expenses maintained themselves modest (compared to the regional values and Romania's commitments in the strategy Europe 2020). On the other hand, the workforce market is the object of some ample reforms whose aim is the improvement of competitiveness of the Romanian economy. The fiscal consolidation – key element of the reform programs and one of the essential criteria in forming the investors' perception regarding the evolution of the country risk- continued. The fiscal deficit retrenched to 6,5% from the Gross Domestic Product in 2010 according to the national methodology (6,4% from the Gross Domestic Product respectively) and the fiscal structural deficit diminished at 5,2% from the Gross Domestic Product in 2010 (compared to 8,3% from the Gross Domestic Product in 2009). The continuation of the structural reforms and of the measures of fiscal adjustment, including in the direction of the

reduction of arrears and the improvement of the financial situation of state companies with problems, remains the central point of the authorities' preoccupation in 2011. The start of a new elective cycle in 2012 can generate though the risk that these reforms be implemented with a certain delay.

## 5. Conclusions

The economic stability in Romania remained robust despite of the difficult internal and external economic context from the previous year. The risks aiming at the banking sector were set off by the credit institutions through own efforts undertaken in the context of the activity that deployed by the National Bank of Romania regarding the prudential regulation, the surveillance and the adequate handling of the risks from the system, efforts that were materialized in the consolidation of the solvability, provision and liquidity levels.

The difficult international context represents a challenge concerning the financial stability from Romania.

The main challenges for the next period: (i) the handling of the contagion risk that could manifest itself in the case of opposed evolutions on the international markets as a result of the sovereign debt crisis or of the significant slow down of the economic growth in the developed economies; (ii) the quality improvement of the banking actives; (iii) the balancing of the structure on coins of the influxes of new credits and (iv) the improvement of the tools to rapidly intervene in the case of the credit institutions that are potentially in difficulty asks for the continuation of the efforts to maintain the solvability, provision, liquidity at adequate levels, and for the adoption of new prudential measures.

The global economy could be affected by a decrease of the growth rhythm, mainly at the level of developed economies. Also, the translation by contagion of the negative effects generated by the sovereign debt crisis at the level of some states from the European Union and from USA as well as the maintenance of vulnerabilities in certain European banking sectors can have consequences on Romania's economic growth, on the capacity of the banking

system to access finances and on the quality of the bank actives.

The answer of the authorities from the European Union for the maintenance of the financial stability and the improvement of the system of economic government at European level had no precedent. The ample package of measures regarding the improvement of the European economic government and the implementation of a new macro-prudential and micro-prudential supervising architecture within the European Union, together with the permanent mechanism of supporting the financial stability, will take part at the potential increase of economic growth in the European Union and to the decrease of the vulnerabilities of the European financial system that the crisis marked out.

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## The Fiscal Facilities to Stimulate the Investments Implemented in Romania and Their Occurrence

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### Abstract

*The fiscal competition and the differential of the imposition quotations can be viewed from various perspectives: for certain countries (especially for those that are disadvantaged from the point of view of the resources, of the geographical location) a favorable taxation system can be viewed as a financial mechanism to attract new investments, while others consider it harmful, hijacking the investments from one country to another. It is then obvious why the internationalization determined globally the reconsideration of the fiscal policies regarding the direct foreign investments. Currently, a special attention is paid to the efficiency of the administration of the excise taxes in the host country, to the fiscal facilities, subsidies and the benefits offered to the contributors because the investing companies are directly influenced by the taxation applied in each country separately.*

**Key words:** direct foreign investments, fiscal facilities, fiscal competition, impact

**JEL classification:** E20,F21

### 1. Introduction

The fiscal policy remains profoundly national in the conditions of the unique European space, the government of each country being responsible for the elaboration and the specific procedures to this domain, despite the efforts to harmonize the fiscal practices. From these stipulations, in the conditions of the obvious fiscal competitiveness, the biggest problems are the settlement of the imposition quotations taking into account that they are a variable taken into account by the foreign investors when they prospect the possibility of the deployment of a tangible or intangible

business in the host country. This is even more so, as the removal of the commercial barriers, the development of trans-boundary activities, the development of the economical areas determined an increased sensitivity of the influxes of capital at the differential of the taxation quotations.

The globalization of the monetary, financial and property influxes generated an ample debate as well as controversies amongst the researchers of the fiscal phenomenon, especially regarding the fiscal competition. The reason of the debate is the fact that the stipulations established by the fiscal legislation from various countries are meant to attract direct foreign investments by forcing the reduction of the imposition quotations, even starting a contest in setting quotations as low as possible.

The empirical studies regarding the impact of the tax excise on the economic growth pointed to the negative relation between these, but it is difficult to measure the potential benefits of the expenses financed from the collected fiscal incomes – the combined effect of distorted tax excises and the benefits of public expenses could lead to a net improvement of the private sector. But the fiscal incomes are not necessarily used for those expenses that could lead to economic growth, maybe because of the insufficiency of the political system or because of the redistribution policies by means of which the society benefits, but they are not reflected in the Value Added Tax increase rate.

### 2. The fiscal competition and the influxes of direct foreign investments

Comparing the evolution of the taxation quotation of the incomes of the companies and the level of the taxation with the influxes of direct foreign investments, it can be appreciated that there is a direct connection

between the fiscal competitiveness and the attraction of direct foreign investments.

The small companies are more sensitive to the fiscal policy than the big ones because the excise taxes and the taxes have a significant weight in the structure of their costs, having at their disposal fewer elaboration instruments of some decrease strategies of the fiscal burden. In exchange, the big companies are capable to negotiate the fiscal treatments and the samples that they pay to the public budgets. In this situation, the multinational companies have a few reorganization and finance of the investments alternatives, depending on the characteristics of the host country. A very important element of the excise tax refers to the fact that the multinational companies can open subsidiaries in countries that are weakly taxed, finding strategies to avoid taxation in this way; the companies are tempted to declare a bigger profit in the weakly taxed countries or to adjust the repatriation of the dividends depending on the fiscal legislation from the provenience country. This possibilities being given, the agreements regarding the double imposition become very important for the fiscal regime of a country.

Another approach of the empirical analyses is separate consideration of the effects of the excise taxes on the disintegrated elements from the relation of determination of the economic development rate (the workforce, the human capital, investments and technological development) and the combination of these effects to see the total impact of the taxation; this method has the advantage that it allows the more correct measurement of the agents' way of reacting to taxation elements, but it has the disadvantage that the effects on the accumulation of physical and human capital are not taken into account.

In the specialty literature, it has been proven that the marginal taxation rates affect more the increase rate than the medium taxation rate.

In the analysis of the impact of taxation on the economic growth rate the question arises if a fiscal reform generates effects of profit on the economic activity, if the decrease of the excise taxes won't generate the stimulation of economic growth, the fiscal revenues decrease, increasing the pressure on the deficit, decreasing the national level of

aggregated economy, generating gaps in the economic growth.

Many economists agree that high excise taxes damage the economic growth, a thing that doesn't always come true in practice – the decrease of excise taxes has positive but modest effects on the economic growth, but contributes at differences at the level of economic activity and the standard of living, especially on long term.

The phenomena of the development of the **underground economy** and of encouragement of **fiscal evasion** generated by the application of too high taxing rates must not be ignored in the demarche of the analysis of the impact of governmental policies on economic growth – Tanzi analyses the effects of a taxation system with arbitrary exceptions and other disintegrated elements: the corruption degree increases, so the production and so the human capital stock decreases; the corruption decreases the rate of economic growth by the produced distortion on the allotment of resources, destroying the relation between the social capitalization and the financial capitalization of an investment.

On the other hand, it is interesting to analyze the effect of the structure of the fiscal system on the economic growth – empirical studies regarding the effects of the various structures of the taxing system on the growth are few, because of the difficulties to collect the dates regarding the taxing rates – Mendoza, Milesi-Ferretti and Asea conclude that the structure of the excise taxes has low effects on the growth on long term; the mix between the direct and the indirect excise taxes play an important role in theory, but practically the plausible changes in the taxing rates don't affect the growth on long term in an economically significant measure, even if they have an important effect on investments. On the contrary, many studies focus on the structure of the taxation at the level of the workforce and show that high values of the contributions to social insurances would have an unfavorable effect on the level of the occupation the workforce and on production.

The realization of fiscal adjustments is necessary to obtain a sustainable economic growth. The taxation creates distortions, generally because it modifies the relative prices both of the final goods, and of the

production factors, in these conditions, the main objectives of the fiscal policy are:

- the construction of a system meant to generate the sufficient incomes increase to the target level, minimizing the level of the afferent distortions at the same time; its contribution to the economic growth apart from its contribution to the macroeconomic stability should be realized by minimizing the difference between the actual production and the potential production and by stimulating the productive investments from the private sector.

An ideal **taxing system** is described by Stosky (1995) as being characterized by:

- an accent on taxes on sales (Value Added Tax), preferably with a single rate and with minimum exceptions, excise taxes on oil products, alcohol, tobacco, luxury goods;
- the absence of export taxes;
- import taxes only for protectionist purposes;
- a simple administrative of the income tax, with a superior moderate rate marginal rate and with a sufficient exemption limit to exclude the persons with modest income.
- excise tax on corporate incomes based only on a low moderate rate, with amortization and other uniform deductible expenses amongst sectors.

The governments have a few fiscal instruments at their disposal that can be used to influence the effective imposition quotations and for the local orientation of the multinational corporations. Traditionally, the specialty literature identifies the following instruments as being useful in attracting direct foreign investments: the reduction of the taxing quotation of the corporations at a competitive level; deferred taxes or exception, exemptions from the taxing of the corporation; exemptions of local or customs excise taxes. These instruments are used on a large scale but their applicability is limited by international conventions. There are also ingenious tactics by which the investor buys the right to maintain the taxing quotation at a certain level even if the taxing regime will change in the future.

The multinational corporations interested to extend themselves take a mix of elements

into account to ensure the best conditions to recover the investments and to obtain the foreseen profit. Starting from these considerations, the researchers showed that most of the companies consider the excise taxes as essential for the location of their investments, under the provision that stability conditions be accomplished: the property guarantee, the financial stability, the development of the finance banking system, the political stability. The host countries are classified as less attractive, attractive and very attractive according to the Purchasing Power Parity / per capita, from the investors' point of view.

### **3. The stimulation fiscal facilities of the investments practised in Romania and their incidence**

The stimulation of direct foreign investments represents one of the main preoccupations of the public authorities from all countries. This is even more striking in the case of the emerging countries, that have to resort to actions meant to reduce the gap in comparison to the developed countries. The investments are the most appropriate instruments to realize this desideratum through their admitted multiplying impact. Romania is not an exception from this economic law, the public authorities frequently appealing to various instruments of fiscal policy meant to stimulate the companies in the direction of assuming investments as dense as possible.

The level of the taxing quotations has an important role in the decision process regarding the deployment of an investment from abroad, but their significance is different. The imposition statutory quotations (nominal) announced by the authorities to impose an activity are analyzed on one hand, and, the effective imposition quotations resulted after the application of deductions, exemptions, exceptions, facilities, delay on the other hand.

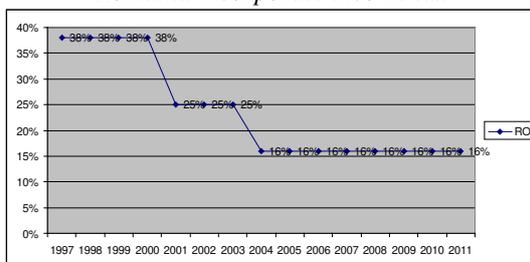
In the context of this problem, the income tax holds the most important place because it has an immediate effect on the measure of the net profit, although other samples in taking the decisions regarding the destination of the investments are relevant: the contributions to the social insurances, the imposition of nonprofit organizations, the

Value Added Tax, the imposition of the incomes of physical persons.

Starting from the whole exemption of profit tax until the possibility of the application of accelerated amortization without the prior agreement of the fiscal authorities, the stimulating effect of these facilities is transmitted, mainly, by means of the fiscal economies realized on the line of the profit tax. In the dimensioning of these fiscal economies, besides the profit tax quotation, the amortization regime applied by the company also exerts influence, their accumulated incidence being resumed at what the specialty literature calls user cost of capital and that represent the minimum rate of capitalization that the company has to realize following the investment to cover its costs (the costs regarding the amortization of the actives, the excise taxes and the payment of the investors that furnished the capitals necessary to the investment).

The determination of the effective imposition quotations can be accomplished using two main methods: the method that uses historical dates and the forecast (or anticipatory) method. The effective quotations obtained on the basis of the historical dates is based on the macro-economical pieces of information obtained from the national accounts or by aggregating the pieces of information obtained from the companies. On the contrary, the anticipatory method takes the excise taxes foreseen to be paid in the future into account, according to the development plans of the company. Synthetically, the evolution of the imposition statutory quotations in Romania are the following:

Figure 1. The evolution of imposition statutory quotations  
Romania – corporate income tax



Source: Eurostat

Having in view the way of expressing the cost of capital use, the main advantages and

disadvantages of different fiscal stimulations for investments can be synthesized:

Table 1. The advantages and the disadvantages of the main types of fiscal stimulations on the line of the profit tax

The fiscal stimulus	Advantages	Disadvantages
The tax holiday (exoneration)	<ul style="list-style-type: none"> <li>- the reduction of the costs of fiscal administration;</li> <li>- the simplification of the procedures of fiscal evidence for companies;</li> <li>- the neutrality regarding the relative rapport of using the production factors (work-capital);</li> </ul>	<ul style="list-style-type: none"> <li>- the beneficiaries are also the companies that realise very big profits and that would have realised the investment also in the absence of the facility;</li> <li>- the increase of the inclination towards activities that determin the avoidance of the payment of the excise taxes by closing some activities and their retrieve (with the same actives) under another name or by the transfer of teh profits to entities that benefit from the exemption;</li> <li>- the stimulation of short term investments to the exclusion of long term investments, considered as having a more powerful stimulating impact on the economy;</li> <li>- the loses of budget revenues are unknown most of the time;</li> <li>- reduced</li> </ul>

<i>The fiscal stimulus</i>	<i>Advantages</i>	<i>Disadvantages</i>
		transparency;
The reduction of the profit taxing rate; (preferential rates)	- generally the same as in the previous case with the determination that the company has to make proof of the framing in the conditions of the taxation at preferential rates (which can determine a slight increase of the costs of fiscal evidence), respectively the reduction of the neutrality in the situation in which the rate reduction is conditioned upon the investment in performing equipments (the increase of the preference for capital);	- the same as in the previous case, but with more reduced and transparent budget costs (because the companies remain in the imposable sphere)
Investment allowance	- they serve better at the promotion of certain types of investments, in certain sectors (usually in equipments); - reduced budget costs and higher transparency;	- they privilege the investment in actives with short functioning duration; - they can lead to repeated buy-sell of actives between companies to repeatedly benefit from the fiscal deduction; - they don't advantage the investments that produce incomes with

<i>The fiscal stimulus</i>	<i>Advantages</i>	<i>Disadvantages</i>
		delay, if the reporting system of the future losses is inappropriate; - high administrative costs;
Investment tax credit	- generally the same as in the previous case, with the determination that they directly reduce the payment profit tax and not the taxable profit;	- the same as in the previous case, still with lower administrative costs;
The accelerated depreciation	-it stimulates the investments in real estate actives with a big functioning duration, compared to the deduction and the fiscal credit - it doesn't encourage the company for a wrong fiscal behaviour that would bring it fiscal advantages;	- it doesn't always take the economic life duration of the active and the real incidence of the physical and moral depreciation into account; - it doesn't advantage the investments that produce incomes with delay, if the reporting system of the future losses is inappropriate;

These types of fiscal stimulations are directly correlated with the profit tax paid by the company, because they either influence directly its measure, or they have indirect effects by means of the cost accounting basis or the rate of the excise tax applied to it.

A special attention has to be given to the fiscal stimulations which link the measure of the advantages for the company to the measure of the invested gross profit, because in this case the incidence is also transmitted on the finance decision of the investments project. Their maximization is conditioned upon the allotment of a great part as possible from the profit as finance source of the

investments because the fiscal advantages directly depend on the size of the reinvested profits.

These types of fiscal stimulations are directly correlated with the profit tax paid by the company, because they either influence directly its measure, or they have indirect effects by means of the cost accounting basis or the rate of the excise tax applied to it. No matter of the applied fiscal stimulations, the authorities' option has to be underlined on reasons that are linked to the assurance of the absolute functionality of the national economy. At the same time, the fiscal stimulations have to be oriented to those investments that mostly generate positive externalities that as many contributors as possible may benefit from, so that the total benefits induced in the economy and in the society surpass the associated costs.

#### 4. Conclusions

The fiscal competition is good both for the contributors and the state. The first activate in a fiscal environment that allows them to obtain bigger profits and a more reduced fiscal pressure, and the state gets bigger budget revenues in the conditions in which the taxation basis increases.

The fiscal competition obliges the authorities to work in conditions of budget restraints (diminished tax quotations) and, in this way, to promote an efficient administration of the excise taxes. Moreover, the business environment also takes into account the quality of the fiscal administration that can be perceived as open or opaque for the investors, requiring more and more predictability, transparency, accordance with the economic legislation and the development stage, apart from the fiscal elements

Most of the countries adopted a philosophy to impose profits meant to sustain the growth and the structural changes in the imposition systems contribute to the reduction of progress, but not necessarily to the reduction of fiscal equity. This could lift the problem of the redistribution of excise taxes at the governments' level, these being amongst the few instruments that the governments have at their disposal in the sharing of the costs and the benefits of globalization.

The competition will accentuate taking into account the new models of business that appear, despite the efforts to adjust the fiscal systems.

Comparing the evolution of the taxation quotation of the incomes of the companies and the level of the taxation system with the influxes of direct foreign investments, it can be appreciated that there is a direct connection between the fiscal competitiveness and the attraction of direct foreign investments.

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## The Systemic Risks – A Main Cause of the Financial Crisis

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### Abstract:

*In this article we attempt to set a starting point for a more comprehensive analysis of systemic risk as the primary ingredient to understand financial crises and as the main rationale for financial regulation, prudential supervision and crisis management.*

*The author try to explain why the failures of financial firms are more likely to pose systemic risks than the failures of nonfinancial firms and discuss possible remedies for such risks.*

*An economic recession on the scale predicted should lead to radical and comprehensive reform of the financial industry. Certain regulations, structures and procedures need to be put in place to ensure that a crisis of this kind never happens again.*

**Keywords:** systemic risk, banks, financial crisis, financial system

**JEL classification:** E44, G01, G21

### Introduction

Systemic risk is a relatively new term that has its origin in policy discussions, not the professional economics and finance literature. The first appearance of the term systemic risk in the title of a paper in professional economics and finance literature was in 1994. That appearance was in a review of a book written by a World Bank economist.

Given its origin in policy discussions, perhaps it is not so surprising that the term "systemic risk" often is used with no apparent precise definition in mind. If it arose from a theoretical analysis as did a term it sometimes is confused with—systematic risk— there would be a very precise definition.

Regular financial stability assessment and the identification of macroprudential leading indicators signaling coming risks to the banking system are of major importance for central banks and supervisory authorities. A safe and sound banking system ensures the optimal allocation of capital resources, and regulators therefore aim to prevent costly banking system crises and their associated adverse feedback effects on the real economy.

In the recent financial crisis, the most important type of risk to the financial system has been “counterparty risk,” which is also known as “default risk.” Counterparty risk is the danger that a party to a financial contract will fail to live up to its obligations.

Counterparty risk exists in large part because of asymmetric information. Individuals and firms typically know more about their own financial condition and prospects than do other individuals and firms. Much of the recent concern about systemic risk has focused on investment banks that deal in complex financial contracts.

Of course, financial firms can protect themselves to some degree in such simple situations. The logic of self-interested behavior combined with market clearing would lead to an appropriate pricing of risk; but in actual financial markets, arrangements are so complex that the nature of risk that firms face might not be obvious. In addition, the value of collateral fluctuates and thus even carefully collateralized deals are subject to some risk.

At the base of systemic risk are contagion effects, various forms of external effects. The concept also includes financial instabilities in response to aggregate shocks. The quantitative literature studying systemic risk is surveyed in the viewpoint of this concept.

In this study we attempt to set a starting point for a more comprehensive analysis of systemic risk as the primary ingredient to understand financial crises and as the main rationale for financial regulation, prudential supervision and crisis management. In the first stage we bring together the most important elements of systemic risk and integrate them into a coherent working notion, which could be used as a base line for monetary and prudential policy decisions to preserve the stability of financial systems. While the “different” character of banks plays a major role, we stress that systemic risk goes beyond the traditional view of single banks vulnerability to depositor runs. At the base of the concept is the notion of “contagion,” a particularly strong propagation of failures from one institution, market or system to another. Especially nowadays the

way in which large-value payment and securities settlement systems are set up as well as the behaviour of asset prices in increasingly larger financial markets can play an important role in the way shocks may propagate through the financial system. While in the presence of rapidly evolving financial institutions and markets and the particular characteristics of each financial crisis it might be futile to look for a single, ultimate definition of systemic risk, it may still be useful to give some general structure to our thinking in this area in order to help avoiding the base of policy making.

### 1. Systemic risk – the key of the problems

*Systemic risk* can then be defined as the risk of experiencing systemic events in the strong sense. In principle, the spectrum of systemic risk ranges from the second-round effect on a single institution or market (column “single systemic event” in Table 1) to the risk of having a systemic crisis affecting most of the (or even the whole) financial system at the upper extreme (column “wide systemic event” in Table 1). The geographical reach of systemic risk can be regional, national or international.

Table 1. Systemic events in the financial system

Type of initial shock	Single systemic events (affect only one institution or one market in the second round effect)		Wide systemic events (affect many institutions or markets in the second round effect)	
	Weak (no failure or crash)	Strong (failure of one institution or crash of one market)	Weak (no failure or crash)	Strong (failures of many institutions or crashes of many markets)
Narrow shock that propagates				
- idiosyncratic shock	-	contagion	-	- contagion leading to a systemic crisis
- limited systematic shock	-	contagion	-	- contagion leading to a systemic crisis
Wide systematic shock			-	- systemic crisis

Source: Oliver De Bandt, Philipp Hartmann, European Central Bank, What Is Systemic Risk Today

The key element in this definition of systemic risk, the systemic event, is

composed of two important elements itself, shocks and propagation mechanisms.

Following the terminology of financial theory, shocks can be idiosyncratic or systematic. In an extreme sense idiosyncratic shocks are those which, initially, affect only the health of a single financial institution or only the price of a single asset, while systematic (or widespread) shocks—in the extreme—affect the whole economy, e.g. all financial institutions together at the same time. An example of an idiosyncratic shock to a national financial system is the failure of a single regional bank due to internal fraud. The sudden devaluation of a noninternationalised currency due to an unsustainable domestic budget deficit can be regarded as an idiosyncratic shock to the world financial system. Examples of systematic shocks to national financial systems are general business cycle fluctuations or a sudden increase in the inflation rate. A stock market crash in itself acts as a systematic shock on most financial institutions. The same applies to a liquidity shortage in an important financial market, which can be related to a crash or to some other event throwing doubt on the financial health of counterparties usually trading in this market.

There is a continuum of intermediate types of shocks (e.g. sectorwide or regional) between the theoretical extremes of idiosyncratic and wide systematic shocks. It is important to note that idiosyncratic shocks that do not propagate widely are “insurable,” in the sense that an investor can protect herself against them via diversification, whereas wide systematic shocks are “uninsurable” or non-diversifiable. Negative systematic shocks, such as a severe recession, will—when they reach a certain strength—always adversely affect a wide range of financial institutions and markets, so that they have been included in the broad concept of systemic risk.

The second key element in systemic events in the narrow sense is the mechanism through which shocks propagate from one financial institution or market to the other. In our view, this is the very core of the systemic risk concept. Systematic shocks are equally important for the non-financial sectors in the economy.

The propagation of shocks within the financial system, which work through physical exposures or information effects (including potential losses of confidence), must be “special.” In what follows we shall look at the various propagation chains in banking and

financial markets in much detail. However, from a conceptual point of view it is important that the *transmission* of shocks is a natural part of the self-stabilising adjustments of the market system to a new equilibrium.

What one has in mind with the concept of systemic risk (in the narrow sense) are propagations that are not incorporated in market prices *ex ante* or can lead to general destabilisation. Such propagations, including those taking the form of externalities, may show particularly “violent” features, such as cumulative reinforcement (“non-linearities”), for example through abrupt changes in expectations.

Obviously, both the occurrences of shocks as well as subsequent propagations are uncertain. So the importance of systemic risk has two dimensions, the severity of systemic events as well as the likelihood of their occurrence. Strong systemic events, in particular systemic crises, are low probability events, which might lead some to consider them as less of a concern. However, once a crisis strikes the consequences could be very severe.

This leads to another dimension of the concept of systemic risk, namely the impact of systemic events occurring in the financial sector on the real sector, more precisely on output and general welfare. One may distinguish horizontal systemic risk, i.e. the concept which is limited to the financial sector alone (through the bankruptcy of financial intermediaries or the crash of financial markets), from vertical systemic risk, where the impact of a systemic event on output is taken to gauge the severity of such an event. In order to keep the scope of the paper manageable we have to concentrate on horizontal systemic risk in the first place.

Banks and other financial institutions are important sources of capital. Therefore, their failure, especially in large numbers, can deprive society of capital and increase its cost. Increases in the cost of capital, or decreases in its availability, are the most serious direct consequences of a systemic failure.

The classic example of systemic risk in this context is a “bank run,” in which the inability of a bank to satisfy withdrawal-demands causes its failure, in turn causing other banks or their creditors to fail. The original failure can occur when depositors panic, converging on the bank to quickly withdraw their monies. Because banks keep only a small fraction of their deposits on hand as cash reserves, a bank may have

insufficient cash to pay all withdrawal-demands, causing it to default and ultimately fail. The chain of subsequent failures can occur because banks are closely intertwined financially. They lend to and borrow from each other, hold deposit balances with each other, and make payments through the interbank clearing system (whereby banks with equity and deposit accounts exceeding their liabilities can offer these excess funds to other banks who wish to increase loans to their customers). Because of this interconnectedness, one bank’s default on an obligation to another may adversely affect that other bank’s ability to meet its obligations to yet other banks, and so on down the chain of banks and beyond.

Sometimes all firms in an industry are “affected by the same cause” and one firm’s failure leads investors to shun an entire industry. Why should the failure of a single firm cause the public to suspect an entire industry? The answer is related to the fact that people have imperfect information. Because depositors lack complete information about the condition of their bank, the failure of one bank can trigger mass withdrawals by depositors of other banks to avoid losses in the event their own bank fails. Indeed, even if a particular depositor believed that his bank was fundamentally sound, it would still make sense for him to withdraw his money if he thought that withdrawals by other depositors might cause the bank to fail. Banking panics are especially dangerous because large-scale deposit withdrawals can make bank failures more likely, as well as cause banks to reduce their lending in an effort to boost liquidity.

The dramatic declines in trading volume and liquidity in the markets for mortgage-related securities during the recent financial crisis also reflected investor panic.

Heavy reliance by investors on the evaluation of mortgage instruments by the rating agencies may have exacerbated swings in market liquidity. For example, a ratings downgrade, specially of a previously highly rated security, could induce panic selling by signaling possible downgrades or losses on similar securities. Ratings downgrades and declining asset values can also force borrowers to post additional collateral to maintain a given level of borrowing.

In general, deterioration in the collateral value of borrower assets was an important amplification mechanism during the recent financial crisis. Falling asset prices caused lenders to demand more collateral, which caused borrowers to dump risky assets, thereby exacerbating declines in their market values and leading to further demands for more collateral.

## **2. Aspects of systemic risk – a short description**

Many aspects of systemic risk are not unique to financial institutions or markets. The failure of a nonfinancial firm, such as a phone manufacturer, will affect the firm’s suppliers and dealerships, as well as the local economies where manufacturing plants and other operations are located.

The failure of a nonfinancial firm would rarely threaten the solvency of a competitor, let alone significantly affect the economy more broadly. Instead, the failure of a large firm could increase the market shares and profitability of the remaining firms in an industry, as well as provide opportunities for smaller firms to enter previously inaccessible markets.

Why do we think the failure of a large financial firm presents systemic risks that the failure of a nonfinancial firm does not? There are at least three reasons.

The first is interconnectedness. In the normal course of business, large commercial and investment banks lend and trade with each other through interbank lending and deposit markets, transactions in over-the-counter (OTC) derivatives, and wholesale payment and settlement systems.

Settlement risk—the risk that one party to a financial transaction will default after the other party has delivered—is a major concern for large financial institutions whose daily exposures routinely run into many billions. The high speed of financial transactions and the complex structures of many banks and securities firms make it especially difficult for a firm to fully monitor the counterparties with which it deals, let alone the counterparties of counterparties. The rapid failure of a seemingly strong bank could potentially expose other firms to large losses. Even firms that do not transact directly with the affected bank can be exposed through their dealings with affected third parties.

A second reason why the financial sector is especially vulnerable to systemic risk is leverage.

Compared with most nonfinancial firms, banks and other financial institutions are highly leveraged that is, they fund a substantial portion of their assets by issuing debt rather than selling equity. During the housing boom, many banks, hedge funds, and other firms that invested heavily in mortgage-related securities financed their holdings by borrowing heavily in debt markets.

Investment banks were especially highly leveraged before the crisis, with debt-to-equity ratios of approximately 25 to 1. By comparison, commercial banks, which are subject to minimum capital requirements, had leverage ratios of approximately 12 to 1.

High leverage meant that financial firms enjoyed high rates of return on equity when times were good but also a high risk of failing when markets turned against them.

A third reason why the financial sector is especially vulnerable to systemic risk is the tendency of financial firms to finance their holdings of relatively illiquid long-term assets with short-term debt. Not only are financial institutions typically highly leveraged, but the nature of their business entails an inherent mismatch in the maturities of their assets and liabilities that can make them vulnerable to interest rate or liquidity shocks. Most financial intermediaries borrow short and lend long—that is, they fund long-term, relatively illiquid investments with short-term debt.

Many investment banks and securities firms rely heavily on commercial paper, repurchase agreements (repos), and other short-term funding sources to finance long-term investments. If depositors suddenly pull their funds from a commercial bank or lenders refuse to purchase a securities firm’s commercial paper or repos, the bank or securities firm could be forced into bankruptcy.

Recognizing the problem of systemic risk, financial firms have long cooperated to limit risks associated with the failures of other financial firms. Cooperative arrangements, such as clearing houses and exchanges, are one way of reducing systemic risks. However, in many circumstances private measures might be insufficient to ameliorate systemic risk.

## **3. Regulation and supervision – causes and effects**

The recent financial crisis has prompted numerous proposals for enhanced government regulation and supervision of large financial firms and markets to address systemic risks. Many proposals call for increased supervision of systemically important financial institutions, as well as new rules for resolving insolvent firms.

On 20 July 2011, the European Commission (the “EC”) published its much-anticipated proposals to implement in Europe the international standards on bank capital recommended by the Basel Committee on Banking Supervision (the “**Basel Committee**”), commonly known as Basel III. The EC’s proposals comprise a draft regulation (in three parts: regulation I, regulation II and regulation III) and a draft directive (together, “**CRD IV**”). In putting forward these CRD IV proposals, the EC observed that “banks have been at the centre of the financial crisis” and that “lessons have been drawn from this and mistakes of the past should not repeat themselves”.

This paper analyses some of the CRD IV proposals relating to the nature of bank capital instruments and in particular focuses on:

- certain notable differences between the prudential capital requirements in Basel III and those in the CRD IV proposals; and
- the potential impact of the CRD IV proposals on tier 1 and tier 2 issuance structures and the emergence of a new breed of subordinated principal loss absorption instruments (including “contingent capital” or “CoCos”) which will become eligible for inclusion in a bank’s “additional tier 1” (“**AT1**”) capital resources (which can comprise up to 25% of a bank’s overall minimum tier 1 capital requirement), tier 2 capital resources (which can comprise up to 25% of a bank’s overall minimum total capital requirement) and, for some banks, national “finishes” imposed on them by national regulators (the scope for which is discussed further below). According to the EC, CRD IV will apply to more than 8000 banks, amounting to 53% of global bank assets, and is estimated to lead to an extra €460 billion of new capital having to be raised by 2019. Other proposals recommend regulation to limit risk-taking and to ensure ample liquidity in financial markets.

Many reform proposals call for the creation of a systemic financial regulator with responsibilities for “macroprudential” oversight

of the financial system. A macroprudential regulator would consider broad economic trends and the impact of a firm’s actions on the entire financial system, not just the firm’s own risk of default. To some extent, regulators already consider broad economic trends and effects, but several proposals argue for bringing all large or systemically important financial institutions under the umbrella of a systemic regulator.

One justification for the regulation and supervision of systemically important firms is that governments are unlikely to permit such firms to fail, or if they do fail, the government will substantially protect many, if not all, of the firm’s creditors from loss. Such a government guarantee - either explicit or implicit - can encourage firms to take greater risks than they otherwise would, which increases the likelihood of their failure. Consequently, regulation and supervision is required to offset the incentive to take excessive risk.

One of the more hotly debated issues surrounding the recent financial crisis is the extent to which fair value accounting rules contributed to the crisis. In textbook financial markets, valuations are the considered outcomes of the views of rational, relatively risk-tolerant speculators with deep pockets. In the real world, however, imperfect information and limited risk tolerance are facts of life that can inhibit the rational speculation necessary to drive prices back to long-term fundamental values. Trading in certain assets might cease during a crisis or trades might occur at widely disparate prices, making the determination of their market value problematic just when the value of transparency is greatest. In addition, by forcing financial firms to realize declines in asset prices immediately, mark-to-market rules might exacerbate a crisis by encouraging asset sales when prices are already falling, leading to further write-downs and financial losses.

## Conclusion

In this study we discussed the various elements of systemic risk with a view to, first, developing a broad concept of this risk, which underlies the understanding of financial crises and which can be used as a baseline for financial and monetary policies to maintain stable financial systems.

The financial system is composed of intermediaries, markets and the infrastructure of payment, settlement and trading mechanisms that support them.

Intermediaries are connected with each other through direct transactions, as in interbank markets, and through similar investment and financing decisions with third parties such as other intermediaries or end investors.

Financial markets, in turn, are connected with each other through the trading activities of financial intermediaries and through end investors active in more than one market. Systemic risk within the financial system relates to the risk that these inter-connections and similarities render emerging financial instability widespread in the system. Even if the original problem seems more contained, important amplification mechanisms can be at work.

This complex network of financial connections is extended through the savings and financing needs of all economic sectors, notably non-financial firms, households and the government. By reallocating savings from individuals and sectors with a surplus of funds to individuals and sectors in need of funds, the financial system plays a central role in the economy. So, systemic risk, in a broader sense, relates to the risk that widespread instabilities in the financial system translate into adverse effects on growth and welfare in the economy at large.

Analysts have proposed regulatory reforms to reduce the danger from systemic risk in the future. In particular, some advocate the creation of a powerful macroprudential regulator that considers a firm's impact on the stability of the entire financial system.

Other ideas for reducing systemic risk include limiting the use of leverage and short-term debt and revising market value accounting rules.

It is too soon to fully determine the causes of the recent financial crisis. Asset price booms and busts that impair the financial system and the entire economy have occurred before. However, the complex nature of recently developed financial instruments has transmitted the consequences of the housing bust to the entire financial system and, ultimately, to the overall economy.

Accordingly, many analysts favor measures to increase the use of organized exchanges for trading derivatives. An improved regime for resolving large insolvent financial firms would limit systemic risk and excessive risk-taking. When the government has intervened to protect

the economy from the failure of a large systemically important financial firm, the shareholders of these firms usually received little or no value for their equity and their senior managers were dismissed or subject to compensation limits.

In conclusion, systemic risks drive most crises, and pose a challenge for several reasons. First, they are not easy to detect with confidence, and are even more difficult to prove.

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# Mergers, Acquisitions and Taking-Over in the Banking System from CEE Countries

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## Abstract

*The present article tackles with the mergers and acquisitions in the Central Eastern Europe countries. The financial domain is dominated by the banking sector and this involves very much the legal aspects to be followed and respected in these kinds of transactions. The mergers and acquisitions have had an upward direction in the context of the economic crisis. Many banking entities are struggling to consolidate their position on the market, and this leads to more and more mergers and acquisitions.*

**Key words:** squeeze-out procedure, pure asset, merger by acquisition, merger by formation, sell-out, cross-border merger

**J.E.L. Classification:** G34

## 1. Introduction

The financial sector in Central Eastern European countries is, in its majority, composed by banking, insurance and consumer finance; while other financial segments (such as asset management funds) are still in development.

The financial sector M&A transactions in CEE currently involve banks or insurance companies. Privatizations of state-owned banks and insurance companies are coming to an end in most CEE countries.

There are considerable differences in the regulatory frameworks in CEE countries which are members of the EU and those applicable in Russia for example.

## 2. Regulatory requirements

Financial institutions M&A transactions will require approval of, or at least consultation with, the regulators (competition and financial regulator/National Bank). The financial sector is often considered a strategic sector, meaning political interference is more likely than in other sectors; even, as recent practices have shown, in “old” EU member states.

In a share purchase <sup>[1]</sup>, the acquisition of substantial shareholdings in banks and insurance companies’ institutions will, in most CEE countries, require a notification to, or consent of, the relevant regulatory authority. This is in addition to general disclosure requirements of significant shareholdings in public listed companies. Based on the EU Banking Directive and Insurance Directive adopted by EU member states, a home state regulator must be notified of the direct or indirect acquisition or disposal of a “qualifying holding” (i.e. a holding which represents 10% or more of the capital or voting rights or which enables the acquirer to exercise a significant influence) in a bank or insurance company. Notification is also required if a qualifying holding changes through thresholds of 20%, 33% and 50% or when the target becomes a subsidiary. The regulator, generally, has three months to oppose the intended transaction if, in view of the need to ensure sound and prudent management of the target, it is not satisfied as to the suitability of the purchaser.

Companies participating in a merger will also normally require the prior permission of the regulator and any new entity will require a new authorization (licence). Where the transaction involves companies from EU member states, passport rights may eliminate the need for a local licence, but the consent of regulators in jurisdictions where the target has its branches may also be needed.

For example, in Russia the total foreign participation is limited by law to 25% of the combined share capital of all Russian insurance companies and, once this threshold is reached, it will only be possible for a foreign purchaser to buy a minority stake in an insurance company, but not a majority stake. The prior consent of the Ministry of Finance is required for any acquisition of shares in an insurance company by a foreign purchaser. The prior approval of the Central Bank of Russia is required for any foreign investment in a Russian bank; and the acquisition of over 20% of the shares in a Russian bank will require a further approval from the Central Bank as well as the Competition Authority.

Under EU legislation, acquisitions may also have implications for consolidated supervision of banking or insurance groups under the Banking Directive and the Financial Conglomerates Directive.

### 3. Share acquisition

Acquisition of a controlling shareholding in the target has, to date, been the prevailing acquisition structure in CEE transactions. The effect of a share acquisition is that the target becomes a subsidiary of the purchaser. It can then depend on the commercial and operational policy of the purchaser whether the two entities will remain formally separate or will be merged e.g. through a subsequent merger procedure<sup>[2]</sup>.

There is a difference between acquiring shares in a listed bank or insurance company (by way of a public takeover bid) and acquiring shares of a privately owned entity, which takes the form of a private transaction (the latter remains the most popular in the region, except for

Poland where all the major banks are listed on the Warsaw Stock Exchange).

In the case of listed banks and insurance companies, the acquisition of a shareholding above certain thresholds will trigger a requirement for a public offer for the balance.

Further, based on the EU Takeover Directive (which has yet to be consistently adopted in all EU member states), where the target is a listed company in an EU member state, a mandatory bid will always be required after the purchaser has acquired control of the target. The percentage of votes deemed to constitute control varies among the EU members (for example 40% in Lithuania, 66% in Poland, with no exact threshold in Czech Republic, where a mandatory tender offer is triggered when actual control is acquired and also each time 2/3 or 3/4 of all votes are exceeded). Minority squeeze-out procedures may also be available to help to acquire all the shares of the target, particularly where there are hundreds or thousands of small shareholders (common to many CEE banks and insurance companies as a result of initial mass privatizations). Based on the EU Takeover Directive, a minority squeeze-out (as well as sell-out) should be available in all EU member states at shareholding thresholds ranging from 90% to 95%.

### 4. Business/Asset acquisition

The business of the target may also be acquired through the purchase of its assets and the assumption of certain liabilities (including deposits for example<sup>[3]</sup>). Although a purchaser may wish to structure the deal as a pure asset sale (which leaves behind any corresponding liabilities), this is not likely to succeed where it is clear that what is being purchased is not only assets, but the entire business, or a stand-alone part of the business. When a business is acquired, it is usually the case that the relevant CEE law will deem that all related liabilities are transferred with the business. This may include liabilities which are not specified in the transfer agreement, or not identified at all. Disadvantages of asset acquisitions include the need for third party consents,

the limited transferability of licences and the permits and the application of transfer taxes.

## 5. Mergers

Local CEE laws may permit statutory mergers between financial institutions but such procedures have not been common to date. Due to existing limitations there is very little scope for cross-border mergers and mergers are predominantly used in transactions between entities in the same jurisdiction.

As a general rule, the effect of a merger will be that all the assets and liabilities of the vesting entities are deemed transferred to the successor entity and vesting entities are dissolved without going into liquidation. This operation may take the form of a merger by acquisition (one or more entities are absorbed by another existing entity); or a merger by the formation of a new entity (two or more entities are consolidated into one new entity).

However, both methods are not always available – for example, in Poland banks may only be merged by acquisition<sup>[4]</sup>.

A merger has the advantage of relative ease with which the contracts, assets and liabilities of the vesting entities may be transferred to the succeeding entity. This is particularly relevant for retail banking – no consents of individual customers (holders of deposits, bank accounts etc.) are required in case of a merger. Merger documentation typically involves a merger plan or agreement between companies participating in the merger, normally requiring the approval by a qualified majority of shareholders of the merging companies, a report by the board or management body and an expert evaluation.

The purchaser will normally have to be authorised to carry on the relevant financial sector business in the target’s jurisdiction (though, in EU member states, passport rights may be available). In addition, the delays and complications associated with the numerous registration requirements for the transfer of some assets (such as real estate) significantly

outweigh the relatively simple transfer requirements for shares.

Despite its disadvantages, an asset acquisition may sometimes be the only suitable acquisition method, for example where only one or more branches or a distinct and discrete part of the business is to be acquired.

Simplified rules apply in EU member states to transfers of insurance portfolios under the EU Insurance Directives. Insurance companies with head offices in an EU member state are able to transfer portfolios of insurance contracts under the single passport regime to another insurer established within the East European Areas. Similar provisions apply to transfers between EU branches of insurers established outside the EEA.

Issues which commonly arise in CEE transactions include the troublesome minority shareholders (including shareholder litigation); in smaller companies, a lack of proper record/minute taking (making it very difficult to determine whether mandatory procedures have been followed in some general meetings or board meetings); the structural errors embedded in standard form documentation (for example standard loan agreements, standard security documents, standard policies, local derivatives contracts, or other standard contracts not having been drawn up in accordance with international market standards); the incorrect contractual arrangements with directors or other key employees of the target; and the uncertain provenance of title to real estate assets.

## 6. Due diligence and commercial issues

As in any M&A transaction, it is essential at the outset of any acquisition of a financial institution in CEE to conduct a thorough due diligence exercise. In CEE, financial institutions have strict rules concerning banking secrecy (or data protection in general<sup>[5]</sup>), which may present certain obstacles to the amount and quality of information available during the due diligence, making it difficult to establish the quality of the credit portfolio of the target.

## 7. Conclusions

Other significant issues to be considered in financial institution M&A transactions in CEE countries often include the merger control. This should be examined under the EC Merger Regulation (where there is a Community dimension) and/or under applicable local regimes.

Notably, Russia applies a separate control regime to mergers of financial institutions (including branches) on the basis of the Law on Protection of Competition in the Financial Services Market.

Tax implications refers, in particular, to the availability of tax relief for cross-border restructuring following a merger (for example on the basis of EU Mergers Taxation Directive), taxation of income flows between associated companies following the transaction, treatment of accumulated losses, implications of double taxation treaties, etc. The post-transactional integration and management of the target is also an important issue to be considered. This will become the responsibility of the new management who will takeover, but this aspect of the merger is often underestimated objectively. This aspect of the problem can be controlled by a fair and honest study upon the employees and employment conditions.

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# Measuring Enterprise Performance: Financial and Non-Financial Indicators

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## Abstract

*The economic environment and businesses, in particular, have evolved significantly over the past decade, becoming increasingly competitive and complex. Under these circumstances, companies have to meet a heavy burden: they need to continuously adapt their activity to dynamic market developments and develop sophisticated performance measurement instruments. Traditional methods used over time have proved to be inadequate to assess the complex activity of enterprises in these dynamic environments.*

*In this context, by reviewing the literature in the field, I intend to analyze the present perspective on enterprise performance measurement. This paper aims to highlight the importance of a multidimensional view on enterprise performance, by showing that performance can be measured using both financial and non-financial indicators, in order to obtain a clear view on overall enterprise performance.*

**Key words:** enterprise performance, financial indicators, non-financial indicators.

**J.E.L. Classification:** M21.

## 1. Introduction

There are many ways of measuring business performance. Conventional approaches use financial ratios to assess the performance of an enterprise, while modern approaches bring the issue of calculating the non-financial indicators, in addition to the financial ones. The need for the latter approach is determined by the fact that non-financial indicators „better characterize business performance, as they identify sensitive points of the organization”. Thus,

the literature shows that non-financial indicators are important for a correct assessment of performance, whereas the use of financial data imposes certain limitations in assessing the total value of the company.

Addressing the different dimensions of performance were, and still are, major concerns of researchers, managers and stakeholders. This concern is motivated by the fact that, naturally, many companies want to improve their performance evaluation systems, aiming to capture the multitude of factors determining their performance. Secondly, multidisciplinary perspectives of performance measurement, such as the balanced scorecard, point out the importance of non-financial measurements of performance, where relevant non-financial indicators should be included.

I will further detail the significance of both types of indicators – financial and non-financial ones, and rationale for their use in evaluating business performance. I will start by addressing the financial dimension of enterprise performance, and continue with the new approaches in the field, respectively , the non-financial view on business performance, pointing out their strengths and limits.

## 2. Financial dimensions of enterprise performance

Enterprise financial performance is measured using financial indicators. Still, there is no specified set of indicators to assess performance in financial terms. Thus, by reviewing literature, it can be noticed that there are many and various ways of measuring the financial performance of the company. (Kedia and Kuntz, 1981, Kohls, 1985; Newgreen et al., 1985, Davidson and Worell, 1990).

Previous literature addressed the financial

performance of a company by measuring its profitability through several financial indicators, such as the percentage of sales resulting from new product sales, the earnings per share (EPS), the profit margin, the return on assets (ROA), return on equity (ROE), or return on capital invested (ROCE) (Salawu and Akinlo, 2005; Selvarajan et al, 2007, Hsu et al, 2007 ; Yang et al, 2010). In addition, return on investment (ROI) and the net income after taxes (NIAT) were also used as indicators to measure financial performance (Grossman, 2000). Interestingly, researchers have developed over time a series of benchmarks for managerial accounting, showing the six dimensions of a business activity, respectively the “individuals’ reward” (salary expenses related to total sales), , “quality” (the number of production errors), “contraction” (for example, the loss of inventory, product defects, sales’ return), “productivity” (payroll expenses reported to outputs), “operating expenses” (total operating expenses related to sales) (Wright et al, 2005).

Financial indicators are often the only instrument used in performance valuation as they translate the whole activity of a company in terms of profitability. The capital market perspective on enterprise performance considers profitability as the only relevant financial indicator reflecting the business performance. Commonly, financial ratios are used as financial indicators of performance. Anghel (2002) shows that the most representative financial ratios of a company are return on investment, indebtedness, capital efficiency, liquidity, cash-flows, inventory turnover, receivables turnover. [2]

Critics of the financial approach to performance show that not all aspects of business activity may be expressed in monetary terms, arguing that information from earlier stages of preparing the annual accounts are in fact only one dimension of the business. In other words, to measure the performance of an enterprise, not only the financial results count, because “it’s like you bring a team to a championship by its past results”, not the present ones; therefore, “a global vision on the interdependence of internal and external, quantitative and qualitative, technical, human, physical and financial parameters”[2] is needed.

Recent approaches to enterprise

performance in terms of value creation have led to the construction of new indicators, such as Economic Value Added (EVA, property of the consulting firm Stern Stewart), Market Value Added (MVA), Liquid value Added and Total Return to Shareholders. These new indicators imposed an active implication of both managers and accountants in the planning, decision making and performance assessments. Therefore, solutions are sought to link earnings and investments, not only across firms, but also at all enterprise units. Moreover, the implementation of new methods of performance measurement intends to resolve the eternal conflict between managers and owners – the agency theory.

### **3. Business performance – the non-financial view**

Unlike traditional approaches to enterprise performance, which evaluate performance only through financial calculus, the modern approaches highlight the importance of estimating several non-financial indicators. In this perspective, non-financial indicators are often used in performance evaluation; they are a central element of the Kaplan and Norton's balanced scorecard. Non-financial indicators such as customer satisfaction, product quality and employee turnover are particularly relevant if the total value of a company cannot be determined through capital market performance evaluation, namely, if a company is not listed.

In the ‘80s and early ‘90s various authors have suggested different systems to manage business performance, such as the performance measurement matrix (Keegan et al., 1989), the performance pyramid (Lynch & Cross, 1991), the results and determinants matrix (Fitzgerald et al., 1991), the above mentioned balanced scorecard (Kaplan and Norton, 1992), the performance measurement process developed at Cambridge University (Neely et al., 1995) and the recent performance prism (Neely et al., 2001, 2002).

Modern approaches to business performance no longer focus on accounting measures solely, but take into account other factors considered to be determinants of future economic performance. One of the best known such theory is the so-called “balanced scorecard”, developed in the ‘90s

at Harvard Business School. However, it should be noted here that there are other similar approaches, such as the European Institute for Quality Management scheme, which has many similarities to the model proposed by Kaplan and Norton. Moreover, this approach is very similar to the performance metrics system developed in the '50s by General Electric.

The latest theories regarding enterprise performance refer to the importance of human resources (Pfeffer, 2010). In this perspective, employees' satisfaction is crucial. The main idea of this theory is that performant businesses have an orientation towards people, and should place people on top of their activity. Indeed, employees' satisfaction leads to higher productivity and product quality, lower costs and reductions in product prices, therefore, higher customer satisfaction, resulting in higher profits and a better position of the enterprise on the market.

According to a new perspective on business performance, namely the one based on the customer satisfaction, organizations achieve their goals - perform, by satisfying their customers more efficiently and effectively than their competitors. Effectiveness refers to the extent that customer requirements are met, while efficiency is a measure of how a company's resources are used to provide a certain level of customer satisfaction. This view is important, not only by the fact that it identifies two fundamental dimensions of performance, but also emphasizes that there may be more than internal factors that influence a company's performance.

On the other hand, firm performance can also be measured by referring to the so-called “pursued performance” (known as a subjective method for measuring performance); from this point of view, enterprise performance can be measured in terms of top management by using a Likert scale (Selvarajan, 2007). Therefore, subjective assessments of management can also be considered in order to assess overall performance.

However, non-financial indicators are not a measurable intrinsic value, in absolute terms. They are rather basic indicators that provide information about future performance of the enterprise, information

that is not found in current accounts. Still, this orientation towards the future has great merit: the past can not be changed and is useful only to the extent that analysis can improve future performance.

Empirical studies in this direction conducted by Ittner et al. (1997), Ittner and Larker (1998b) and Banker et al. (2000) confirmed the role of non-financial indicators as key determinants of future financial results. This type of indicators “are especially needed to measure performance and reward management when current management actions affect the financial long term profitability of the company, but are not reflected in contemporary accounts”[4] (for example, delaying expensive maintenance activities at the cost of future availability of equipment, and therefore bearing the cost of a lower financial returns).

#### **4. A proper approach to enterprise performance**

Certainly, in order to reflect the overall activity of the company, as a sum of activities of all actors involved, performance should be addressed by its many facets, being influenced by internal factors, such as management, employees, product quality or production costs, but also by external factors, such as customers' preferences and expectations, competition, access to information.

Neely (1998) considers that an appropriate performance measurement system consists of three interconnected elements:

- individual indicators that measure efficiency and effectiveness of business activities;
- A set of indicators that are combined to measure overall performance of the enterprise;
- an infrastructure through which information is collated, sorted, analyzed, interpreted and disseminated.[5]

A study conducted in 2006 by Chow and Van der Stede [3] on a sample of 128 companies reveals the fact that they use both financial and non-financial indicators to assess overall enterprise performance, but also subjective assessments on performance. Thus, they show that, given their sample, the performance measurement system includes a

variety of indicators: indicators based on internal factors - 26%, financial indicators - 25%, subjective assessments of management - 19%, employee-oriented indicators - 15 %, and customer-oriented indicators - 15%. On average, the firms' investigated performance evaluation was determined by financial indicators - 49%, non-financial indicators of 30% and subjective management assessments on performance - 21%.

Thus, an accurate assessment of overall enterprise performance requires consideration of financial indicators, as well as non-financial ones. However, as we have discussed previously, enterprise performance is often measured using financial indicators; undoubtedly, financial indicators are necessary in business performance analysis. However, taking into account their reliance on past evolutions of the firm and the fact that they do not offer the possibility of predicting future performance, financial indicators are considered to be insufficient for a meaningful assessment of performance. Consequently, they neglect those aspects of the company that can not be quantified in monetary terms. Non-financial indicators, on the other hand, can provide useful information for future performance of the company (Anderson, Fornell, & Lehmann, 1994, Banker, Potter, & Srinivasan, 2000; Behn & Riley, 1999, Ittner & Larcker, 1998b), but they can never be used separately in assessing performance.

## 5. Conclusions

Financial indicators used in performance evaluation lack in predicting the future, offering only one view of a company's activity and focusing on the past. Non-financial indicators, on the other hand, are used to provide information about future performance of the enterprise, solving, to a certain extent, the limitations imposed by the financial indicators' calculus. Hence, it is obvious the need of combining the two types of indicators, resulting in a proper evaluation of the overall performance of a company.

Summarizing, in order to determine relevant business performance, a balanced multidimensional system is required, which must include both financial and non-financial dimensions of performance, which can reduce the limits of the two categories of

indicators.

The specifics of each activity, especially individual business objectives, require different proportions of indicators to be included in the performance evaluation system, and even different indicators from one company to another. Thus, in determining the overall performance of a company, the quality of the indicators chosen is very important. However, the number of indicators to be taken into consideration should be limited in order to ensure a clear, overall, past and future performance.

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## Theoretical Considerations On Local Budgets

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### Abstract:

*This paper provides an overview of local budgets, or otherwise highlights the importance of these tools - local budgets, in the financial autonomy mechanism. Local communities know better than central authorities, their possibilities of obtaining financial resources and needs on expenses for providing local partner services. All these resources and needs are identified in local budgets.*

**Keywords:** budget, local budget, financial decentralization

**J.E.L. Clasification:** H6,H61, H72

### 1 Local finances organisation

Public finances are rooted in the empowerment of local authorities in managing these communities.

Local communities are state separate human communities that have public authorities other than those of the state. This is an absolutely necessary condition of financial autonomy as administrative autonomy would not be possible without financial autonomy, which provides material support (funding) of operation.

There is a strong argument, namely that the local communities have the resources money to perform its origin and especially public expenditure needs to be covered for the production of local public services.[1]

Distinct organization of local finances, based on their financial autonomy allows relieving central finance a number of

expenses, reducing the number and magnitude of cash flows between the two structural levels of public finances and a clearer track how funds are used up. After all, the separation of local and central finance, as in other fields, is determined by economy reasons. Local finances better and more effectively meet the requirements of public utility land.

Degree of financial centralization varies depending on concentration of country administration, on whether the local authorities are subordinate to central government. However, major issues of national interest, strategic, those that affect all citizens, belonging to central funding, another method not possible (defence, public order state, state administration, external relations, environmental and citizen protection, art, health , education, science) and macro policies of reconciliation, stability and welfare are financed from central funds.

Financial decentralization begins to operate beyond the limits from which the use area of national interest public goods and services begins to shrink and the cost comparison of decision-making at central level is too high. These are some utilities such as roads construction, public lighting, municipal services, local transport, schools etc. There are also differences in the demand for public utilities and their possibilities of providing an administrative - territorial unit to another. In addition, local communities are open, have different relationships between them. All this implies local self-financing. [2].

Regardless the autonomy degree of local communities, it is considered that at the financial decentralization should be considered certain principles, as the stability requirements of country's public finances, as follows:

a. The principle of diversity, explained due to the forms variety and extent of requests for goods and services;

b. The principle of equivalence in public services financing, explained regard geographical benefits that they bring citizens;

c. The principle of accepting cost decentralization, determined by regional tax differences, which interferes with the spatial distribution of economic relativity;

d. The principle of centralized redistribution and stabilization imposed by the reality that local communities do not have the tools for achieving their macroeconomic or political perspectives;

e. The compensation principle of financial flows between communities caused by income involuntary transfers on behalf of economic differences and that are detrimental for the achievement of spending programs for some of these. For preventing such situations require government intervention with corrective measures;

f. The principle of insurance for vital social services, according to which this task is the responsibility of central authorities. Government should provide all citizens minimum essential public services (health, education, social security);

g. The principle of equitable access to public financial resources, determined by the situation of local communities whose balance between needs and fiscal capacity is defective, requiring resources minus compensation through government transfers on account of predetermined scheme;

h. The principle of financial balance, according to which the distribution between public authority's levels must ensure management performance within the limits duties and powers of each. This means that public financial resources to be redeployed for covering the costs with public sector operation in state administration and local communities alike.

Operation of local finances based on financial decentralization has common techniques of public finance.

Effects obtained in the operation of local finance refers first at the assumption of some state finances duties, and at local resources and expenditure increase, which recently led at the acquisition of the right to borrow debt capital market. Also, local finances have gained wide expertise in legal and budgetary control, local authorities having a proper accounting system.

## **2 The concept of local budget - an instrument of local financial autonomy**

Local public finance delimitation is the result of financial empowerment of local public authorities. Organic growth is related to their role within the budget decrease of public budgets.

Separation of local and central government finances are based on reasons of efficiency in using public funds. Local finances better and more effectively meet the requirements of public utility land. Thus, financial decentralization is warranted to operate beyond the limits of the area from which the use of public goods and services of national interest begins to shrink and the cost compared to central decision-making increases, becoming too high. Moreover, the demand and the possibilities of providing and adaptation public utilities are different from an administrative - territorial to another. These conditions require the use of local funding of local public goods. [3].

In Romania, local public finances are organized in close connection with the administrative - territorial. Hierarchical levels which institutionalize financial structure of the local public are: county, city, town, village.

In its simplest form, the budget concentrates an estimate of proposed expenditures and necessary revenue to finance them, being a powerful tool for allocating limited resources to needs that have the same importance in the community.

By local budget we understand that it is a document in which is enrolled income and

costs as part of local, over a period of one year. Local budgets are budgets of territorial - administrative that has legal personality. Each village, town, municipality, district of Bucharest, respectively Bucharest, prepare its own budget, under conditions of autonomy.

Local budgets are planning tools and financial management activities of the territorial -administrative. Its structure reflects the autonomy degree of local government to central and regional links between the various administrations. Also, local budgets reflect income flows and local government costs, how to finance the expenditures by purpose and coverage of deficits.[4].

Local budget is often called operational plan being used in planning and guiding the local community in the next fiscal year and serves as the basis for financial reporting by the City Council, Ministry of Finance and citizens.

The significance of the local budget has grown as local government is increasingly placed in a position to increase resources and improve productivity and managerial responsibility.

### **3 Legislative aspects on local budgets**

The general legal framework in the financial and budget in Romania is provided by the Constitution of 1991 revised following the 2003 referendum, public finance nr.500/2002 Law, Law no.273/2006 on local public finances, the State Budget Law and Law on state social insurance budget (annually adopted), special laws establishing special funds and other specific normative acts.

Concerning things from the perspective that Romania has joined the European Union, it took many negotiations in the pre-accession in terms of Chapter 29 (Financial and budgetary provisions) from the chapters list where the acquit is divided. Closing this chapter has been possible mainly due to developments related to other relevant chapters of the financial-budget and the

adoption by our country of harmonized legislative acts with European legislation.

Thus, the Law on public finances (500/2002) is aligned with the Council Regulation on the Financial Regulation nr.1605/2002 budget of the European Community and provides budget principles and construction rules, responsibilities of the institutions involved in the budget process, budget calendar, the budget process stages, rules according to which budget implementation takes place, the penalties applicable to infringements of the law.

Law no.273/2006 on local government finance establish the principles, framework and procedures for training, administration, employment and local public funds and responsibilities of local authorities and public institutions involved in local public finance.

The main institutions involved in the budget process in Romania are the Parliament, Government, Ministry of Finance, the principal loan. The principal officers of the local budgets are presidents of county councils, the mayor of Bucharest and the mayors of other administrative units. Those under the subordination of the main credit are called secondary and tertiary. The main responsibilities of authorizing officers in developing and implementing the local budget include:

- draft its own budget;
- budgetary credits distribution on lower hierarchical units;
- revenue collection following up;
- accounting organization and updating

### **4. The content and structure of local budgets .**

Local budgets consist of two main sections: localities income and expenses.

According to local public finance law, revenues and expenses are classified based on budget classification approved by the Ministry of Finance. The main types of income that are included and charged in local budgets are provided in the annex at the local public finance law but also in the annual state

budget law with any amendments thereto for the respective year.

In the main, local budgets income are structured as follows [5]:

Own revenues consist of:

- local taxes
- increment tax from the subordinate local companies
- taxes from the population (tax on land, buildings, tax on vehicles owned by individuals and others)
- buildings and land tax from legal persons
- other direct taxes (tax on vehicles owned by legal entities and others)
- tax on shows
- other indirect taxes (taxes and fees for licensing and operating permits, legal fees, stamp duty, stamp duty for notary activity and others)
- payments from public institutions (other income from circulation on public roads, the monthly contribution of parents or legal advocates for children in nursery maintenance, contributions payable by beneficiaries of social services canteens and others)
- miscellaneous income (income from recovery of costs, imputations, damages, fines, penalties, penalties under the law)
- capital income (income from the assets sale of public institutions, sale of state housing funds, income from sale of property belonging to private sector, privatization proceeds)

Deducted from the income tax rates:

- Amounts deducted from income tax to balance local budgets
- Amounts allocated by the County Council of the income tax to balance local budgets

Amounts deducted from value added tax (to fund decentralized spending and balance the budgets of local municipalities)

Grants:

- Subsidies from state budget, current and capital
- Subsidies from other governments

Classification of public expenditure by different criteria enables economy content knowledge and the role of various

expenditure categories and their structure within appropriate budget classification. The main general criteria for the public expenditure classification are of two types namely: administrative and economic.

Especially in the budget plan, states financial practice and international organizations held different types of classification, known as budget classification, namely: administrative, economic, operational, financial.

Administrative and departmental classification is based on institutions criterion where through public spending, ministries, public institutions autonomous administrative units, being useful because budgetary allocations are determined on these beneficiaries. It has however the disadvantage that a ministry, government department, agency, county, city, town, meet varied destinations expenses. In addition, the ministries structure (other central structures and departmental), respectively, public institutions subordination changes periodically, making the public expenditure grouping under this classification does not ensure over time comparability. Usually, this criterion is used to allocate public spending budget authorizing officers.

Economic classification is based on two criteria: the first considers the content consumption process expressed that the costs are divided into: current expenses (operating) and capital expenses (for investments), the second has in view the nature of actions financed and divide the expenditure in : public service expenditures and transfer expenditures (cash resources).

Current expenditures are those that ensure the proper operation and maintenance of public institutions. They represent a determinate consumption of financial resources and spending must be annually renewed, having the largest share of total public expenditure. [6]

Capital expenditure (investment) is reflected in the goods procurement for the material production sphere or the immaterial endowment sphere (public institutions) with fixed assets, leading to the development and modernization of public patrimony.

The expenses for public services, generally, includes, staff remuneration, other benefits cost items, including supplies for the public institutions proper functioning or furniture, appliances and equipment acquisition.

Transfer expenses objectifies into passing money operations from the budget to legal persons (institutions with self-financed activities, productive enterprises) or individuals (retirees, unemployed, students, pupils, etc.). From this point of view, they can have an economic character (subsidies, restructuring of some economic activities, etc.) or a social character (scholarships, pensions, other benefits).

Functional classification used as criteria (in expenditures grouping) areas of activity that are directed toward public financial resources or other destinations, related to the performance of transfers between different levels of public administration, interest payments on public debt and provisioning at the disposal of executive authorities.

Financial classification takes into account when payments are made, i.e. how to use public funds. According to this classification, expenditures are grouped into:

- a) permanent;
- b) temporary or treasury operations;
- c) virtual or pos.

Expenses are provided in local budgets according to budget classification and materialize the financing ways of specific operations carried out locally.

Because currently this structure of local budgets expenditure is aligned to the international, we can present the list of those expenses as given in Annex 2 of the local public finances law, placing them in specific categories of functional classification:

- Executive authorities (general public services);
- Defence and public order, education, health, culture and religion, social;
- Services, public and residential development;
- Transport, agriculture and other economic activities;
- Others actions;

- Transfers;
- Loans;
- Interest payments and other expenses related to public debt;
- Loans repayment;
- Reserve funds.

In the economic classification, local budgets expenditures are grouped as follows:

I. Current expenditure

- Staff costs;
- Expenditure on goods and services;
- Subsidies;
- Transfers;
- Interest on internal and external public debt;
- Reserves

II. Capital expenditure

III. Loans

IV. Credits refund and interest payments and loans fees

Economic classification shows the nature of financed expenses due to public funds and with it can determine which shares have different types of expenditure in total budgetary expenditure

## 5. Conclusions

Local public finance plays an essential role in the transformation process of modern societies, corresponding with the responsibilities appropriate increasingly larger local granted.

So if local budgets were allowed more time on a secondary place, they have become vital to the entire public sector. They are primarily for local collectivises, but also for the central authorities. A local budget that has sufficient resources does not need transfers from the central budget.

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# Professional Judgement and Risk Propensity in Financial Audit

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## Abstract

*During the course of an audit mission, the quality of the auditor's work is intrinsically linked to two main determining factors: the auditor's professional judgement and the auditor's risk propensity. This paper examines professional judgement and risk propensity from an audit perspective and from an academic perspective. The emphasis is on explaining the concept of professional judgement in audit and on the managerial risk behaviour in a decision making context. The research objective is to identify the extent to which theories on the determinants of risk behaviour address the critical importance of risk in business decision making and the link with the auditor's professional judgement. It is discovered that there are two main risk behaviour theories that explain the risk propensity of business decision makers and that risk propensity can influence professional judgement.*

**Key words:** audit, professional judgement, risk behaviour, decision making .

**J.E.L.:** M10, M41, M42.

## 1. Introduction.

We live in a world where risk is present in every decision that is made. The external financial auditing industry sector is no exception. Financial audits exist to add credibility to the implied assertion by an organization's management that its financial statements fairly represent the organization's position and performance to the firm's stakeholders and to consolidate trust in the business world. The financial statements must present information that are true and fair, that reflect the economic reality of the transactions, that are impartial, prudent, relevant and credible. As a professional and an expert in accounting, the financial auditor and his work, respecting laws and

International Standards on Auditing, adds credibility to the financial statements.

The financial auditor is required to make decisions that will imply a certain degree of risk that will impact on the firm's profitability and reputation. The concept of risk taking has played a central role in business research in the last few decades. Risk is a concept whose definition has not generated a consensus in the academic or business circles but is generally accepted that it relates to issues of unpredictability, decision making and potential loss. Risk is intrinsically linked with decision-making and every decision made in business implies a certain degree of risk. The importance of risk to decision making is attested by its position in decision theory, by its standing in managerial ideology and by the high level of interest in risk assessment in management. This paper will look into risk behaviour theories from a managerial perspective building on previous research done by many scholars.

All these facts prompt to a more considerate approach towards the use of professional judgement in every stage of an audit and to allocating a greater importance to the issue of risk propensity.

## 2. Professional judgement in audit.

Throughout his work, the financial auditor uses an important and central element: professional judgement. Professional judgement is the cornerstone for the audit profession and is applied in all stages of an audit, from planning stage to the audit opinion.

Professional judgement in auditing is the application of relevant knowledge and experience, within the context provided by auditing and accounting standards and the rules of professional conduct, in reaching decisions where a choice must be made between alternative possible courses of action [1]. By referring to professional standards, concepts like independence and

objectivity, professional competence, integrity, professional scepticism and responsibility are implicitly incorporated in the definition of professional judgement. It is clear that professional judgement takes place in the context of professional standards reflecting the collective judgements of the profession. Professional standards are therefore important in exercising professional judgement as they act as references and lighthouses for auditors. The absence of comprehensive professional standards combined with factors such as the increased frequency of business failures and the inability to meet public expectations have increased auditors' exposure to liability claims. The quality of professional audit standards will definitely impact the professional judgement of the auditor and both will impact the quality of the audit work. However, the auditor's risk propensity plays an important part and directly influences the professional judgement of the auditor as well as the quality of the audit work (see Figure 1.).

Figure 1. The relationship between professional judgement and risk propensity.  
(Original conception of the author)



### 3. Behavioural aspects of risk taking

Academic theories which attempted to explain the risk behaviour of decision makers date back as far as 1738 [2] and there are a significant number of empirical studies in the area of risk taking behaviour. However, these studies have not produced uniform findings.

Some scholars underline the importance of understanding the personal attitudes to risk and considers the attitude and behaviour dimension one of the key dimensions to understanding risk. The rationale of the importance of understanding the decision makers' risk behaviour is that, to a certain extent, the strategies of an organisation reflect the dispositions of their managers in terms of their background, beliefs, attitudes and problem-solving styles [3]. This behavioural aspect of managers' risk taking in decision making introduces the fundamental question about the determinants of risk behaviour. What exactly determines or influences a manager's risk behaviour when making a decision? There are currently several views accepted. The theories of risk taking behaviour are split into two major competing paradigms: one which emphasizes the importance of individual dispositional differences, which is called the dispositional view, and one which emphasizes the importance of situational factors, called the situational view. There are also views which try to integrate the dispositional view and the situational view, called integrative views.

### 4. The dispositional view

The individual dispositional view focuses on the individual differences in risk taking behaviour. For this school of thought, the general traits and general dispositional tendencies of the decision makers are believed to dictate their risk taking attitude. It argues that some people have a natural predisposition to be more risk-seeking or more risk-averse than others, irrespective of the situation or the context of the problem. In support of this theory, a significant number of empirical studies have reported on individual differences in risk taking behaviour. In 1970, Alderfer and Bierman [4] use two questions from Kogan and Wallach's Choice Dilemma Questionnaire [5] relating to financial investment, alongside other types of questions, to substantiate considerations regarding individual differences in attitudes towards risk choice in financial investment. In a study that directly examined the consistency of dispositional risk taking behaviour in two groups, one risk-seeking and one risk-averse, Schneider and Lopes [6] found that the risk-seeking group tended to

prefer riskier choice on a consistent base when compared with the risk-averse group. Other scholars [7] observed that some people were more tolerant towards risk than others and found that individuals tend to be consistent in their attitudes towards risk. In an experiment in which the roles of risk attitude and tolerance for ambiguity in predicting choice were jointly assessed, Ghosh and Ray [8] found that both risk attitude and ambiguity intolerance determined choice behaviour.

## 5. The situational view

Many empirical studies suggest that situational factors such as the framing of the problem and the context in which the decision on risk is taken have a greater influence on risk taking behaviour. Slovic [9] argues that high correlations between risk-taking measures in structurally different settings are highly unlikely, suggesting that different settings in which decision on risk is made will have different decisional outcomes. March and Shapira [10] find that managers, as decision makers, make a sharp distinction between taking risk and gambling, which implies that the context or situation of the decision plays a major role in risk taking behaviour. In line with these findings, a very strong argument in favour of the situational view of risk taking behaviour comes from a seminal study conducted by Kahneman and Tversky [11] in which the authors advance an alternative theory of choice under risk – the prospect theory. Essentially, the prospect theory suggests that individuals tend to interpret the outcomes of a risky decision according to a reference point – such as the status quo - which changes depending on whether the outcome is framed as a gain or as a loss.

## 6. Conclusion.

The possibility of human error in decision making is a critical reason why the study of risk in decision making tasks and, in particular, professional judgement is important. Since scholars first articulated the fundamental question about the determinants of risk behaviour in terms of whether they are dispositional or situational, the issue remains unresolved. However, there have been

attempts, along the years, to resolve this issue by researchers who advanced the integrative theories but with little or no success at all. The most popular theories about the determinants of risk behaviour are those articulated by Kogan and Wallach: the dispositional view, which considers the personal characteristics of a decision maker such as natural predisposition towards taking or avoiding risk to be determinant of the type of decision taken and the situational view, which considers the context in which the decision is taken to be determinant of the decision maker's risk behaviour, irrespective of dispositional preferences. There seem to be a contradiction between the two views. However, the professional auditor has a powerful tool at his/her discretion: professional judgement. The current challenge of financial auditors is to gain an understanding of how risk propensity affects the decision making process and how to make the best use of auditor's most important tool - professional judgement.

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## Some Accountancy Considerations Over the Cession of Claims

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### Abstract

*The assignment of debts is the operation in which the creditor (assignor) transmits voluntarily, for value or with voluntary disposition, the right of debt to another person (assignee) who becomes in this way the creditor instead of him and can cash from the debtor the given debt.*

*The accountancy of the contracts of assignment of debts to the assignee (the person who took over the debts) must be done according to the specified clauses of each contract. Through the assignment of debts, the right to debt of the cessionary is transmitted to the assignee for the nominal value of the debt, even if the transmission was done at a lower price.*

*According to the accountancy regulations, in the case of claim assignment, the difference between the value of the assigned debt and the sum paid to the assignor represents income at the date of the report of rights and obligations, based on the contract clauses.*

**Key words:** cession of claims, doubtful debts, cessionary, releaser, adjustments for debts depreciation

**Jel Code:** M40, M41

### 1. Introduction

The accountancy of the contracts of assignment of debts to the assignee (the person who took over the debts) must be done according to the specified clauses of each contract. Through the assignment of debts, the right to debt of the cessionary is transmitted to the assignee for the nominal value of the debt, even if the transmission was done at a lower price.

According to the accountancy regulations, in the case of claim assignment, the

difference between the value of the assigned debt and the sum paid to the assignor represents income at the date of the report of rights and obligations, based on the contract clauses.

### 2. General aspects regarding the assignments of debts

The assignment of debts is the operation in which the creditor (assignor) transmits voluntarily, for value or with voluntary disposition, the right of debt to another person (assignee) who becomes in this way the creditor instead of him and can cash from the debtor the given debt.

The accountancy of the contracts of assignment of debts to the assignee (the person who took over the debts) must be done according to the specified clauses of each contract. Through the assignment of debts, the right to debt of the cessionary is transmitted to the assignee for the nominal value of the debt, even if the transmission was done at a lower price.

The transmission of the claim takes place at the date of the closure of the contract, if there are no other provisions.

The doubtful debts are registered distinctively in the bookkeeping (account 4118 “Doubtful clients or in contention” or in the analytical accounts of the debts accounts, for other debts aside from clients).

Taking out of the bookkeeping of a claim can be done by giving it to another creditor. According to the accountancy regulations, in the case of claim assignment, the difference between the value of the assigned debt and the sum paid to the assignor represents income at the date of the report of rights and obligations, based on the contract clauses.

Together with the right for claim, the assignee gains through the effect of conveyance and the lack of any given stipulation in this manner, all the rights,

accessories and guarantees of any nature of the assigned claim.

If it was not conveyed otherwise, the interests and any other income of the claim, become mature, but uncollected yet by the assignor, revert to the assignee starting with the date of cession.

### 3. Particularities regarding the organization of accountancy in claim cession

#### a. At the assignee, the specialized company in retrieving claims [1]

1. Taking over of the claim according to the contract of cession of claims:

- cession price is lower than the nominal value:

461/4111 Clients	=	%
“Various debtors”		462
		“Various creditors”
		704
		“Income from providing services”

2. Registering the payments performed by the entity, representing the price of the cession:

462	=	5121
“Various creditors”		“Bank accounts in lei”

3. At the end of the year, while unfolding of the closure work of the financial year, the entity noticed that it can take back only 90% of the value of the assigned debts. As a consequence of noticing the risk of not payment for claims of 10%, it constitutes an adjustment for depreciation:

6814	=	496
“Operating expenses regarding adjustments for depreciation of current assets”		“Adjustments for depreciation of claims- various debtors”

4. At the payment date there can be receive a percent of 90% from the value of taken claims:

5121	=	461
“Bank accounts in lei”		“Various debtors”

5. In the same time, there will be proceeded to the renewal of income of adjusting the balance by depreciation of the taken claims through cession:

496	=	7814
“Adjustments through depreciation of claims		“Income through adjustments for

– various debtors” depreciation of circulating assets”

6. Recording in accountancy of the sums that cannot be cashed, according to the court order – 10%

654	=	461
“Losses from claims and various debtors”		“Various debtors”

#### b. At the assignor [1]

1. Passing of the claim to uncertain clients:

4118	=	4111
Uncertain clients or in litigation		Clients

2. Recording in accountancy of the cession claim

%	=	4118
461		Uncertain clients or in litigation
Various debtors/ Retrieval		654

Loss in claims and various debtors

3. Collecting the equivalent value of the cession, from the retrieval company:

5121	=	461
Bank accounts in lei		Various debtors/Retrieval

### 4. Case studies regarding the accountancy of claim cession

#### 4.1 Case study number 1 regarding accountancy of claim cession

S.C. Student A S.R.L. sells to S.C. Student B S.R.L. at the date of 1<sup>st</sup> November 2010 goods in value of 500.000 lei. According to the contractual clauses, the payment of the equivalent value by S.C. Student B S.R.L will be done until at least 30<sup>th</sup> December 2010. Because S.C. Student B S.R.L is facing certain financial problems, it has not made any payment to S.C. Student A S.R.L until the due date mentioned in the contract.

At the beginning of the year 2011, the court gives an order entrance for S.C. Student B S.R.L in the procedure of insolvency, and at 1<sup>st</sup> March 2011, the entity S.C. Student A S.R.L concludes an agreement of cession of claims with the entity S.C. Debits S.R.L., entity specialized in debts recovery. After the contract of claims cession, all the rights and obligations of S.C. Student A S.R.L are taken over by S.C. Debits S.R.L. According to the contract of claims cession, the price of cession is 490.000 lei. All the companies are not VAT payers.

**a. Bookkeeping of the operations at entity S.C. Student A S.R.L – assignor**

a1. – Registering in bookkeeping of the operation of sale of the goods in 1<sup>st</sup> November 2010

4111	=	707	500.000 lei
Clients		Income from goods sale	

a2. – At 31<sup>st</sup> December 2010, on occasion of the stocktaking, the claim is valued at the probable value of cashing and it is recorded in accountancy an adjustment for depreciation for the entire value of it. Based on the analysis done by experts and jurist, it is appreciated that taking into consideration the financial problems of the client S.C. Student B S.R.L, the probable value of cashing the debts is zero.

Consequently it is decided to reflect in the books of a provisory adjustment to the level of the entire value of the debt:

4118	=	4111	500.000 lei
Uncertain clients or in litigation		Clients	

and

6814	=	491	500.000 lei
Expenses for exploiting regarding adjustments for depreciation		Adjustments for claims depreciation-clients	

a3. – At 1<sup>st</sup> March 2011, entity S.C. Student A S.R.L records in its books the cession of claims:

%	=	4118	<u>500.000 lei</u>
461		Uncertain clients or in litigation	490.000 lei
Various debtors S.C. Recovery S.R.L.			
654			10.000 lei
Loses through claims and various debtors			

and together with that, it goes back to the income the adjustment for depreciation made beforehand:

491	=	7814	500.000 lei
Adjustments for depreciation		Income from adjustments for depreciation	

a4. Cashing the equivalent value of cession from S.C. Recovery S.R.L.:

5121	=	461	490.000 lei
Bank accounts in lei		Various debtors/ S.C. Recovery S.R.L.	

**b. Accountancy of operations at entity S.C. Recovery S.R.L. – assignee**

b1. Taking over the debt, according to the contract of claim cession from entity S.C. Student A S.R.L.:

461	=	%	<u>500.000 lei</u>
Various debtors/ S.C. Student B S.R.L		462	490.000 lei
		Various clients/ S.C. Student A S.R.L	
		704	10.000 lei
		Income from providing services	

b2. Discharge of claim payment to S.C. Student A S.R.L.:

462	=	5121	490.000 lei
Various creditors/ S.C. Student A S.R.L.		Bank accounts in lei	

b3. After that the debt is followed by S.C. Recovery S.R.L. and according to the evolution of the financial situation of S.C. Student B S.R.L. there can be made adjustments for depreciation in the bookkeeping of the entity that has taken over the claim, in this way:

6814	=	496	
Working costs regarding adjustments for depreciation of circulating assets		Adjustments to depreciation of claims-various debtors	

**4.2 Case study number 2 regarding the accountancy of claim cession**

S.C. Student A S.R.L. has to get from S.C. Student B S.R.L. the sum of 200.000 lei. According to the contractual clauses, the payment of the equivalent value of the goods by S.C. Student B S.R.L. is to be done in 90 days. Because S.C. Student B S.R.L. has some financial problems, it has not made any payments to S.C. Student A S.R.L. until the due date stipulated in the contract. Because the debit has an ages older than 200 days, the entity S.C. Student A S.R.L. has entered into a contract with the entity S.C. Debts S.R.L., entity specialized in debts recovery. After the contract of claims cession, all the rights and obligations of S.C. Student A S.R.L are taken over by S.C. Debts S.R.L. According to the contract of claims cession, the price of cession is 190.000 lei. All the companies are

not VAT payers. The company S.C. Student B S.R.L. has been announced by this contract of claim cession.

**a. Accountancy of operations at entity S.C. Recovery S.R.L. – assignee**

a1. Taking over the debt, according to the contract of claim cession from entity S.C. Student A S.R.L.:

461	=	%	<u>200.000 lei</u>
Various debtors/ S.C. Student B S.R.L.		462	190.000 lei
		Various clients/ S.C. Student A S.R.L.	
		704	10.000 lei
		Income from providing services	

a2. Discharge of claim payment to S.C. Student A S.R.L.:

462	=	5121	190.000 lei
Various creditors/ S.C. Student A S.R.L.		Bank accounts in lei	

a3. After that the debt is followed by S.C. Recovery S.R.L. and according to the evolution of the financial situation of S.C. Student B S.R.L., at the end of the financial year notices that it can get back only 90% so it will make a depreciation adjustment, in this way:

6814	=	496	20.000 lei
Working costs regarding adjustments for depreciation of circulating assets		Adjustments to depreciation of claims–various debtors	

a4. In the next year, it cashes from S.C. Student B S.R.L., the sum of 180.000 lei:

5121	=	461	180.000 lei
Bank accounts in lei		Various debtors/ S.C. Student B S.R.L.	

a5. In the next year, it is retaken at income the adjustment for claim depreciation:

496	=	7814	20.000 lei
Adjustments for claim depreciation – various debtors		Income from adjustments for depreciation of circulating assets	

a6. In the next year, it is recorded as losses the unpaid difference, as following the bankruptcy of S.C. Student B S.R.L.:

654	=	461	20.000 lei
Losses from claims and various debtors		Various debtors/ S.C. Student BS.R.L.	

**b. Accountancy of operations at entity S.C. Student A S.R.L – assignor**

b1. After 200 days the passing of the debt to uncertain clients:

4118	=	4111	200.000 lei
Uncertain clients or in litigation		Clients	

b2. The entity S.C. Student A S.R.L records in bookkeeping the claim cession:

%	=	4118	<u>200.000 lei</u>
461		Uncertain clients or in litigation	190.000 lei
Various debtors S.C. Recovery S.R.L.			
654			10.000 lei
Loses through claims and various debtors			

b3. Cashing the equivalent value of cession from S.C. Recovery S.R.L.:

5121	=	461	190.000 lei
Bank accounts in lei		Various debtors/ S.C. Recovery S.R.L.	

**5. Conclusions**

In connection with the theme tackled, there can be drawn the following conclusions:

- the income from or connected to the claims cession are taxable incomes;
- the losses registered at the taking out of evidence at the unpaid debts are deductible, only in the following cases [3]:
  1. the bankruptcy procedure of the debtors was closed based on a court order;
  2. the debtor has deceased and the claim cannot be recovered from the heirs;
  3. the debtor is dissolved, in the case of a limited company with a sole associate or liquidated with no successor;
  4. the debtor has major financial difficulties which affects the entire patrimony.
- the accountancy of the contracts of claim cession to the cessionary (the person who took over the debts) must be done according to the specific clauses of the contract;
  - together with the right for claim, the cessionary gets, through the cession effect and in the lack of any specific stipulation in this way, all the rights, accessories and guarantees of any nature of the cession claim;

- if it was not conveyed otherwise, the interests and any other income of the claim, become mature, but uncollected yet by the assignor, revert to the assignee starting with the date of cession;
- in the situation in which according to the contract, the purpose of the operation is not the recovery of debts, the taking over company of the correspondent claims of a credit given takes the position of the creditor, the operation is exempted from VAT;
- in the case, in which the analysis of the contract says that the operation represents the recovery of the claims, this is considered for the person who takes over the claims as a service made with payment, taxable from the VAT point of view, regardless of the fact that the person who takes over the claims, takes or not the risk of not cashing them;
- the expenses regarding the value of the alienated commercial debt are deductible expenses;
- in what it concerns the income of the recovery society, we consider more adequate the usage of account 704 instead of account 7588 [2], the way the MPF regulations provide, because the activity of recovery of debts represent an activity of services.

## 6. References

- [1] *Accountancy monographs*, Rentrop& Straton, București, 2010.
- [2] *MFP guide, regarding some aspects over the accountancy European directives*, 2010.
- [3] *Law no.571/2003 regarding the fiscal code with previous adjustments and completions*.

## Some Considerations Over the Simplification of Costs Calculation for Small and Medium-Size Entities

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### Abstract

*However small and medium companies can easily use the extra accounting method, which is based on a table, where the production cost components are found. Nevertheless, small and middle-size entities can easily use the off balance sheet method, which has at its base a table in which are found the components of the production costs. Using the accounts from the new class is not mandatory; the costs calculation can be made in off balance sheet, with the help of Excel tables or with the help of cumulative documents.*

**Key words:** cost calculation, classification of costs, distribution of indirect expenses, rational charge, off balance sheet method.

**Jel Code:** M40, M41

### 1. Introduction

Nevertheless, small and middle-size entities can easily use the off balance sheet method, which has at its base a table in which are found the components of the production costs. Using the accounts from the new class is not mandatory; the costs calculation can be made in off balance sheet, with the help of Excel tables or with the help of cumulative documents.

### 2. Legal provisions on management accounting

According to the Accounting Law no. 82/1991, as amended and supplemented (GO no. 37/2011), legal persons under the law (commercial companies, national companies, stand-alone units, national research and development institutes, cooperative societies

and other legal persons, public institutions, associations and other legal persons, profit or non-profit, unincorporated subdivisions, based abroad, based in Romania, and unincorporated subdivisions in Romania, owned by legal entities registered abroad, collective investment structures that are not represented by the articles of association, as set out in the capital market law, pension funds, private pension funds and other entities organized under the Civil Code), are required to organize and run their own accounting, including management accounting adapted to the specific activity. According to the same bill, also responsible for management accounting organization, is the manager, officer or other person bound to the management of such entity.

On the other hand OMFP no. 1826/2003, on some measures on the organization and administration of management accounting provides a number of provisions concerning the organization of management accounting, among which: according to the specific of the activity, management accounting will provide mainly for recording operations on the collection and distribution of expenditures by purpose, i.e. activities, departments, stages of manufacture, cost centers, profit centers, as appropriate, and costing of acquisition, production, processing of incoming goods, work performed, services provided, running production, current assets etc., in the production units, commercial, service, financial and other fields; accounting management is organized by the administrator of the legal entity either by using specific accounts or accounts by developing of financial accounting, either with their own operational and technical evidence; the use of accounting accounts and their symbols shall be such that the storage and access system of the information

obtained to be flexible and allow a wide range of options; the list of management accounts is adapted to the purposes, namely: emphasizing cost flows, determination of inventory costs, determining revenues and results according to the activity that generates them, making predictions, etc.

Also, OMFP no. 3055/2009 contains some rules on management accounting, but the references made are done through the rules for evaluating the cost of production; these rules include: the production cost of an asset comprises the purchase cost of raw materials and supplies and the production expenses directly attributable to the asset; the cost of production or of processing the inventory and the production cost of fixed assets include the direct costs related to production, namely: direct materials, energy consumption for technological purposes, direct manufacture and other direct production costs, design costs and share of indirect production costs allocated as rationally related to their manufacture; in the production of property, examples of expenditure within other directly attributable costs are: costs of site development; initial delivery and handling costs, installation and assembly costs, costs of testing the correct operation of the asset, professional fees and commissions paid in connection with the asset etc.; the cost of inventories of a service provider includes labor and other expenses directly related to the personnel engaged in provision of services, including the staff responsible for supervision and appropriate private utility; the production cost can include a reasonable proportion of expenses that are indirectly attributable to the property, insofar as they relate to the period of production; including in the cost of inventories overheads may be appropriate if they represent the cost for bringing the inventories to the desired place and form; examples of costs that should not be included in the cost of inventories, but are recognized as expenses in the period in which they occurred, are the following: loss of materials, manufacture or other costs of production recorded beyond normally allowed, including losses due to wastage; storage costs, except where such costs are necessary in the production process, before passing into a new phase of manufacturing; storage costs are included in the cost of production when

necessary to bring inventories in place and condition in which they are situated; overheads (expenses) generated by the administration, not involved in bringing inventories to final form and place; bargain sale, unallocated fixed costs, which is recognized as an expense in the period in which it appeared, the allocation of fixed costs is based on normal production capacity (activity); production fixed costs consist of indirect production costs which remain relatively constant regardless of production volume, such as: depreciation, maintenance of departments and equipment, and management and administration departments costs; the normal capacity of production is the estimated production to be obtained on average over a certain number of periods, under normal circumstances, taking into account the loss of capacity resulting from planned maintenance of equipment..

### 3. Cost calculation

The information presented in the OMPF. 3055/2009 can be classified into the following categories: cost classification, allocation of indirect costs, reasonable charging, cost of borrowing, losses, production in progress [2].

#### a. Costs classification

According to OMFP no. 3055/2009, entities classify costs on the following criteria:

- according to the functions of the entity, costs are classified as: acquisition costs, production costs, selling costs, administration costs;
- according to the identification within the object of calculation, costs are classified as direct costs, which are identified within an object of calculation, and indirect costs that are related to multiple objects of calculation;
- according to their behavior in relation to production volume, we have variable costs, which vary in proportion to the production volume and fixed costs that do not change with production volume.

In the calculation of production cost, entities must identify and analyze the costs, according to three criteria. The OMPF no. 3055/2009 provides that the stock

assessment is achieved at the cost of production, which includes direct costs and a share of indirect production costs; hence the use of a method for calculating the full cost, i.e. the cost of production includes direct and indirect costs, both variable and fixed.

#### **b. The distribution of indirect costs**

Using the methods of calculating the full cost (global, per phase, on order, standard, on activities, etc.), involves the use of distribution databases on cost objects, of indirect cost. OMFP no. 3055/2009 does not refer to the way in which distribution bases are chosen, only stating that the production cost can include a reasonable proportion of expenses that are indirectly attributable to the property, insofar as they are related to the production period.

The OMFP no.1826/2003 further mentions that when the costs of production, of processing cannot be identified separately for each product, they are allocated on the basis of rational procedures consistently applied (simple division procedure, the quantitative procedure, indicators of equivalence procedure, quantitative equivalence of the secondary product with the primary product procedure, the value deduction of the secondary products procedure etc) [3].

Among the bases of distribution, according to which indirect costs of cost objects are allocated are the following: consumption of raw materials, direct wages, product number, batch number, direct costs, total revenues, etc. [1]. They will choose the distribution base that significantly affects the cost of cost objects and its profitability.

#### **c. Rational imputation**

The OMFP no. 3055/2009 requires a rational allocation of indirect costs, so in the production cost is included only part of the fixed indirect costs (depreciation, maintenance of equipment and departments, management and administration costs, etc. sections), and their allocation is carried out based on normal production capacity. Rational imputation is explained by the fact that because fixed costs are the same regardless of output, their imputation on product must be made depending on the use of normal production capacity.

Normal production capacity is the estimated production to be achieved on average over several intervals in normal

circumstances, taking into account the loss of capacity resulting from planned maintenance of equipment.

#### **d. Cost of Borrowing**

The OMFP no. 3055/2009 underlines a series of clarifications to the cost of borrowing, among which: borrowing costs that are directly attributable to the acquisition, the construction or production of an asset with a long manufacturing cycle may be included in the costs of that asset, for example, borrowing costs may include the interest on the borrowed capital to finance the purchase, the construction or production of assets with a long manufacturing cycle and commissions for these loans; borrowing costs may be included in the production costs of an asset with a long manufacturing cycle, insofar as they relate to the period of production; the borrowing costs incurred by the entity in connection with the loan funds may be included in the cost of goods or services with a long manufacturing cycle; capitalizing borrowing costs should cease when making most of the activities necessary to prepare the asset with a long manufacturing cycle, for the use of default or sale; in respect of including such borrowing costs in the value of assets, they must be presented in the notes.

#### **e. Losses**

OMFP no. 3055/2009 states that should not be included in the cost of inventories, but are recognized as expenses in that particular period, the loss of materials, manufacture and other production costs recorded above the normal permissible variation, including losses due to wastage.

Losses are consumed resources, which are not present in the final product.

#### **f. Production in progress**

The OMFP no. 3055/2009 offers a series of clarifications to the production in progress, among which: the production in progress, representing production, which has not passed through all stages of processing, set in the technological process and the products not subject to tests and technical reception or unfinished, within the production process services and studies in progress or unfinished are also included; the value of products and services under execution is determined by the inventory of unfinished production by the end of the cycle, by technical means of ascertaining the degree of completion or

execution stage of technological operations and its assessment at production costs.

Given the production in progress, the cost of finished goods is determined by the following formula: production cost + the cost of the initial stock of production – the cost of the final stock of production in progress.

#### 4. Organization of costs calculation through the off balance sheet method

In what concerns the ways of organizing the management accounting, only OMFP no. 1826/2003 makes some specifications, from which we mention: management accounting

Expenses	Producti- on	Auxilia- ry	Administ- ration	Distribut- ion
-raw material s (601)	P1: 15.000 P2: 10.000			
-supplies (602)	2.000	1.000	500	500
-power and water (605)	4.000	2.000	1.000	1.000
-wages (641)	P1 : 1.000 P2 : 1.200	1.000	4.000	2.500
-amortiza- tion (681)	10.000	1.000	500	5.000

it is organized by the administrator of the legal entity, either by using specific accounts, or by developing accounts from the financial accountancy, or with the help of its own technical and operative bookkeeping (the off balance sheet accountant). Nevertheless, small and middle-size entities can easily use the off balance sheet method, which has at its base a table in which are found the components of the production costs. Using the accounts from the new class is not mandatory; the costs calculation can be made in off balance sheet, with the help of Excel tables or with the help of cumulative documents. The entities have in hands advanced programs for costs calculation, without using the accounts from class 9, the calculation algorithm being the same, the spending elements being centralized with the help of tables (spending synoptic tables). In order to ensure the accuracy of the processed information there will be a confrontation with the expenses from the financial bookkeeping. This off balance sheet method of organizing the calculation is proper for small and middle-size entities, which do not have indirect costs localized in many production divisions.

In the matter of organizing the management accounting and the calculation of the production cost, through the off balance sheet method there will be presented the following case study.

#### 5. The case study regarding the organization of costs calculation through the off balance sheet method

An entity gets two products A and B. The organizational structure is formed by: a productive center (production division), an auxiliary center (a maintenance and repairing workshop), an administration center and a sale center. The standard cost of the finite products were of 27.000 lei for A and 19.000 lei for B. The auxiliary division has worked 300 hours for production and 200 hours for distribution. The indirect costs divided considering the number of hours of direct labor, 350 hours for A and 250 hours for B. The administration and sale expenses are divided according to the effective cost of production. The production expenses are presented in the following table.

Table no. 1 Expenses elements -lei-  
Source: prepared by author

Requirements: To be established **the effective cost of production and the total cost** using **the method of own technical and operative bookkeeping (the off balance sheet)**.

For solving there will be done the following **preliminary calculations**:

a. allotment of the auxiliary costs to the main centers:

- the allotment coefficient -k 922 :  
*Auxiliary*

$$(k_{922}) = \frac{\text{Expenses}}{300 + 200} = \frac{5.000}{500} = 10$$

- the allotment of these for production, and for sale:

$$\text{Cauxprod.} := 300 \times 10 = 3.000 \text{ lei}$$

$$\text{Cauxdes.} := 200 \times 10 = 2.000 \text{ lei}$$

b. allotment of indirect costs on the products:

- the allotment coefficient -k 923 :  
*Indirect*

$$(k_{923}) = \frac{\text{expenses}}{350 + 250} = \frac{16.000 + 3.000}{600}$$

$$k(923) = 31,666666$$

- allotment for each product:  
 $Cir_a := 350 \times 31,666666 = 11.083lei$   
 $Cir_b := 250 \times 31,666666 = 7.917lei$
- c. allotment of administration costs and sale of the products:
  - the allotment coefficient-k 924,925 :

$$(k_{924,925}) = \frac{6.000 + 10.000 + 2.000}{27.083 + 19.117}$$

$$(k_{924,925}) = 0,3896103$$

- allotment for each product:  
 $Cra := 0,3896103 \times 27.083 = 10.552lei$   
 $Crb := 0,3896103 \times 19.117 = 7.448lei$

d. The effective cost and the total cost will be determined according to the following table:

Table no. 2 Synoptic table of expenses -lei-

Expenses	Direct Costs		Auxiliary costs	Indirect costs	Administrative costs	Sale costs
	P1	P2				
Raw materials supplies	15000	10000	1000	2000	500	500
Power and water			2000	4000	1000	1000
Wages	1000	1200	1000		4000	2500
Amortization			1000	10000	500	5000
Advertising						1000
<b>Total</b>	<b>16000</b>	<b>11200</b>	<b>5000</b>	<b>16000</b>	<b>6000</b>	<b>10000</b>
Allotment of auxiliary expenses				<b>3000</b>		<b>2000</b>
Allotment of indirect expenses	<b>11083</b>	<b>7917</b>				
<b>Effective cost</b>	<b>27083</b>	<b>19117</b>				
Allotment of administrative/sale expenses	10552	7448				
<b>Total cost</b>	<b>37635</b>	<b>26565</b>				

Source: prepared by author

## 6. Conclusions

In what matters the organization of management accounting and the calculation of production cost there can be drawn the following conclusions:

- in terms of how management accounting is organized, only OMFP no. 1826/2003 offers specifications, among which: management accounting is organized by the

administrator of the legal person, either by using specific accounts or by developing accounts in financial accounting or using their operational and technical evidence (extra accounting);

- but for large firms, where direct and indirect costs are localized in several centers (departments) it is required the rational use of the new class of accounts, using computer software to facilitate work;
- in no accounting regulation mentioned, one finds rules of operation of management accounts, of the new class;
- also, in any mentioned accounting regulations there is no presentation of the adaptation of management accounting and accounts of the new class in production, trade and services;
- in all accounting regulations mentioned, one could not find in detail the methods of calculation, being listed only in the OMPF no. 1826/2003 (standard cost method, the method of controls, the phase method, the comprehensive method, direct costing method or other methods adopted by the legal person according to the organization of production, the specific activity, the characteristics and needs of the technological process);
- GO no. 37/2011 does not present further details on the organization and management of accounting management, but only increases the number of legal persons entitled to apply it;
- regardless the organization of management accounting, accounting or extra accounting, the manager must choose the most appropriate calculation method and system of organization, depending on: the type production, technological process, manufacturing classification, the objectives of management, business seasonality, production cycle, object of activity etc.;
- the lack of a rigorous cost calculation, regardless of its

organization, leads to a wrong setting of selling prices, with direct influence on profitability;

- using the accounts from the nine class is not mandatory, the costs calculation can be handled in the off balance sheet, with the help of Excel tables or with the cumulative documents;
- nevertheless the small and medium size entities can easily use the off balance sheet method, which has at its basis a table in which there are found the components of the production cost;
- the entities have advanced programs for costs calculation, without using the accounts from class 9, the calculation algorithm being the same, the spending elements being centralized with the help of tables (spending synoptic tables);
- in order to ensure the accuracy of the processed information there will be a confrontation with the expenses from the financial bookkeeping;
- this off balance sheet method of organizing the calculation is proper for small and middle-size entities, which do not have indirect costs localized in many production divisions.

## 7. References

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# The Contemporary Conditions, Limitations and Trends in Situations of Fragility for Romania

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## Abstract

*Situations of fragility, triggered by gaps and failures in governance, is both, an important obstacle in the way of a country sustainable development and to regional stability and international security, creating, also, security risks worldwide and uncontrolled migration flows. The socio-economic, environmental and political conditions that have arisen, as a consequence of UE integration for Romania, presents some major challenges to contemporary democracy, both in terms of how to structure institutional responses in ways that effectively deal with UE strategies, and how to include a variety of actors in decision making processes, as are enfranchising civil society and other non-state actors.*

*This paper try to provide a evaluations of contemporary conditions, qualities, and trends over time in the four fragility dimensions (political, security, economic and social) of societal-systems analysis for Romania, for 1995-2010 period, using five different fragility measurement indices.*

**Keywords:** state fragility, fragility measurement indicators, Romania.

**J.E.L. Classification:** C82, E02, H12

## 1. Introduction

In many countries, with developing economies, fragility is a constant, because it has as a foundation societies structurally unstable, vulnerable to crises, external shocks, epidemics, drug trafficking, natural disasters or environmental degradation, societies in which cultural heritage and cultural diversity are endangered.

As the paper title implies, I consider that a

*macro-comparative evaluations of contemporary conditions, qualities, and trends in Romania State Fragility need to be integrated into the making of public policy, both nationally and internationally level.*

The concept of state fragility is related to the concept of security, in terms of conflict prevention and this phenomenon is specific to transition economies, over the last decade, mainly in integrating themselves into the world economy.

Of course, such an approach involves three core dimensions of societal-systems analysis: conflict, governance and development dimension, but, in this paper, I will summarize that analysis of national security level.

Following the introductory part, related literature was overviewed in the second part and the methodology, data and results were put forth in the third part and finally the findings were interpreted and a general review was made.

## 2. Theoretical background

Literature fails providing a unique and comprehensive definition of "state fragility". Failure, weakness and vulnerability have often been used as synonyms for state fragility, so, this concept has been associated with various combinations of dysfunctions, such as:

- inability to provide basic services;
- unstable and weak governance;
- a persistent condition of poverty;
- lack of territorial control, and
- high propensity to conflict and civil war.

Analyzing state fragility may consider both the determinants of state fragility and a short summary of the current fragility indices, with their limitations and delineates.

In an attempt to make the concept of

"fragile states" operational for development policy, Stewart and Brown (2009) [1], proposes a three-pronged definition of fragility: authority failure, service entitlement failure or legitimacy failure.

Similar definitions of "fragile states", or "fragility" can be seen in a lot of studies, reports or working papers made by international organizations or development agencies, but there are debates about the term's definition, accuracy, usefulness, and indicators.

A well known definition is that of the British Department for International Development, which defines fragile states as states in which the government is either unable or unwilling to deliver basic functions, such as service entitlements, justice and security, to the majority of its people, including the poor.

McLoughlin (2012) [2] presents a critical perspectives on the evolution and usage of terms used to describe and typologise "fragile states" as is the The Centre for Research on Inequality and Social Exclusion, definition: fragile states as "failing, or at risk of failing, with respect to authority, comprehensive service entitlements or legitimacy".

The World Bank uses the term "low-income countries under stress" (LICUS) as well as fragile states, and defines them as states characterised by a combination of weak governance, policies and institutions which undermine the state's capacity to deliver services, control corruption and provide for voice and accountability. They are also states at risk of conflict and instability.

The term "fragile states" has undergone conceptual interpretations and changes to avoid pejorative label it provide, such as, from the notion "fragile states" has been the notion "state fragility" or "situations of fragility".

Many question emerges about how far is it possible to define and measure a fragile states, and to distinguish between different types and processes of state fragility?

Both in the academic literature and in official documents five indices are recurrent, (Newman, 2009) [3] the Failed States Index, the Global Peace Index, the Human Development Index, the Index of State Weakness, and the State Fragility Index.

### 3. Methodology, data and results

So, there is already a policy framework to address various dimensions of fragility and to the diversity of its measurement indicators, which is why, it is necessary to specify some technical notes:

1. *The Failed States Index*, produced by The Fund for Peace in collaboration with the Foreign Policy Journal is a critical tool in highlighting not only the normal pressures that 177 states experience, but also in identifying when those pressures are pushing a state towards the brink of failure. *The Failed States Index* is rated on a 1 to 10 scale with 1 (low) being the most stable and 10 (high) being the most at-risk of collapse and violence, for 12 indicators: (i) *Mounting Demographic Pressures*, (ii) *Massive Movement of Refugees or Internally-Displaced Persons*, (iii) *Vengeance-Seeking Group Grievance*, (iv) *Chronic and Sustained Human Flight*, (v) *Uneven Economic Development*, (vi) *Poverty and Sharp or Severe Economic Decline*, (vii) *Legitimacy of the State*, (viii) *Progressive Deterioration of Public Services*, (ix) *Violation of Human Rights and Rule of Law*, (x) *Security Apparatus*, (xi) *Rise of Factionalized Elites*, (xii) *Intervention of External Actors*. Think of it as trying to bring down a fever, with high being dangerous and low being acceptable.

Table no. 1. *The Failed States Index for Romania in 2006-2011*

The Failed States Index for Romania	2006	2007	2008	2009	2010	2011
Demographic Pressures	6.5	5.5	5.3	5.6	5.4	5.1
Refugees and IDPs	3.9	3.8	3.5	3.4	3.2	3.2
Group Grievance	5.4	5.2	5.2	5.3	5.6	6.0
Human Flight	5.5	5.2	5.2	5.1	4.9	5.0
Uneven Development	6	6.1	6.1	5.8	5.6	5.8
Poverty and Decline	5.9	5.7	5.2	5.3	5.6	5.8
Legitimacy of the State	6.2	6.1	5.9	6.2	6	5.9
Public Services	5.3	5.2	5.2	5	4.8	4.5
Human Rights and Rule of Law	4.8	4.8	4.8	4.5	4.3	4.0
Security Apparatus	3.5	3.4	3.4	4.3	4.1	4.1
Factionalized Elites	4.1	4.5	4.7	5.1	5.2	5.2
External Intervention	5.5	5.4	5.4	5.5	5.5	5.2
<b>TOTAL SCORE</b>	<b>62.6</b>	<b>60.9</b>	<b>59.9</b>	<b>61.3</b>	<b>60.2</b>	<b>59.8</b>
<b>RANK</b>	<b>102</b>	<b>126</b>	<b>128</b>	<b>129</b>	<b>128</b>	<b>126</b>

Data from The Fund for Peace, available on line at <http://www.fundforpeace.org/global/>

2. *The Global Peace Index* is published by the Institute for Economics and Peace in collaboration with the International Institute for Strategic Studies, The World Bank,

various bits of the UN Institute of Peace and the Economist Intelligence Unit and an international team of academics and peace experts. The Global Peace Index supplies an overview of the trends in armed conflicts in 153 countries by measuring 23 macro-indicators, ranging from a nation's level of military expenditure to its relations with neighbouring countries and the level of respect for human rights and tries to measure peace or to rank countries around the world according to their peacefulness.

Table no. 2. The Global Peace Index for Romania in 2007-2011

The Global Peace Index for Romania	2007	2008	2009	2010	2011
<b>TOTAL SCORE</b>	1.682	1.611	1.591	1.749	1.74
<b>RANK</b>	36	34	31	45	40

Data from the Institute for Economics and Peace, available on line at <http://www.visionofhumanity.org/>

3. The Human Development Index is a composite statistic used to rank countries by level of "human development" developed by UN Development Programme (UNDP) since the beginning of the 1990s. The HDI aggregates the three principal health indicators, education indicators and income or living standard indicators. It measures the development of countries throughout the world, assessing a state's capacity to supply fundamental public goods or to distinguish whether a country is a developed, a developing or an under-developed country, and also to measure the impact of economic policies on quality of life.

Table no. 3. The Human Development Index for Romania in 2007-2011

The Human Development Index and its components for Romania	Dimensions	2006	2007	2008	2009	2010	2011
Life expectancy at birth	Health	72.700	73.100	73.310	73.500	73.800	74.000
Mean years of schooling	Education	10.200	10.300	10.300	10.400	10.400	10.400
Expected years of schooling	Education	13.900	14.200	14.700	14.900	14.900	14.900
Gross National Income (GNI) per capita	Living standards	9.870	10.733	11.722	10.385	10.863	11.046
<b>TOTAL SCORE</b>		0.757	0.767	0.778	0.778	0.779	0.781
<b>RANK</b>							50

Data from United Nations Development Programme, available on line at <http://hdr.undp.org/en/statistics/>

4. The Index of State Weakness in the Developing World was designed to provide

policy-makers and researchers with a credible tool for analyzing and understanding the world's most vulnerable countries. The Index considers four critical spheres: economic, political, security, and social welfare, based on 5 indicators in each basket. Taken together, the 20 indicators yield a balanced picture of how developing countries perform or fail to perform along multiple dimensions. Within each basket, the indicator scores are standardized and aggregated, creating individual indicator and basket scores ranging from 0.0 (worst) to 10.0 (best). The 4 basket scores are then averaged to obtain an overall score for state weakness, ranging from just above 0 to just short of a perfect 10, to produce a ranking of states on the basis of their relative weakness Rice and Patrick (2008) [4].

Table no. 4. The Index of State Weakness for Romania

The Index of State Weakness for Romania			
ECONOMIC BASKET	7.91	GNI per capita	4.38
		GDP Growth	4.50
		Income Inequality	8.92
		Inflation	6.20
		Regulatory Quality	7.45
POLITICAL BASKET	6.77	Government Effectiveness	6.23
		Rule of Law	6.45
		Voice and Accountability	7.74
		Control of Corruption	5.16
		Freedom	8.33
SECURITY BASKET	8.42	Conflict Intensity	10.00
		Gross Human Rights Abuses	6.39
		Territory Affected by Conflict	10.00
		Incidence of Coups	10.00
		Political Stability and Absence of Violence	7.06
SOCIAL WELFARE BASKET	8.54	Child Mortality	9.56
		Access to Improved Water and Sanitation	4.79
		Undernourishment	10.00
		Primary School Completion	9.93
		Life Expectancy	8.36
<b>Overall Ranking</b>		<b>121</b>	
<b>Overall Score</b>		<b>7.91</b>	

5. The State Fragility Index and Matrix, developed by Center for Systemic Peace in collaboration with Center for Global Policy covers 162 countries with populations greater

than 500,000 and it is based on four performance categories: conflict security, political governance, economic development and social development.

Table no. 5. The State Fragility Index and Matrix for Romania in 2006-2011

The State Fragility Index for Romania	2006	2007	2008	2009	2010
Effectiveness Score	2	1	1	1	1
Legitimacy Score	4	4	4	4	3
Security Effectiveness	0	0	0	0	0
Security Legitimacy	1	1	1	1	1
Political Effectiveness	0	0	0	0	0
Political Legitimacy	2	2	2	2	2
Economic Effectiveness	2	1	1	1	1
Economic Legitimacy	0	0	0	0	0
Social Effectiveness	0	0	0	0	0
Social Legitimacy	1	1	1	1	0
Region	5	5	5	5	5
<b>TOTAL SCORE</b>	<b>6</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>4</b>

Data from The Polity IV Project, available on line at <http://www.systemicpeace.org/polity/polity4.htm>

Of course, in agreement with Mata and Ziaja (2009) [5] it can identify other indicators that can measure a state fragility, including Country Indicators for Foreign Policy Fragility Index developed by Norman Paterson School of International Affairs (Carleton University), Peace and Conflict Instability Ledger developed by Center for International Development and Conflict Management (University of Maryland), Political Instability Index developed by Economist Intelligence Unit or World Governance Indicators, Political Stability and Absence of Violence developed by The World Bank Institute.

It should, therefore, choosing the most appropriate indices for a certain application, because any application, requires detailed awareness about an index's capability, so, it is important to make a distinction between intended and real usage of an index. The range of possible uses for fragility indices, mainly revolving around early warning and early action information, evaluation of interventions, policy guidance, public awareness, research or risk analysis.

#### 4. Conclusions

A simple comparison of the rankings of Romania fragility, using different indices indicates some discrepancies. But, these results should not be surprising because, as evidenced by Mata and Ziaja (2009) [5], Fragility indices are used for different

purposes, by:

- development practitioners and government officials in order to guide future action and for investigating the dynamics of state fragility;
- researchers to investigate causes and consequences of state fragility;
- media and the public to keep track of risks to human wellbeing;
- international organizations to monitor larger trends of global political stability and for determining which countries need a different aid approach.

Over time The European Union has criticized Romania for failing to reform their courts, reduce corruption and fight organized crime. But more serious is that Romania's government collapsed this days, following weeks of protests against austerity measures. I suspect that protests and civil unrest in Romania and in Europe also, will be factors in the actual rise of fragility.

#### 5. Acknowledgement

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## Traditionalism and Efficiency

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### Abstract

*Information is an essential element of the transactions and financial markets, but it can access various forms (usually named soft and hard information). The new technologies modify the pattern of communications and thus substantially changing the performance of the markets and financial institutions. The financial institution that provides credit used to obtain the soft information only if the hard information generates contradictory signals or if it is difficult to apprehend. One of the great advantages of hard information is the reduction of trading costs by using less specialized employees or computers. When soft information is substituted with hard data, appear a concentration, the loss of information being imminent. The question that arises is how much information is lost and what is their quality. Dependence of investment decisions of the others' is often why stock market problems appear.*

**Keywords:** soft and hard information, financial markets

**JEL Classification:** E61, F36

### 1. Introduction

For financial markets and financial institutions the action of collecting, processing, and transmitting information is one of the main goals. This primary component of the transactions and financial markets can access various forms.

Hard information is quantitative, simple to store and to communicate, and usually their content is independent of the gathering procedure. Soft information is considered information that is difficult to centralized and expressed numerically. Frequently, the soft information is often sent forward in script format and may include opinions, ideas, predictions of economic development, plans

of managers and market reactions [1]. Eventually, the soft information can be also stored, interpreted and converted into a numerical code. The problem lie in how much original information may be lost through this process, at what expenses and how useful it can be.

Ultimate for information transmission is its meaning that can be independent of person or collection method. According with Kirschenheiter (2004), hard information is when everyone agrees on its meaning. Honest disagreements arise when two people perfectly observe information yet interpret this information differently (i.e. soft information) [2]. The type of information is fundamental in economic research because it helps to understand markets and institutional design.

Because the soft information is difficult to capture, there are more sources of hard information in use.

The type of information affects the quality of financial reporting that further influences the cost of equity capital for firms. In the economic literature there are studies (for example the works of Amihud and Mendelson (1986) and Easley and O'Hara (2004)) that suggest the fact that, increasing the quality of financial information reduces the information asymmetries and hence lowers the cost of capital [3,4]. Botosan (1997) documents a negative association between the cost of equity and voluntary disclosure level for firms with a low analyst following and no association between these variables for firms with a high analyst following [5]. In addition to Botosan (1997), Botosan and Plumplee (2002) address another question: Does type of disclosure matter? The answer is clear and starkly – the type of disclosure is critical [6].

Cohen (2006) demonstrated that there is a positive relation between investors' enquiry for some specific information and the quality of financial reporting. This is his answer to

the question: *does information risk really matter?* [7]

## 2. The Role of New Technologies

The new technologies modify the pattern of communications and thus substantially changing the performance of the markets and financial institutions, these being skilled in transmitting and processing information that are reduced to numbers. One of these changes is, therefore, an increase confidence in the hard information in the disadvantage of the soft information, the first one being more used in the financial transactions.

In the last years the society is faced with other problem – the abundance of information, partly as a reaction to an easy access to storage. But information growth can increase the difficulty of data management and data protection. An increased storage space, as a result of technology evolution, can encourage data redundancy.

## 3. The Analysis of Hard and Soft Information

The transformation of the banking system in the last decades was partly driven by different types of information used for lending decisions. On the other hand, in the last decades, the firms developed from small family business to large corporations. This change influences both, the entities that collect the information and the entities that are investigated.

Banks have been created along time deposits of information about credited institutions. This information was first collected by frequent personal contact, so that in time banks assembled more detailed images than what was available in public records.

The empirical studies support the idea that the large banks are more impersonal and less efficient at making relationship loans and growing bank size may lead to credit rationing.

Because banks were focused on those who were most difficult to observe and monitor (e.g. SMEs), most of the information that was collected was soft information. With technological advances and increased pressure from competitors (which led to cost

reduction), increased the use of hard information. The utilization of hard information brings smaller transaction costs, access to a broader market and also assures the lasting of information.

Soft information (Stein - 2002) is difficult to record [8]. Registration cost is very high. The financial institution that provides credit used to obtain the soft information only if the hard information generates contradictory signals or if it is difficult to apprehend. If the loans are securitized the lender is the investor in a security, represented by a portfolio of borrowers. Since soft information cannot be verified by an independent observer, it may not be claimed by the creditor investor. Therefore, the price they gave it to financial instruments (securitized loans) depends only on hard information. This creates a problem of moral hazard for creditor investor.

One of the great advantages of hard information is the reduction of trading costs by using less specialized employees or computers. Hard information is more conventional; it reached the same configuration and is processed in the same way for each application or transaction. This standardization produces savings in the production process through economies of scale.

Once the computer system is designed to provide credit scores, the added cost of new applications in the system is insignificant. This is one argument why loans based on hard information have become preponderant. The increased use of this information in the crediting process can lead to an increased competitiveness of these markets. First, the standardization of information and thereby the reduction of trading costs can increase the market size. The volume of consumer loans and loans granted too small companies is not high and therefore, the existence of high fixed costs may make these loans very expensive. The standardization of information through automation can reduce transaction costs enough to make these loans profitable.

Mortgage loans and credit cards (initially called credits by signature) were made in the 50s based on soft information obtained through personal contact, as then it was a local market. Now it became a national market based on hard information, often obtained through impersonal contact. This

led to a greater availability and undisputed cheaper capital for the middle class (Nocera - 1994) [9].

The quality of information can increase the market competitiveness. Once that information is systematic and easy to propagate (*hard* information), it becomes very difficult to master. In the early emergence of rating agencies, they published in their quarterly reports just a summary of the information they had about the institutions requiring credit. Quantitative information was made public and easily comparable. Those who needed detailed reports on some customers bought them. By keeping information in a way difficult to transmit and maintain the quality of soft information, the rating agencies hoped to maintain the control of them and thus obtain higher revenue from collected information.

Once that information is hard, its transmission and estimating become easier. The electronic information can be easily understood and transmitted, independent of its collector.

The information's durability is also higher when the information is hard. The fact that it can be easily stored means that its preservation for future decision is made at low cost. The fact that information can be read out of context means that it can be transmitted to people working in different parts of the organization (Stein - 2002) [8].

One reason for the lower cost of delivering hard information is that there is less information. Replacing soft with hard information inevitably results in loss of information.

The constriction of information is not desirable, mainly when there are no processing costs. Most of the soft information is obtained from lengthy discussion with the person who takes the credit. In reality, persons that are lender or are working in the risk management department have allocated a limited time for each decision. Thus, to prevent an information overload, it is necessary to reduce them to what is most important. As the organization is greater and the more we advance in the hierarchy, the more the information must be better concentrated (or decisions should be delegated).

When soft information is substituted with hard data, appear a concentration, the loss of

information being imminent. The question that arises is how much information is lost and what is their quality. The concern emerge for small companies and individuals under the increasing consolidation of banking and increasing of credit decisions based on scores for credit granting. There may be very good company but they can look bad on paper (when we look only at hard information), and they are being denied from credit.

Empirical evidence so far is mixed. It is clear that many small companies are abandoned when their banks merge, but also new small banks can cover this gap.

Rajan, Seru and Vig (2008) have shown that a model to estimate the probability of bankruptcy has been calibrated for a period with a securitization regime at a small scale, will underestimate the probability of bankruptcy in a period of massive securitization. Therefore, models used by S & P, Moody's and Fitch do not account for a variable that proved to be important - the extent of securitization phenomenon. In a market with small scale securitization developments we do not have the same type as on the market with "massive" securitization. Their study concludes with the proposal of another model, another vision of how the market progress and demonstrate the fallibility of the current models. It's not a condemnation of mathematical models but a widening of their application framework by including a broader range of variables [10].

Often, investors' losses on stock markets appear because their decisions are subjective and influenced. One of the common errors made by investors everywhere is about the fact that their investment decisions are the result of the herd effect; their decisions are similar to each other. Dependence of investment decisions of the others' is often why stock market problems appear. So, often, investors cease to invest according to their own strategies based on evidence and accurate and prefer to follow the path imposed by other investors. According to behavioural finance, the more an investor knows less the more easily it is affected by group mentality. The investors are more ignorant, the faster fall in panic, creating the premises of real stock collapse.

Looking at the role of soft and hard information in bank-firm relationships, Fredrikson (2012) argues that an information

deficit of hard information regarding a firm’s reporting conservatism is balanced with soft information obtained by using relationship lending technology [11].

#### 4. A Final Remark

On the financial markets, the price of assets is driven by various factors that are simple and correct transformed in some numeric codes. We can say that the market convert the soft information in hard information which actually is the assets’ price. Unfortunately, the academic research is still looking for a way riddle this issue.

#### 5. Acknowledgment

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# The Usefulness of Mathematical Tools for Economic Analysis

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## Abstract

*The current financial crisis generated a large debate for the degree to which the mathematical models are relevant for decision making in business and macroeconomic analysis. Instruments like Value-at-Risk, Copula functions and regressions were almost “negotiated” in the non-specialized literature.*

*The use of the mathematical tools in the economics profession and research probably started with the creation of the Econometrics Society in the 1930s and the foundation of the journal Econometrica, which, according to ISI Thomson Relative Influence Score, is the most prestigious journal in the field of Applied Mathematics.*

*This paper takes into account the ideas of normal distributions and the concepts of regression and factor analysis to present the way in which these mathematical models succeeded to create new ways of development in the field of economics.*

**Keywords:** mathematical models, normal distribution, regression analysis, factor analysis

**J.E.L. codes:** A12, C10, C20

## 1. Introduction

The current financial crisis generated a large debate for the degree to which the mathematical models are relevant for decision making in business and macroeconomic analysis. Instruments like Value-at-Risk, Copula functions and regressions were almost “negotiated” in the non-specialized literature.

Some theoretical trends in economics are trying to provide arguments against the use of the mathematical tools in decision making at the micro and macroeconomic levels. However, the main research literature

provides powerful support of these instruments and document all the research questions by using the standard regression-like approaches.

The use of the mathematical tools in the economics profession and research probably started with the creation of the Econometrics Society in the 1930s and the foundation of the journal Econometrica, which, according to ISI Thomson Relative Influence Score, is the most prestigious journal in the field of Applied Mathematics.

This Society was founded as a result of the initiatives of Irwin Fisher and and Ragnar Frisch and the journal Econometrica was issued for the first time in 1933. Since then, the products created in this journal and others developed in the field of quantitative economics developed the tools that economists need in order to make better decisions and to better understand the complexity of the factors that characterize this sophisticated system.

This paper takes into account the ideas of normal distributions and the concepts of regression and factor analysis to present the way in which these mathematical models succeeded to create new ways of development in the field of economics.

There are a few ideas that are presented: the fact that mathematical tools are in continuous development both in the mathematical disciplines and in economics, the constant treatment of the non-normal phenomena that are studied in the main economic analyses and the way in which a very simple model, like for instance the regression analysis, may induce new paradigm in the interpretation of the economic phenomena.

The arguments presented in this paper are meant to support the use of mathematical tools in economics and defend from the critiques of the “heat” of the moment.

## 2. The constant development of mathematical tools

Following the important stream that supported the use of mathematical models for decision making at the macroeconomic level, an important migration of mathematicians and physicists was felt in the second half of the last century. In my opinion there were two arguments for that: the availability of the data and the importance of prediction.

The main tools used for the economic analysis of the data started with the use of the instruments created under the framework of time series analysis. In a nutshell, this means the use of statistical tools for the characterization of variables that change with time. In time the data started to be available, first at the macroeconomic level and after that at the microeconomic one. The concept that "history repeats" was at the root of all these developments. However, since everybody needed good tools for decision making, the very idea of the way in which the fact that history repeats can allow us to make conjectures about the future was conceptualized. Therefore, ideas like ergodicity and stationarity gained momentum and their introduction in the set of assumptions started to be considered part of any standardized procedure.

The system that is stationary is a system that has stable properties and therefore at any moment in time these properties are found again and again. If this happens then we can provide information about the probabilistic behaviour of any stochastic variable. On the other hand, an ergodic variable is the one for which the properties in a sample are the same as the properties of all the population of possible realizations of the variable. This means, in a common language, that on average, the variable follows a certain track for a large period of time and for any sample it has properties that are found in any other sample.

There are tools for the analysis of these properties. As we know, econometricians develop statistical tests that may provide us with information about the fulfilment of each of these two properties. They are important because any statistical conjecture that may be formulated on time series data relies on the accomplishment of these two important properties. Actually, in case they are not

fulfilled the statistical results of any kind of analysis are false and therefore, have no economic value.

The use of this kind of analysis for all studies in economics is now a standard and it is mentioned in any book of econometrics. However the test for these properties evolved in time. The standard Dickey-Fuller test for stationarity was developed in 1979, but the standard statistical nowadays use the Augmented Dickey-Fuller test, which has been developed further on in paper in the 1980s and 1990s. The Phillips-Peron test, which also provides information about the stationarity of a time series, was developed in 1988. There are, of course other tests of stationarity that were developed after these moments. In many instances econometricians showed that the standard Augmented Dickey-Fuller test performs better in finite samples than many other tests.

This is a very simple proof of the fact that the mathematical tools are developing as time passes into more and more complex instruments that allow for better approaches to the analysis of these matters.

There are many examples of the development of these tools for economic analysis. The mathematical models are not only mere applications of mathematical tools, i.e. instruments that were previously created in mathematics, but actually a standalone discipline with the objective to create better tools needed in the process of a better understanding of the economic phenomena and useful to support the theories formulated by economists. The field of mathematical finance, for instance, is one example for this stream of arguments. On one hand it produces mathematical models in support of financial theories and asset pricing (the field of stochastic processes initiated by Merton and Black and Scholes) and on the other hand it provides instruments for the empirical analysis and measurement of the economic phenomena, useful in the area of risk management.

The creation of knowledge in this area started with a simple approximation of the reality under the form of the assumption that the central forces that generate the dynamics of prices in the market are the result of many pieces of information that impact these prices and generate the random perspective that can be observed in general, irrespective of region,

industry or cultural settings. This is translated in the assumption that the returns are normally distributed. However, since the introduction of this assumption in the finance theory, the main work realized in research dealt with the efforts to understand the errors of this approach and generate better assumptions for the characterization of the data.

Another important approach is the development of the Bayesian framework of analysis. In this respect there is need to mention the fact that this field is continuously developing and it generates a higher level of sophistication that is founded by the mainstream research results. For instance, the Capital Asset Pricing Model developed by Sharpe and Litner in 1964 is based on the Markowitz model of 1952 and is developed further by the model of Black and Litterman in 1990 in a Bayesian framework. The model turns out to have the roots in the classical CAPM model but it extends the approach further on by generating a powerful and sometimes better (i.e. supported by empirical analyses) instruments.

We should consider this stream of research as being an important proof of the fact that the research literature does not stand still. It produces new results in a continuous manner.

Therefore, the plain argument that the mathematical tools are not to be used by economists does not stand since the mathematical tools are in a continuous development. If we say that both the methods developed until now and the methods that will be developed further on are of no use then we actually disregard the progress realized until now in this field and disconsider the work of many researchers that provided tools that are used both by macroeconomists and by the entrepreneurs, since they are willing to pay for this type of research, either by hiring specialists or by contracting consulting companies able to produce such analysis (the RiskMetrics company is merely one of the many such entrepreneurs).

### **3. The normal distribution – a simple assumption**

As mentioned before, the normal distribution is a simple tool situated at the root of most of the economic analysis in the

mainstream approach. As we know, the use of this assumption is motivated by the fact that the dynamics of economic variables are the result of news appearing in the market. As such, the Law of Large Numbers shows that if the realizations of a certain variable are independent and drawn from the same distribution, then the random variable migrates asymptotically towards the normal distribution. This is actually the result of news that are influencing the values of the economic variable to go up and down according to the opinions of market participants with respect to the quality of the news.

This approach was first used by Bachelier in 1900 to generate the first asset pricing model. He considered the market price of a financial instrument to behave like a simple random variable for which the changes in the value are determined by numerous small impacts of both positive and negative signs and with various intensities. The approach is a simple extension of the physical model developed by Einstein in 1905 for the characterization of molecules that are impacting a small particle in a glass of water, according to the observations made by the botanist Robert Brown. This generated the mathematical model called the brownian motion or the simple normal diffusion process. The importance of this model for mathematical finance is extraordinary due to the fact that it introduces the possibility to characterize the economic variables by simply assuming that the factors that are influencing a variable are many, of different intensities and with different signs.

The normal distribution assumption was invalidated shortly after it was used by the Black and Scholes on one hand and Merton on the other hand. Their papers were published in 1973, but in 1976 we already witnessed the introduction of the diffusion with jumps. This is a simple model that takes into account one of the most important properties that were empirically observed in the dynamics of the returns of financial instruments – the “fat tails” effect.

Even though the normal distribution was used in his model, Merton knew that the normal distribution is the one that governs the behaviour of returns on the financial markets. Empirical evidence, acknowledged from the 1970s until the 2000s

showed that the stock market returns are not normally distributed. Cont provides important evidence in this field in a paper in year 2000. He collects all the statistical properties of the returns and call them “stylized facts”, showing that they can be found in almost all financial instruments irrespective of nature (equity, debt or foreign exchange), region, industry or national culture. Maybe there are differences in their intensities that may also change in time, but for sure they are present more in a subjective manner.

The “fat tails” effect mentions the fact that the stock market returns have higher frequencies of appearance than predicted by the normal distribution. It is a way of saying that the normal distribution underestimates the magnitude of the returns when they are very large both in the negative and the positive directions.

The very early approach to this observation was done by Merton in the jump-diffusion model but a later paradigm was generated by the GARCH (Generalized AutoRegression Conditional Heteroskedasticity) family of models in the 1980s. This is a further proof of the fact that these models are not the same as the mathematical models created at the beginning of the last century and also of the fact that there is a great deal of research in the field of relaxing the normal distribution assumption.

For instance the Value-at-Risk indicator that is used as a standard foundation for the computation of the amount of capital to leave in a current account to cover for potential losses, may be easily computed under the framework of the normal distribution but it is far more sophisticated in case we decide to compute it in a non-normal framework. In case a company decides to use the normal distribution manner of computation, then the results can be devastating in case we have a -23 sigma event (i.e. an event that is basically impossible under the normal distribution but which can be observed in the market in case of a crash similar to the one from October 1987 or the one on September 2008). We can not predict such events as they are generated by uncertain phenomena, but the risk management discipline teaches us that we can protect ourselves against them by using the correct mathematical tool for the

computation of the capital needed as a provision.

The constant focus of the literature in the field of mathematical finance to generate better instruments borrowed from mathematics or physics and adapted to finance is more than obvious. Actually all the researchers are basing their analysis on the previous works of other analysts and they made clear efforts to provide better tools.

#### **4. The regression paradigm**

The regression is probably the mostly used instrument in the field of economics. It is now considered a basic tool that is present in all the books of econometrics in their first pages. The regression is part of many analyses from the empirical use of the CAPM and APT (Arbitrage Pricing Theory) models to more sophisticated uses like the Altman model which provides the rating grade for a company in the attempt to measure the risk of default and the computation of the hedge ratio in the field of derivatives.

The regression generated a new way of understanding the economic realities. Trying to find the factors that are influencing the dynamics of a certain economic variable, we can assume the fact that this variable is determined by some (usually few) factors that may be more important and by many others that are numerous, have small impact and manifest both positive and negative effects on the respective variable. This produces the phenomenon of compensations that are common in the impact of factors on the dynamics of the economic variables in general. According to a standardized statistical result, these compensations converge asymptotically to the normal distribution, which is a mathematical tool that we can easily understand.

Starting with the use of regression, we can base all the analyses realized in economics by the fact that the random variables are influenced by some factors and, if we can identify these factors, then we can explain part of the behavior since the rest of the variation of the respective random economic variable is characterized by the normal distribution because each of the rest of the factors have the tendency to influence the variable in a lower extent.

This made way for a better approach to

analyze the behaviour of random economic variables. If we understand that each of these variables may be the result of some other factors then we can find their implications and we may determine the economic forces that are generating these dynamics. The paradigm of factor decomposition is not supported by any other approach and it is suitable for the statistical techniques developed in mathematical finance.

## 5. Conclusions

If there is a problem in the use of mathematics it is actually in the fact that the people using these tools are not using the correct ones. The history of the use of mathematical tools for economic issues shows a great deal of efforts in the direction of the development of better instruments that cover a wider set of possibilities and that relax the set of assumptions. The mathematical construction of any kind of argument is a powerful one and relies in the field of logic. If there is a problem in the reasoning then this problem is necessarily a break in the logic.

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# The Impact of IFRS Conversion in the Romanian Banking System

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## Abstract

*Globally, the recession has forced an important rethink on the banking industry, with banks having to reconsider the fundamentals of their ways of doing business. This is all the more so, given the high profile bank failures in 2008, and the subsequent negative publicity as governments were forced to intervene to protect the sector from collapse. But, currently, they face a challenging future due to the fact that National Bank of Romania (“NBR”) and the Ministry of Public Finance committed to adopting the legal framework necessary for the implementation of IFRS by Romanian banks starting with the financial year ending 31 December 2012.*

**Key words:** banking, conversion, IFRSs, loans, provisions.

**J.E.L. Classification:** G21

## 1. Introduction

The objectives of the present paper are to identify the most important accounting change impacts on business processes, systems and data resulted from the IFRS conversion of Romanian Banking System starting with 1st January 2012.

National Bank of Romania issued the Order 27/ 2010 “Accounting regulations in accordance to international reporting standards for credit institutions” and a new IFRS chart of accounts.

Romanian banks will need to adapt to the new legislation, and therefore to commit significant capital and human resources for this purpose. Introduction of global standards will help many banks to make savings and

Improve the efficiency of the finance function.

Many developed countries, including the European Union and Australia implemented

IFRS in 2005. This was a big step which involved many challenges, but it has also brought significant benefits on the long run.

## 2. Content

The first difference between IFRS and the local reporting standards is that the IFRS includes a conceptual framework. The principles set out in this framework provide a basis for setting accounting standards, and a point of reference for the preparation of financial information where no specific guidance exists.

Under IFRS, financial information must possess certain characteristics for it to be useful. The IFRS Framework requires that financial information should be understandable, relevant, reliable and comparable.

Romanian GAAP information disclosed in financial statements must be understandable, reliable, and comparable and is considered from the viewpoint of materiality (comparable to IFRS). A general rule applies that entities are required to maintain their accounting records correctly, completely, conclusively, understandably, in a clear format and in a manner ensuring permanence of accounting records.

## 3. Amortized cost valuation

Under IAS 39 loans are carried at amortized cost with the use of effective interest rate, the method not used under RAS by the Banks, where the commission are deferred mainly using the linear method.

In accordance with par. 9 of IAS 39 the amortized cost of a financial asset or liability is the value of the asset or liability measured at initial recognition minus principal repayments plus or minus cumulative amortization using the effective interest rate method of any difference between the initial amount and the maturity amount and minus

any reduction (directly or through the use of an allowance account) for impairment and uncollectibility.

Therefore, to determine the amortised cost of a financial asset or liability (or a group of financial assets or liabilities) and allocating the interest income or expense to appropriate periods it is necessary to use the effective interest rate method.

The effective interest rate is the rate which discounts exactly the estimated future cash flows or payments made in the expected period to maturity of a given financial instrument and in justified instances in shorter periods – to the net carrying amount of a financial asset or liability. Calculating the effective interest rate requires the Bank to estimate the future cash flows, accounting not only for interest and principal payments but also for all commission received and paid which in accordance with IAS 18 constitute an integral part of the effective interest rate, transaction costs, premium or discount and other cash flows resulting from the provisions of the financial instrument contract, including advances, call options etc. Future cash flows should not, however, take into consideration potential future losses related to the uncollectibility of loans.

In order to comply with IFRS requirements, the banks should first revise their accounting policies with a change in the method of loans valuation, including the description of effective interest rate calculation algorithms and the list of commission, if any, to be included in the effective interest rate.

Upon conversion, the Bank should produce a complete list of loan related commission income together and decide for each item on the appropriate accounting treatment under IFRS.

Also, the banks should update accounting the monographs with respect to booking of commission amortization but also to revise their internal chart of accounts from internal systems, in order to include new accounts for booking deferred commission.

#### **4. Impairment model**

IAS 39 contains specific requirements for impairment of financial assets. The basis of the measurement of the loans is the present value of the future cash flows expected to be

generated by the loans. Under RAS the Banks used to apply to loans prescribed coefficients in order to calculate provisions.

The Banks needs to adjust the accounting policy with respect to impairment rules as defined by IAS 39. It is recommended that the general accounting approach is described in the accounting manual.

Chart of accounts should also be revised to include new accounts for booking impairment allowances.

#### **5. Unwinding interest**

IAS 39 requires recognition of interest income on impaired loans calculated with the use of effective interest rate on the net exposure; under RAS the Banks stops accruing interest income on loans 180 days past due and for loans below 180 days past due interest income is accrued but provisioned with the use of the same coefficients used for provision calculation.

In this respect, new accounting policies with related to recognizing interest income on impaired loans need to be revised.

#### **6. Write-offs for loans**

Under IAS 39 the assets can be written off only if they meet the derecognition criteria as specified by IAS 39 or the asset does not meet the definition of an asset anymore i.e. it is not probable that future economic benefits will flow to the entity.

Although the current treatment of the Banks with respect to writing-off loans falls within the derecognition criteria of IAS 39 (as RAS rules are more strict than IFRS), it is recommended that the Banks revises their approaches and updates the accounting policies accordingly.

Establishing criteria for write-off should be aligned with the development of impairment methodology and should take into account the current collection process.

#### **7. Disclosures**

IFRS contain broader disclosure requirements relating to financial assets than RAS.

Therefore, disclosures relating to loans and loan impairment need revision compared

to the prior years financial statements. Also the changes in the IT systems will have an impact on the source data for disclosures.

### **8. Accounting for AFS revaluation**

Under IAS 39 any gain or loss on AFS (available for sales financial instruments) shall be recognized in other comprehensive income except for impairment losses, interest accrued and foreign exchange gains and losses on monetary assets. Under RAS unfavorable differences to fair value are recognized in the current profit and loss account, while favorable differences to fair value are not recognized.

Accounting policies with respect to revaluation of AFS securities to fair value need revision, so that gains and losses from revaluation are recognized against other comprehensive income and accrued interest, FX differences on debt securities and impairment losses are recognized through profit and loss account.

### **9. Fair valuation of debt securities**

IFRS contain guidance on the fair valuation, including the following: if the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique; if there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.

In order to implement this requirement, a new process of assessing whether the market for securities is active or not active needs to be put in place in the banks. . According to IAS 39 published price quotations in an active market are the best evidence of fair value , therefore it is recommended to be used directly market quotations based on an established procedure e.g. market prices are taken directly from the source (e.g. Bloomberg, Reuters) at a certain hour on the last day of the month. Documentation of this procedure needs to be established e.g. archiving print-screens from the source of market quotations.

### **10. Embedded derivatives**

Under IFRS an embedded derivative should be separated from the host contract and accounted for as a derivative. RAS does not mention embedded derivatives. There might be differences in interpretation whether there is or not a financial instrument with embedded derivative.

The solution would be to design and implement a documented process for embedded derivatives identification. Verification of the existence of embedded derivatives should be performed when a new product is offered to clients, through a review of the implications of contract clauses.

Upon conversion to IFRS for statutory purposes the Banks might also reviews existing contracts (financial instruments and non-financial contracts) in order to identify any existing embedded derivatives.

### **11. Fixed and intangible assets**

Moment of starting the depreciation under IFRS shall begin when the asset is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management; under RAS the practice is to start depreciation in the month following bringing the asset into use.

Impairment under IAS 36 requires assessing at each end of the reporting period whether there is any indication that an asset may be impaired. If any such indication exists the entity shall estimate the recoverable amount of the assets. IAS 36 defines to thresholds for the impairment test (recoverable amount and value in use) which is distinct to the RAS requirements.

Bank may prepare a procedure for impairment testing under IAS 36, containing a documented assessment at each balance sheet date whether there are any indications of impairment and carrying out impairment test if there are such indications. E.g. a decline in the value of market prices of property could be defined as an indicator for carrying out impairment tests on property.

Useful lives under IFRS are strictly defined as are currently under Romanian legislation. Therefore, the banks should review the amortization rates to ensure that they follow the expected useful economic

lives of the assets. Specifically if there are assets which are fully depreciated and still in use it may suggest that the depreciation rates applied are too high.

Residual value – under IAS 16 depreciable amount (i.e. the amount actually charged to profit or loss over the life of the asset) is calculated by deducting the residual value from the cost or valuation of the asset. IFRS also state that an entity must review the residual values of all its items, and therefore all parts of them, at least at each financial year-end. Upon conversion to IFRS for statutory purposes it is recommended that the Banks review existing fixed assets in order to verify their residual value and if applicable, introduces these values in the fixed asset register. Also, a new process should be put in place of documented assessment at each financial year-end whether there are any changes to the residual value of fixed assets.

### **12. Deferred tax**

Under IFRS, for temporary differences, differences between the carrying amount of an asset or liability in the balance sheet and its tax base the entity should create deferred tax asset or liability, while under RAS deferred tax is not recognized.

Additionally, IAS 12 restricts the recognition of deferred tax assets to the extent that it is probable that taxable profit will be available against which the underlying deductible temporary differences can be utilized.

IAS 12 also requires a disclosure on the reconciliation of the nominal tax rate and effective tax rate.

In order to adapt to the change above, the Banks may prepare a pre-defined schedule for the calculation of deferred tax assets and liabilities, which should include for each item of the Bank's balance sheet a comparison of the carrying amounts with their tax base with the reconciliations of these amounts to the accounting and tax records. In addition, as a control procedure and for the purpose of preparing the required disclosure in the financial statements, there should be a procedure implemented of reconciliation of effective tax rate to nominal tax rate

### **13. Definition of IAS 24 and scope of related party disclosure**

While IAS 24 has specific guidance about when a person/ company should be recognized as a related party, RAS has no guidance related to this; disclosure scope is also different. I point out that close family of key management and companies controlled by banks should be identified as related parties. The related parties disclosure note to financial statements under IFRS should include in particular the presentation of the amount of the transactions e.g. the volume of loans granted to related parties or the volume of deposits received from related parties during the reporting period (not only outstanding at the balance sheet date as presented in the previous financial statements) and disclosing the fact whether these transactions are secured (if applicable); the presentation of guarantees given or received; describing the terms and conditions of the main related parties transactions.

Presentation of the balance sheet, profit and loss account and the statement of other comprehensive income – IFRS contain specific requirements to the presentation or the main statements which is different to RAS.

The main points to be taken into account are, among others: presentation of the balance sheet should be made in order of liquidity (improvements to the previous presentation in the IFRS financial statements recommended); separate presentation of assets/ liabilities arising on derivatives and current tax receivable/ liability; Interest accrued and EIR adjustments presented together with the related assets/ liabilities carried at amortized cost; No items of income and expense are presented as “extraordinary”.

### **14. Conclusion**

The papers aim is to outline some of the main changes brought by the IFRS conversion taking place in the Romanian banking system.

These changes are significant, and the best way to reduce the burden of implementation and gain the most benefits is to act early and to perform periodically testing procedures. The convergence of IFRS is currently implemented in most of the banks.

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# Virtualisation the Accounting Information System Infrastructure

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## Abstract

*Cloud Computing is a form of globalising IT&C services and represents one of the main solutions to the current issues of global economy with a view to cutting operational costs and focusing on IT&C services in several global conglomerates. Cloud solutions save companies costs on servers, licences, software, hosting, collocation, maintenance, highly specialised technical personnel, updating and upgrading of all kinds, by using a single service. This paper aims at presenting the current issues of increasing the efficiency of the computing system infrastructure which assists the accounting of companies. We have analysed aspects related to concepts such as Cloud Computing, Infrastructure as a Service (IaaS) and Virtualisation. Moreover, the essential features, the models associated to the cloud computing concept are highlighted as well as the advantages of the virtualisation of the accounting information system infrastructure.*

**Cuvinte cheie:** Cloud Computing, IaaS, PaaS, SaaS, Virtualisation

**Clasificare J.E.L.:** M4, F3, H8, Q56, D8, G1, L8, C6, C8, D5, L6,

## 1. Introduction

Recession starting in 2008 has determined companies to face pressure related to making costs more efficient. Such companies understood that Cloud Computing technology brings along flexibility, scalability, and a significant reduction of operational costs. Along with Cloud Computing, virtualisation represents a technique to create a virtual version of the features of a computer, such as its hardware components, the operating system, the storage environment, etc.

Therefore, companies are no longer interested in purchasing licences, hiring specialised personnel, in their hardware redemption, maintenance, and upgrading. Motivation to purchase IT&C solutions is increasingly dependent on cutting costs, the infrastructure security, and efficient management of resources. Many companies are sensitive to security needs, confidentiality, and selective access. There is an increasing number of companies with employees working from remote locations or who are travelling, or sub-contracting companies. In both cases, the need for security and confidentiality is an absolute priority. Therefore, the lines below deal with the concepts of Cloud Computing and Virtualisation and their impact on the accounting information system infrastructure.

## 2. Cloud computing

Cloud Computing System is a solution to using external computing resources, which can be configured to meet the customer's needs: servers, storage space, applications, and services. Cloud can be used on demand and in elastic quantities. Cloud Computing System represents a model of on-line service and application supply and does not require own infrastructure or software licenses, such resources being accessed via the Internet from a simple terminal or by means of mobile devices. AppNor definition [08]

The United States National Institute for Standards and Technology (NIST), an authority in the field, defines cloud computing as a model of access services via network (Internet) to distributed computing resource systems that can be configured on demand (servers, storage space, applications, and services). Such systems can be made quickly available requiring minimum management and intervention efforts from both the customer and the provider. Access is

convenient and can be made from anywhere and the user does not need to know the location or configuration of the systems supplying such services. Or more simply expressed, applications and data run and are stored elsewhere than the servers of the user who can have remote access to them (e.g., via the Internet but not necessarily). [07]

The essential features of Cloud Computing System:

- Resources are available on demand. A consumer can secured unilaterally computing capacities such as server-time and storage capacities (e.g., network storage), according to their needs, automatically, not having to conduct human interaction with each of the services providers;
- Access to broad band network. Capacities are available in the network and accessed via some standard mechanisms, which promote the use of a heterogeneous platform (i.e., mobile phones, laptops, iPads or work stations);
- Resources are shared. The computing provider’s resources (i.e., network storage, processing capacities, memory, and network band) are reunited to serve more consumers by means of a multi-tenant model (i.e., more so-called tenants), with different physical and virtual resources dynamically assigned according to the consumers’ demand. The term of independence of location where resources are available is introduced;
- Elasticity / Scalability. Capacities are “elastic” in order to secure a fast scaling “upward” or “downward” according to the demand of resources. To the consumer, the available computing capacity seems to be unlimited and can be assigned in any quantity, at any time;
- Measuring the services. Control systems in Cloud control and optimise automatically the use of the resources by means of measuring mechanisms at an abstract level tailored to the service type (e.g., data storage, processing, band width, and the number of accounts of the active users). The degree of the resources use can be monitored, controlled, and reported to ensure transparency both to the provider and to the consumer of the used services. [05]

Cloud Computing Implementing Models:

- Private Cloud. The cloud-type infrastructure is designed to the exclusive use of a single organisation which has many consumers (business units). It can be owned, managed, and operated by an organisation, a third party company, or a combination thereof and can physically exist ‘on-premises’ or ‘off-premises’;
- Community Cloud. The cloud-type infrastructure is designed to be exclusively used by a specific community of consumers in organisations that share preoccupations or interests (e.g., mission, safety requirements, policy or compliance issues). It can be owned, managed, and operated by an organisation, a third party company, or a combination thereof and can physically exist on-premises or off-premises;
- Public Cloud. The cloud-type infrastructure is designed to the open use of the public. It can be owned, managed, and operated by an organisation, a third party company, or a combination thereof. It is located on the Cloud Computing provider’s premises;
- Hybrid Cloud. The cloud-type infrastructure is a combination of two or more distinct Cloud infrastructures (e.g., Community, Private, or Public), which remain single entities but are connected by a propriety or standardised technology that allows for the portability of data and applications on demand. [05]

Models of usual Cloud Computing-based services:

- Software as a Service (SaaS). Customers use applications made available to them by the provider and such applications are hosted on a cloud-type infrastructure. Applications are available “on demand,” from various devices, via a web-browser-type of interface (e.g., web mail), or via the interface of a dedicated application. The consumer needs neither to administer or control the basic infrastructure behind the applications (including the network, servers, operating systems, data storage) nor the application itself, except for the limits imposed by the settings of the application based on the types of users;
- Platform as Service (PaaS). The capacity provided to the consumer to implement,

install, and use on the Cloud infrastructure of the provider’s applications created or purchased by the customer, by using programming languages, libraries, and tools supported by the provider. The consumer does not administer and control the basic infrastructure, including the network, servers, operating systems, data storage – but is in control of the applications installed and configuration settings and, possibly, of the host environment of such applications;

- Infrastructure as Service (IaaS). The capacity provided to the consumer by ensuring the computing power, storage space, connectivity as well as other fundamental resources. In this case, the consumer is able to implement and run their own client-software, which includes the choice of the operating systems and applications they are to use. The consumer neither administers nor controls the basic infrastructure but is in control of the operating systems they installed as well as a possible limited control over the selection of the network components. [05]

Benefits of Cloud Computing System:

- Low costs. Costs incurred by IT necessary to a business can be cut down to 30% - 40% over a three to five year span. On a medium to long term, investment costs (CAPEX - Capital expenses) will turn into operating costs (OpEx - Operating expenses) which is beneficial to most companies. IT costs which can be cut down and redistributed are those costly investments in infrastructure (e.g., servers, network equipment, equipment mandatory to set up a data-centre or server-room facility), licences, maintenance and repairs, operating / administering, data archives, and redundancy;
- Performance. The computing power, or MIPS, as performance indices can exceed by far the capacity of the infrastructure in an ordinary company. But the real benefit in terms of performance comes from the fact that all systems in a Cloud are constantly monitored for the best distribution of resources and for hardware breakdown likely to occur to have no

consequences and to be able to be repaired without bringing the systems to a halt;

- Security of data. Cloud computing providers implement highly updated solutions for data backup and redundancy. The prevent data loss and a client will most often not be affected in case a storing unit has broken down. Moreover, the same provider may have more data centres in different geographical locations and will use more Internet providers and utilities (power supply, for instance), as the end goal is protection against disaster (irrespective of their nature) and securing the on-going development of the business;
- Scalability / Elasticity. Most companies size their infrastructure so that they can withstand peaks. Consequently, the average use is far below their real power. Cloud computing allows for a dynamic distribution of resources and proportional payment for services. This means that a company can distribute a larger amount of supplementary resources for a strictly limited time without incurring significant supplementary costs.
- Security of information. All cloud providers should implement a set of standards so as to cover all customers’ protection related issues. Most providers have already complied with known and accepted standards such as ISO 27001, PCI DSS, COBIT, and the solutions they offer are better than what their customers can implement. To mention only a few, physical protection of the infrastructure, encrypting, powerful authentication mechanisms, warning and alarm systems in case of unauthorised access;
- Mobility. In Cloud, data can be accessed at any given time and from anywhere, from any device connected to the Internet. This means that users and customers can access data via a web-browser from their office, from home or when travelling by using the laptop, an iPad, or a smart phone. [04]

### 3. Virtualisation the accounting information system infrastructure

Virtualisation is an IT&C architecture concept which allows sharing and assigning hardware resources of a server in more virtual machines (VM). Thus, the possibility of more operating systems running simultaneously on a single hardware platform is created. Virtualisation involves the running of an operating system on virtual machines (computers) simulated with the help of a dedicated software application. Such applications can emulate the operation of all components of a real information system (e.g., FDD, CD-ROM, HDD, memory, CPU, USB devices, network board). The virtual machine consists essentially in a folder of variable dimensions which simulates the hard disk and other several folders that contain the configuration of the respective machine. The computing power and the RAM memory are shared from the real machine resources whereon the emulation application is installed. [11]

Virtualisation allows for more virtual machines - with heterogeneous operating systems - to run separately, one beside the other, on the same physical machine. Each virtual machine has its own set of virtual hardware whereon an operating system is loaded together with and applications as well. One can copy, move, or save very fast a virtual machine so that in case of disaster the entire system can be restored even in a few seconds. Virtual machines are isolated from the host-machine or from other virtual machines and, should one virtual machine block, the rest are not affected. [10]

Virtualisation allows the users to maximise physical resources most efficiently. The functions of the virtualisation server allow more systems to run independently on a single computer. Virtualisation of the server transforms the hardware into software, creating thus a virtual hardware resource on a server which incorporates CPU, RAM, and hard disks. The computing resources of the physical server are gathered and used by the virtual server in a controlled manner. By virtualisation, the data (i.e., information), do not leak beyond the virtual server and the applications can only communicate over the internet connections.

There are two types of virtualisation:

virtualisation based on software and virtualisation based on hardware. In a software virtualisation environment, virtual machines actually share the same kernel and use the resource of the main node. As a rule, this type of virtualisation has very many benefits in the field of hosting as resources can be assigned dynamically in real time without the need to restart the node. In a hardware virtualisation environment, the virtualisation mechanisms partition exactly the hardware resources. Limitations are hardware and can be modified only if the instance of the virtual machine is restarted. It is commonly used in the enterprise/commercial environment.

Advantages of AISI virtualisation:

- Cutting down the administration and IT&C infrastructure costs;
- A greater flexibility by introducing some new software applications in a very short time;
- Cutting down costs incurred by technical human resources by means of a simpler administration of the servers;
- Increasing efficiency of the physical resources existing on the server;
- Reducing non-operating time in case of errors or unexpected interruptions;
- Reducing power consumption by the necessary reducing hardware resources;
- Increasing the employees' productivity by means of automatic installation of software and applications in the virtual environment and their dynamic updating;
- Increasing efficiency of the IT infrastructure by means of a better use of physical resources available on the server and, depending on circumstances, their sharing with all servers in the company;
- Cutting down the number of incidents triggered by the incompatibility of software resources.

Depending on the needs and characteristics of your company, virtualisation services rely on Beck et al. applications.

### 4. Conclusions

Cloud computing will have an impact on organisations, companies, and private users and will change the meaning of the concept 'computing power' as we understand today.

Benefits such as speed, collaboration, scaling, and availability, combined with possibilities to reduce costs by means of optimised and efficient calculation are attractive to many providers but mostly to potential beneficiaries. Therefore, Cloud Computing and Virtualisation respond to the market demands with respect to cost reduction and flexibility at economically insecure times. If by virtualisation multiple virtual machines, with heterogeneous operating systems can run separately, one next to the other, on the same physical machine, by means of cloud computing almost all necessary resources can occupy a position on the Internet and share, sometimes, even among users who are completely independent from one another: software (programs) and data/information are downloaded from the Internet on the user's computer on demand, as if they were mere utilities such as water or electricity. Companies with dynamic, adaptable, and flexible infrastructures can focus on cost reduction, risk management, and improvement of service quality. A critical component of dynamic infrastructure is virtualisation. Created to simplify, consolidate, and improve flexibility and performance in server clusters, solutions for data storage and information networks, virtualisation can improve the use of company resources; it can reduce the operating complexity and related costs; it can help a company respond faster and more efficiently to the changes in the economic environment.

## 5. Acknowledgments

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## Accounting Information System Infrastructure as a Service

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### Abstract

*Why Infrastructure as a Service? Because by finding an answer to this question, we will find solutions relevant both to the reduction as much as possible of initial costs incurred with the IT&C infrastructure and to a better control of the operational costs such as services delivered very fast and meeting the contract requirements in terms of quality, security in continuing the business and control over investment. The paper aims at presenting the current issues related to increasing the efficiency of IT&C services which assist the company accounting. The paper analyses aspects referring to the concepts of Infrastructure as a Service and outsourcing IT&C services related to such infrastructure. Moreover, the paper highlights the advantages, the disadvantages, and the risks associated to the concept of Infrastructure as a Service as well as the benefits of applying these new technologies to the process of outsourcing IT&C services assisting the company accounting.*

**Cuvinte cheie:** Cloud Computing, IaaS, Virtualisation, Outsourcing

**Clasificare J.E.L.:** M4, F3, H8, Q56, D8, G1, L8, C6, C8, D5, L6,

### 1. Introduction

The current issues of global economy have prepared the ground for the new trends in information technology and communication, highlighting now outsourced services, a concept of a major interest from the point of view both of reducing IT&C infrastructure costs and of environmental protection. In the current globalising context, information has become the bridge built to help business sustenance and competitive advantages. Besides the trends in the field of information

technology and communication, the importance of being informed and knowledgeable outlines the necessity of extending and modernising the computing infrastructure of the companies. But as the world continues to develop IT&C technologies, as the world becomes increasingly interconnected and more intelligent, the ability to manage and deliver reliable information and knowledge, as strategic resources, becomes the critical element which makes organisations more intelligent and more competitive. The explosion of information can truly be turned into a business opportunity form many organisations. Lacking a dynamic information infrastructure, many people will realize that they face higher operational costs and a greater exposure to business related risks as they try to obtain new visions in order to make better business decisions. The following lines present the analysis of the concepts of Infrastructure as a Service (IaaS) and outsourcing services used to assist company accounting.

### 2. Accounting information system infrastructure as a service (AIS-IaaS)

Accounting information system infrastructure the AIS-IaaS provides represents the outsourced services of the companies' IT&C infrastructure – including “on demand” dedicated servers and virtual servers meant to address companies. Thus, companies can benefit from the latest generation equipment and services infrastructure without having to purchase and “in house” administer such infrastructure. This service addresses mainly the large and medium-sized companies which need a dynamic scalability of the infrastructure, i.e., an increase or decrease of IT&C resources in real time according to the development of the business.

Companies oriented toward a fast response to the market requirements can opt more easily for investing in key competencies, in extending their operations on other markets or in their solution portfolio while reducing their IT&C infrastructure-related costs by 40% by means of outsourcing such services.

The provider can offer high-performance hardware, on-going monitoring of the service by a specialised team, support via telephone or e-mail, a high level of security, network speed and availability, guaranteed connectivity via VPN or Internet for an unlimited traffic volume based on a monthly subscription. [02]

A dedicated server means a server tailored to the beneficiary's needs the provider makes available for the customer and that operates only for such customer. A dedicated server means increased security, flexibility, speed and stability, the beneficiary being the only one to have access to such server. A virtual server offers the power and freedom of an environment similar to the one provided by a dedicated server at a much lower price. The highly advanced hardware configurations of the server ensure maintaining and almost instant response time at an amazing peak transfer rate. The virtual server offers an unparalleled level of freedom allowing for full control and access route at all levels of the environment assigned to the beneficiary on the server. [05]

Infrastructure as a Service (IaaS) or Hardware as a Service (HaaS) provides hardware so that the customers can install what they may want and instead of purchasing servers, software, racks and paying to the data centre for the space assigned, the beneficiaries of such services rent such resources (i.e., space on the server, network equipment, memory, CPU cycles, storage space). The IaaS or HaaS requirements are: agreements at the service level (SLA), available hardware, network, internet connectivity, virtual environment, and utility-type payment. We should also add that SaaS and PaaS provide applications to beneficiaries whereas HaaS does not. [06]

The main benefits of AISIaaS, besides cutting down costs by 40% of total costs of having expensive technologies, are: • cutting down personnel-related costs (especially in cases requiring advance technical expertise); • increasing productivity; • support and

expertise specific to the business; • equipment / resources procurement is less time consuming; • based on SLA (service level agreement), the system ensures a high level of inter-operability and availability • Infrastructure can be dynamically scaled upward and downward, based on the needs for resources required by the applications; • equipment can serve to more customers at the same time (multi-tenant); • resource consumption is paid as utility, hence, the providers cash as resources are used; • Providers offer a higher level of availability of data and a better protection against disaster, at lower prices, for an increased redundancy and reliability; • elimination of costs related to data-centre (or server-room, in its traditional meaning): cooling equipment, physical access protective systems, utilities, fire-prevention measures.

### **3. Services of the accounting information system infrastructure**

The main services of the accounting information system infrastructure (AISI) can be outsourced, together with their related problems and the benefits which may be generated as a result of their outsourcing. Such issues are dealt with below:

- IaaS (Infrastructure as a Service) - Infrastructure that adjusts to the beneficiary's business - the provider undertakes to provide high quality services in the field of data and applications protection and management. The provider has the latest technologies to enable them provide the best services of dedicated servers, virtual servers, storing on demand and data protection. For all such services, the provider makes available for their customers a wide range of configurations and equipment from the best manufacturers, hosted on the provider's own Data Centre. Benefits: • cutting costs, scale savings - by using efficiently the resources made available by the Provider; • On Demand - the provider's infrastructure is permanently and promptly available to ensure the needs to supplement resources, as per the customer's business needs; • "Pay as much as you use" - the provider offers their customers the optimal costs/benefits ratio; • transfer of responsibility for the

- administration of the infrastructure to the provider’s experts, based on a strict SLA;
- monitoring and technical support are ensured on a 24/7 basis by a specialised team;
  - a high level of security and availability of the infrastructure hosted by the Data Centre;
  - Eliminating investments in a Data Centre, equipment and licences as they are made available by the Provider. Thus, the infrastructure becomes an operational expenditure;
  - predictable budget, depending of the existing needs, based on fixed monthly costs which leads to eliminating redemption of investment.
- VPN Connectivity & Internet - The performance of connectivity services supplied is ensured by the presence of the largest connectivity providers in the country. Redundancy is ensured via different access ports to the Data Centre for each communication provider. Numerous methods and channels to access technologies allow the provider to guarantee both the security of the network and their flexibility. The data centre is connected via optic fibre to the national and international providers’ networks by using a multitude of links, which secures significant band capacities. Benefits: • fixed monthly cost including unlimited traffic, connection administration, and monitoring by means of appropriate equipment; • an IP platform allowing the beneficiary free communication even if document exchange, IP voice or even video conferences is involved; • the possibility to organise the applications which are used by the beneficiary for certain groups in order to operate more easily and to prioritise according to their needs; • the possibility to centralise expensive resources within the network whether one or more locations are involved without imposing distance-related limits; • the ability to choose that more working stations communicate among to one another directly or only via the central office; • the certainty that the provider is close by in case the installation of a new presence point is required to extend the business; • Service Legal Agreement to be signed by both parties as a warranty for the provider’s services.
  - Hosting and collocation - Collocation Services shall secure hosting for equipment in the provider’s data centre, releasing the beneficiary of such costs and the effort involved in developing an in-house storing area, including specific requirements related to security, fire-prevention, and cooling. Benefits: • specific storing areas for one or more servers; reduced fixed costs - without supplementary expenditure for power supply, air conditioning, or security; • fast installation; • high security level data centre and networks; • the provider can secure cabling services from the chosen server; • permanent, i.e., 24/7/365, support within the data centre; • access to the provider’s data centre resources; • ownership over hardware and all components in the life cycle of the equipment; • on demand, the Provider can offer professional services or Managed services.
  - Hosted Storage Space - Hosted Storage Space services are designed to help the beneficiary simplify the process and cut costs related to storing data and to meet the needs for increased security of the data handled within the organisation. Benefits: • a high degree of availability and scalability without massive capital investment; • sizable reduction of costs for premises, equipment, and administration; • increase of efficiency and retrieval of data in case of disaster/continuity of business; • saving and keeping data in a secured environment - Data Centre; • dynamic dimensioning of the storing area and contracting thereof depending on current needs at a given time; • compliance with regulations in force in the organisation’s operating field; • the beneficiary’s servers will use the storing services as on any other disk and can access the storing capacities of hundreds of TB; • consulting and support on a 24/7 basis offered by a professional team based on a SLA; • support for multiple storage tiers; • no time consumption on negotiations with storage services providers; • Transparent, easily predictable and budgeting costs.
  - Virtual Tape - replication services for the

- data saved in virtual tape libraries (VTL – Virtual Tape Library), in the Provider’s Data Centre, can be used by beneficiaries depending on the storage space required at a given time, on the availability degree required for VTL equipment, and on the number of subsidiaries for which centralising data saved is desired. Benefits: • high level of performance, higher than tape storage technologies, secures the reduction of back-up windows and restoring the duplicate data; • efficient use of storage space by eliminating duplicate data; • a high degree of availability, scalability, and reliability of the duplicating infrastructure; • protection of data against unauthorised access - data encryption; • efficient use of data connection for duplication, by data de-duplicating and compression before duplication; • reduction of costs related to communication lines for duplication by using standard IP VPN connections; • elimination of costs related to physical storage and moving tapes to other locations with a view to securing the data saved in case of disaster; • reduction of costs related to premises, equipment, administration, and maintenance services and hardware support; • saving and keeping data on virtual tapes within a secured environment - Data Centre; • dimensioning and contracting the storage area depending on the needs and dynamic development of the storage capacity and of the performance level and availability, on demand; • compliance with the regulations in force in the field; • support for multiple storage tiers; • a single fee, a single contract, including support services; • Duplicating Services on Virtual Tape helps the beneficiary plan, design, implement, integrate, administer, and optimise storage infrastructure for back-up depending on the need at a given time.
- Secure Remote Replication - By using duplicating services, the beneficiary’s data are saved continuously, synchronously and asynchronously, in a data centre built to meet the latest technological standards, and the critical production applications will be restarted in case of disaster in this data centre in the shortest time possible, on dedicated back-up servers. Benefits: • high degree of availability, scalability, and reliability of the duplicating infrastructure; • securing consistency of duplicate data by integrating them with the production applications; • minim impact on the application performance during data duplication; • reduction of costs related to area, equipment, and administration; • securing retrieval of data in case of disaster/continuity of business; • duplicating and keeping data in a secured environment - Data Centre; • dimensioning and contracting the storage area depending on the needs and dynamic development of the storage capacity and of the performance level and availability, on demand; • compliance with the regulations in force in the field; • consulting and support on a 24/7 basis offered by a specialised personnel; • support for multiple storage tiers; • a single fee, a single contract, including support services; duplicating service helps the beneficiary plan, design, implement, integrate, administer, and optimise the primary storage infrastructure for data duplication depending on the needs at a given time.
  - Cloud Back-up & Recovery - Availability, security, and flexibility to protect the most important data of the company by means of Cloud Back-up & Recovery. Benefits: • facilitates managed-type protection of critical data both on-site and off-site in order to enhance availability; • allows for the reduction of total costs by choosing a cloud back-up solution; • facilitates management of regulations in certain industries; • facilitates installation process; • a high security level, as this is one of the most secure platforms of security data in the industry; increases profitability and reduces risks; • Continuous Data Protection (CDP), which refers to the fact that the data are automatically protected whenever change is operated thereon (asynchronous back-up).
  - Hosted Video Monitoring & Archive (HVMA) - live access to footage recorded in remote locations via Hosted Video Monitoring & Archive (HVMA).

Benefits: • video surveillance over the Internet is an attractive and efficient method from the point of view of costs as compared to traditional alternatives; fixed monthly costs for SaaS service and eliminating initial and operational costs • easy integration to any IT infrastructure; • possibility to visualise live directly in the browser of the video content at quality standards that can be customised; • programmed recording of footage; movement detection/recording; • saving footage in archive via browser; • storage / back-up for recordings; • various level of accessing video cameras / recordings; • e-mail alerts; fast and easy capability to scale; • Independence from special network cables or other analogical equipment; • much larger volume of digital images that can be gathered; • higher efficiency as compared to tape recording; • faster auditing when incidents are reviewed; • monitoring can be conducted from anywhere via web-based applications. [08]

#### 4. Conclusions

Outsourcing services of the accounting information system infrastructure will determine a dramatic change of business over the following years. The higher and higher pressure put on increasing operation efficiency and implicitly the sharp reduction of costs is only one factors f change. The development of the technological complexity, the need for automation, standardisation, and simplifying operations efficiently as well as the orientation toward dynamic, scalable resources are only a few of the trends that influence the way companies will approach the issues related to the accounting information system infrastructure. On the other hand, the possibility of using the infrastructure and the applications as services without making any significant investments (IaaS – Infrastructure as a Service) makes outsourcing such services one of the strategic options more and more frequently adopted by the top management. Outsourcing IT&C services represents a safer and less costly alternative than developing and maintaining the company own infrastructure, in-house developed applications, or purchasing licensed applications. Such scenario requires

considerable financial and human resources. Moreover, costs are minimal and predictable and the company resources can be focused on strategic functions.

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## Influence of Tax Pressure over Tax Evasion

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### Abstract

*The development of the civilisation leads to the increase and diversification of human needs, and implicitly, to increase of the demand for public goods and quasi – public goods. In consequence, the financial effort claimed by their fulfilment increases from one period to another, leading to over – dimension in the demand of public financial resources, which are nevertheless restricted and most often, insufficient. Given this context, a problem arises regarding the identification of an efficient solution to procure greater and greater public financial resources. May it be the monetary emission without coverage to this regard? Taking into account the harmful effects on the long and average term of such a measure over the stability of macroeconomic indicators (and here we take into account, first of all, the amplification of inflation trends), we appreciate that the answer can only be negative. May the effective solution be represented by contracting State loans or increasing the general taxation level? Taking into account that the State loans are assimilated, most of the times, to certain “postponed taxes”, it is obvious that in certain cases, the effect is the same: increase of the taxpayer’s tax burden (either immediately, or in a future period). Although the effect of the two action driven directions is non – popular, they are certainly preferred to a monetary emission without coverage. There is a single amendment: the public authority should resort to their application in practice only when the disproportion between the demand and supply of public financial resources is obvious and prior public expenses were reduced to a minimum level, under which there is no other “limit”.*

**Key words:** tax pressure, public financial resources, unique taxation rate, inflation, taxation basis/grounds, tax evasion

**J.E.L. classification:** E62

### 1. Introducing - Tax Pressure

Starting with the definition of tax as being a necessary bad, the taxation is undoubtedly approached as a coercion factor for the taxpayer, especially that the respect for the law and tax culture are more reduced. Nevertheless, irrespective of the tax civility of the taxpayer, the tax charges shall be perceived as follows: the more uncomfortable and unjustified the tax burden is, the greater the tax pressure or the more the management of public financial resources assimilated to political, discrete and incorrect decisions. Within the context of such an analysis, we have to mention that the public authority may use the tax and fee system to influence the stages of social reproduction process, since the taxes and fees stand for an efficient lever at disposal of public authorities to perform different objectives that they have proposed through the governing system (irrespective if they are economic, political, social, demographic, etc). This conception that potentiates the interventionist role of the State in economy was formulated by John Keynes and found a series of advocates all over the world, especially after the great economic crisis of 1929 – 1933, when it was appreciated that the free mechanisms of the market cannot correct its imperfections from itself.

A general degree of taxation not necessarily very high (from the strict mathematical point of view, relating it to other countries), but with an emphasized seizure aspect, conjugated with a hostile business environment and an obvious normative volatility, may generate the taxpayer’s “orientation” towards the economy’s informal side, justified by the need to survive. Even if we do not intend to

bring pro and against arguments to the morality of underground economy (although the subject may not have lacked interest), we cannot stop from noticing that the economic agents claimed many times the excessive character of the taxation in our country, which does not correspond to the capitalization requirements, generating – at the same time – an acute lack of capital that the Romanian economy copes with, which obviously aggravates the sustainable economic growth. More than that, the present situation passes through an acute liquidity crisis internationally speaking, and the effects of such a case are also felt in the Romanian economy (to analyze the growth of interests granted by the bank institutions when opening deposits, and implicitly, the growth of the financing costs pertaining to the activity of economic agents based upon the sources attracted).

### **1.1. Unique taxation rate**

Although the European directives in the taxation field of activity strictly regulate the indirect taxation, in case of direct taxation, there is a certain freedom in at the level of each Member State. Starting from this fact, our country should orientate itself towards the valorization of a competitive advantage in the competition to attract capitals, especially by relating them to emergent markets.

Certainly the unique taxation rate of 16% (inserted on January 1<sup>st</sup>, 2005) is appreciated as being capable to ensure the premises of such fact and to lead to the sensitivity of the taxpayers’ tax related consciousness, significantly reducing their motivation to resort to evasion practices. Nevertheless, the introduction of the unique taxation rate does not have to be accompanied by the introduction of other taxes of fees or by the increase of the already existent unique taxation rates, but by a superior and more efficient collection of tax liabilities that are granted on a preferential basis (such as exemptions, postponements or installments of due tax obligations), as well as by the fixed and unitary application of the coercive measures in order to prevent and sanction the tax evasion.

Within the context of such an analysis, we can clearly identify that as of January 1<sup>st</sup>, 2007, the substance modifications brought to

local taxes and fees (especially in the way they are arranged) led to their significant increase, standing for, at the same time, obvious additional expenses for the taxpayers individuals and legal persons (and here we take into account the taxes related to means of transport). On the other side, nevertheless, the related taxes shall represent an important local finance source, which may ensure the functional grounds for the decentralization process through increase of the local communities’ financial autonomy, which is a necessary measure especially from the perspective of the Romanian adherence to the European Community. At the same time, we have to notice that in the field of local taxes and fees, the possibilities to shirk from the taxation (practically, tax evasions) are low.

Criticized by part of the political class, promoted and supported by the other part of the political spectrum, the unique taxation rate of 16% represented an efficient approach in promoting a new tax perspective. The pessimism generated by the introduction of a unique taxation rate was only reported in documents, as the statistic figures are encouraging in this respect. Not only that the public financial resources were not diminished, but the State budget income recorded a nominal increase (in 2005, as opposed to 2004) by 16.2%, which means (taking into account the inflation index) a real growth by 6.6%. For the objectivity of the analysis, we must take into account the structural evolution of the taxes and fees related to the State budget and we must nevertheless accept that when it comes to income and salary taxes (the most “affected” by the relinquishment of taxation in progressive rates on income installments), a decreasing trend of 5.4% was recorded (in nominal terms), respectively 13.2% (in real terms). This drop was nevertheless compensated (at the State budget) by the increase of VAT collections, by 36.1% (in nominal terms), respectively 24.9% (in real terms). The explanation is relatively simple and it is structured on the essence itself of such a tax policy: by relaxation of direct taxation the population’s available income increased, which were oriented (in part) towards the encouragement of consumption and, in consequence, towards the stimulation of the economic activity, with a direct quantifiable effect in the economic growth.

Given such conditions, important mutations took place in the structure of the incomes pertaining to State budget (by reversing the weigh related to direct taxes in relation with the indirect taxes).

The famous American economist A. Laffer asserted about the unique taxation rate practiced in our country the idea according to which “what is simple and small is beautiful and benefic”. Behind this value related judgment, we can decode that a low taxation rate aims to reduce the diminishing risk of productive efforts, refreshing, at the same time, the investment and savings process. We don't have to forget about the inflation risk by taxation, in the sense that an increase of taxes and fees related to salary rights leads to increase of the production cost and in consequence, of the general price index, and implicitly, to inflation. On the other side, nevertheless, many assert that an increase of taxation in the field of indirect taxes leads to the diminishing of solvable request caused by decrease of purchase power and implicitly to the consumption discouragement and the limitation of inflationist phenomena. Taking into account the evolving trend of public financial resources after the insertion of the unique taxation rate, compared to the existent case prior to its insertion, both from level and structural point of view, we must admit that in parallel to the insertion of such a rate, new taxes were inserted or the level of those existent at that time increased. Even we cannot state that the measure of applying the unique rate discouraged the social categories with modest income, it certainly favored the social categories with income above average. Nevertheless, if we make a comparison, the increase of certain existent taxes (especially in case of indirect taxes from the excise category) triggered the same affects at the taxpayers, irrespective of the income that they register (even in such a case, the effects are more felt among those that record small income). In addition, the considerable increase of local taxes and fees after January 1<sup>st</sup>, 2007, determined a considerable financial effort from the taxpayers, non – differentiated according to the income they record, but correlated with the fortune held by each of them (even such a measure has a logical justification, that is the necessity of financial autonomy growth of local public authorities). Due to such reasons, those that claimed the

unique taxation rate bring in the first place the idea of noncompliance with the principle of tax equity. On the other side, we don't have to forget that the insertion of the unique taxation rate for the income related to salary rights was accompanied by the grant of personal deductions (tax relief), grant that is correlated to the level of gross income recorded and to the number of persons supported (in the idea of complying with the principle of tax equity). In addition, many assert that, given the conditions of maintaining the taxation state in progressive rates per income installments, the growth rhythm of public financial resources would be superior to the one recorded after the insertion of the unique taxation rate.

According to an objective inventory, both strong and weak points generated by the insertion and subsequently, the step – by – step generalization of the unique taxation rate of 16%, we must admit that we cannot say that everything is only black and white, as the truth is somewhere in the middle, and at the same time, we cannot conclude without saying that the measure of the unique taxation rate of 16% represents the premise for efficiency measures in the Romanian tax system, and on the long term, the useful effects shall be gradually amplified, especially from the perspective of restricting the evasion related trends (by disappearance of the “motivation”) and of restricting the dimensions of the phenomenon in itself.

## **1.2. Maximum tax efficiency**

The economic analysts sought to identify the maximum level of tax efficiency, which is that tax level that the taxpayer is ready to accept voluntarily and thus, to pay his tax duties, ensuring a conciliation between the maximum of public financial resources and the maximum of bearable point from the taxpayer. Many economists share the thesis related to “the tax that kills the tax”; in other words, the insertion of a new tax or the increase of the already existent tax diminishes the bearable point level of tax charges, and thus, the economic agents have in mind the main objective represented by the “escape” from the new tax constraint to which they are subject to (obviously, by means of more or less ingenious methods, more or less legal or moral). It is useful to

mention in such a context the theoretical grounds that can be identified in Laffer curve.

The theoretical essence of Laffer's curve is based on the principle “too much tax, no tax”, according to which when the taxation level is null, the budget income is null and in addition, when the taxation level is 100%, the budget income is null. Between the two extreme limits, we must identify the optimal taxation level that ensures a maximum of satisfaction for both State budget and for the taxpayer. To this regard, the tax specialists reached to the common conclusion that the more fearful the tax evasion is, the higher the taxes are. This is the reason why any State, for the fulfillment of its income, needs to dimension and distribute its public duties in such a manner that any taxpayer could fully pay his taxes in due time. If such a thing is not taken into account, it leads to a lack of efficiency of the tax system. Thus, irrespective of the training of the tax inspector or the size of the sanctions applied, it is possible that the State fails to cash from the taxpayer the requested taxes. Given such circumstances, any taxpayer would do his best to escape such unbearable rigors, and one of the methods is the “tax fraud”.

Although Laffer's initiative is praiseworthy, its application in practice is debatable, since the identification of an optimal size of the taxation threshold is more theoretical, especially if influenced by a series of economic, political, psychological factors that vary from one country to another (and first of all we have to take into account the development level of each country, which is reflected in the size of gross domestic product per capita, as well as the structure of public expenses specific to each country). In addition, the structure of public financial resources differ very much according to the development level of each country (as the destination it has when public expenses are involved).

Given the circumstances according to which the general taxation degree is high, in order to cope with eventual claims from the taxpayer regarding such measures, a theoretical approach is imposed regarding the efficiency of public expenses that are about to be involved, putting the emphasis on social compensation of facilities (which is structured in its turn, from theoretical point

of view, on Hicks – Caldor theory regarding the consumer's surplus).

The central point of Laffer's theory is represented by correlation of the level of mandatory take-offs to the dimensioning of informal economic sector, opinion that we totally agree upon. Laffer's argument does not take into account and it does not make the distinction between the short-term and long-term evolution of the curve. For example, in the periods of economic growth, the reduction of the general taxation level is normally sufficient to generate useful effects. We cannot assert the same thing for the periods of economic recession, in which the tax stimulation is most of the times not enough to encourage the investment process and most of the times speculative behaviors occur.

The theory promoted by Laffer's curve has met a considerable practical impact in many countries, and the most suggestive examples to this regard is United States of America and France. On the other side, it is true that in France existed certain criticisms to the address of practical applicability of Laffer's theory, starting from the premise that the elasticity of taxable income opposed to the superior taxation rates is very low. The theory formulated by Picketty is based upon the ideology of the economic doctrine pertaining to supply theory, since it aims towards the analysis of the activity through the prism of the supply and less through the prism of demand (specific to economic policies of Keynes's type). In addition, Picketty brings in discussion the problem related to the population's effective contributive capacity, according to its purchase power. From those hereinabove mentioned, it results that the when the political decision was taken regarding the taxation tightening, the short, average and long term effects must be objectively compared to the objective proposed (maximization of public financial resources), because an uncontrolled growth of taxation (over a certain level) discourages the initiation of savings and investments, in shortens the taxation grounds and it cancels certain benefic effects regarding the level of budgetary income brought by the increase of the taxation rate. For example, the exaggerated taxation of the work factor shall lead either to abstinence from working, or to

redimensioning (obviously, in the sense of growth), of the work carried out on the black market. An excessive taxation of profits shall determine the exclusion of certain competitors or, more seriously, their gliding towards the non – inventoried stream of informal economy. To this regard, the promoters of the economic liberated school support the reduction of the tax pressure as a determining factor to refresh the economic activity. Michel Albert considers the excessive taxation as a brake in front of the economic growth and development, since it has a discouraging effect over the initiatives carried by the daring ones and by the entrepreneurs. On the contrary, the reduction of the taxation degree leads to limitation of direct intervention of the State in the economy (due to lack of financial resources) and thus, the following is restrained: the possibility to promote in practice certain discretionary measures, taking part in the unchain of the society’s creating energies.

Laffer’s conceptual model undoubtedly contributed to the evolution of the economic doctrine that tries to explain the correlation between the growth of tax pressure and the extension of the non – inventoried economy.

The model in itself did not manage though to answer the following question: why do the mandatory take-offs increase if such a fact is quantified in decrease of the State’s tax incomes?

The answer to such an antagonistic situation has been decoded, even if partially, by means of the model grounded by J .M. Buchanan and D. B. Lee, which starts from the premise that the modification of the taxation level only causes average or even long term effects. From theoretical point of view, we make the distinction between the short term and the average or long term behavior. To this regard, a certain taxable matter corresponds to a certain function of tax collections (in relation to the general taxation level existent at that time). When the taxation rate grows, the public authority places its stake on the growth of tax income, since it considers that the mass of taxable matter is not modified, although, given the conditions of tax pressure growth, part of it is dissipated. Moreover, the “leakage” rhythm of the taxable matter is most of the times more emphasized than the one related to increase of the taxation rate and in

consequence, a series of tax income disappear.

Most of the times, when the public authority takes into account the taxation growth, it places its stakes on tax illusion phenomenon (which is known in the economic doctrine under the term of tax anesthesia). This fact supposes an increase of mandatory take-offs under the form of taxes and fees, without the simple taxpayers effectively perceive the additional tax burden that comes to their duty. As a rule, the tax illusion phenomenon does not suppose modifications of the taxation rates or the insertion of new rates, but modifications in the way in which the already existent taxes are arranged (and sometimes, perceived). It is obvious that the phenomenon is encouraged by a tax structure as complex as possible (and even ambiguous), which does not allow the determination of reliable data regarding the price of taxes owed by the taxpayers. When the increment intent regarding the tax burden becomes perceivable among a great mass of taxpayers, the public authority shall proceed, with the purpose of minimizing the political – electioneering costs of the measure, to generalization of the compensations induced by the increase of tax burden; in consequence, it shall seek to justify that only the new taxation level is capable to ensuring the public financial resources necessary to finance as many public goods as possible, thus satisfying, the society’s collective needs.

Starting from those hereinabove mentioned, we propose top identify the causes that determine the amplification of the tax pressure. Certainly, an active implication of the public authorities in the economic environment leads to expansion of public expenses and to a greater and greater demand for public financial resources. To this regard, the famous economist Peter Drucker formulated the hypothesis according to which “the State makes the rules, the State makes the standards, the State supplies, but the State does not execute”.

The undesirable attitude of the taxpayers towards the taxes is indissolubly correlated to the stability and accuracy of the legislative frame and the institutional frame, as well as to the efficiency that the taxpayer perceives over the methods regarding the management and usage of public financial resources. The legislative inconsistencies in the tax field as

well as the asymmetry and the normative volatility shall increase the taxpayer's "interest" in exploiting such dysfunctions and in identifying new tax evasion related methods, and given such conditions, the tax riots tend to amplify more and more, and the tax evasion will finally become a "national sport". The adversity towards taxes may be significantly reduced if the related legislative frame is coherently structured, and if the tax representativeness apply the legal regulations in the field to their professional spirit, in good – faith and equidistantly from all taxpayers, without making discriminations between them (according to their financial position, social position, political affiliation). To this regard, the financial – tax related performance control must not create to the taxpayer the image according to which the control institutions are obsessed with the idea of tax sanctions. The administrative structures with assignments and skills in the financial tax field must ensure an appropriate behavior for the unitary application, without resorting to bribes to make sure everything is in place. In those previously mentioned, one idea stands out, that is a growth of the tax pressure shall be felt by the taxpayers as a form of aggression (more or less justified) over the income that they regulate. Given such circumstances, their preoccupation shall be deviated from a permanent performing economic management to an efficient tax management, which allows them to identify "the escape doors" from the rigorous tax regulations. Most of the times, the problem regarding excessive taxation is reduced to limitation of costs engaged, by means of an efficient approach of a tax optimization, which also include the transfer of the taxable matter to another jurisdiction, which supposes a easier tax charge. Given such context, the self – generation of the underground economy occurs, in the sense that the refrain from paying the taxes by certain taxpayers hinders the taxation grounds and the level of public financial resources, which engenders a harsh taxation, which, in its turn, shall "motivate" the inclination of other taxpayers to the informal side of economy. When the legal, transparent system of market economy blocks, a spontaneous and more advantageous distribution of resources occur, although by hidden ways. When such an "avalanche

effect" occurs, the continuous and constant diminishing of the taxation grounds cannot be compensated by the growth of the taxation level anymore, and the rearrangement of the functional "game rules" can only be performed by removing the causes that led to this state in the tax evasion behavior encountered at the economic agents.

Even so, we can quantify the obtaining effects of an eventual decrease of the tax level, taking into account the taxation modalities to avoid the prohibited aggravation and depth of the budgetary deficit (even if on the short term, until the materialization of useful effects generated by a tax relief). Finally yet importantly, the public authority must operate such a tax reduction according to the stages of business cycle, taking in account a functional modification of the tax structure, as well as the curve pertaining to relatively marginal advantage distribution of the tax burden per sectors of activity with the economic potential (without transgressing the neutrality tax principle)

## 2. Conclusions

Although the tax policy promoted by the public authorities aims to reply to a series of objectives, we consider that it must take into account, first of all, the limitations of tax pressure, since the taxation must be regarded not only as an attribute of the State, but as a lever that is necessary to take into account the taxpayers' will and consent to the tax that is structured on the principle of the taxpayer's positive influence. From such perspective, the efficiency of a tax system is not only appreciated by the absolute size of the collected income, but also by the level of bearable point of the taxpayers, as a guarantee of his lack of motivation to transgress the tax legislation

Starting from the three roles of the taxes (financially, they represent the components of the most important financing source of the social welfare. Due to them, the financial resources available to the State are accumulated and distributed, but they also represent tools used in the macroeconomic management with direct influence over the economic environment.

On the other side, given the fact that the national offer of goods and services is under

– dimensioned and undoubtedly characterized by a somewhat rigidity, we recommend the decrease of the average tax pressure, as a useful and even necessary approach in stimulating the real economy, given that the elasticity of such an offer, upon fluctuation of average taxation rate, is not negligible. The practical promotion of certain compatible compensatory complementary policies may determine the over – dimensioning of the taxation grounds when the general tax degree is reduced and thus the forecast shocks in collecting public financial resources may be attenuated (or even avoided).

Starting from the most visible effect of tax evasion, that is the delocalization of certain financial resources from their natural scope (and legal scope) to supply funds to the consolidated general budget, we consider that the circumscription of the phenomenon in itself within certain controllable limits must represent a priority of the tax policy and to this sense, the reduction and restriction of the tax pressure represent an efficient means in preventing and combating the tax evasion, since it aims to the cause, and not to the effect of such a phenomenon, respectively to

the premises that motivate the taxpayer's evasion related behavior. The tax legislation must take into account not only the punitive measures, but also those measures that may generate a correct tax behavior of the taxpayers, which aims to restriction of the tax evasion phenomenon.

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## The Place of Public Decision in Competitiveness Encouragement in the New Global Economy

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### Abstract

*The purpose of this approach is to identify the reserved place for state action in economy and its priorities in the new global environment. The major objectives subordinated to the approach intend to point out the characteristics of the thinking currents in order to emphasize that these were strongly influenced by the system of economic and social relations, by the development level of the economies and the major disequilibria from their elaboration moment and subsequently to analyze the current impact of public decisions on the competitiveness of the companies, countries economies and the state place in the new global economy.*

**Keywords:** economic theories , fiscal policy, economic competitiveness.

**J.E.L. Classification:** B2, E6, H2.

### 1. Economic theories and public policies

Through the human society evolution the philosophical currents and economic theories which focused on the competences of the public decision-makers have exercised a significant impact on the tax policy evolution, and respectively, on the way in which this one was and is used in order to achieve the political, economic and social-type goals aimed by them. If what we call as tax policy nowadays, initially had to provide the maintenance of the state order, subsequently it focused on guaranteeing the developed activities and then on the services

and advantages provided and guaranteed by state, and more recently on the fulfillment of its coming functions and tasks.

Thomas Hobbes, the founder of the „social contract theory” which was subsequently developed by Jean-Jacques Rousseau, asserted that, state represents a way of free association of the people who give up to a part of their freedoms and make sacrifices by paying the taxes in exchange for the performance of certain activities. For the classicists of the German philosophy (Hegel, Schelling, Fichte), the founders of the „organic theory”, state is a product of the human society and taxes are necessary for providing the pecuniary funds designed to maintain the state order. According to Adam Smith, the founder of the „equivalence theory”, which was also supported by Montesquieu subsequently, the value of the taxes determined by state depends on the price and size of the services performed by it. In the „sacrifice theory” as opposed to the „social contract theory”, state does not longer represent a social organization based on the will of its citizens, but a product which is necessary for the historic development of human societies, their members having the duty of paying the taxes taken up by state for the fulfillment of its coming functions and tasks.

If the classical economists - the supporters of the liberal doctrine such as Adam Smith, expressed themselves in favour of limiting the state functions to the traditional ones, considering that the optimal resources allocation implied the free competition protection by it, the neo-classic economists asserted that in order to ensure a pure and perfect competition, the public authority

interference was necessary. „The organic theory of the state” developed by the German school radically impugns the classic and neo-classic approaches, justifying the necessity of the state interference on the grounds that it represents the society interest. The interference dimension generated two currents; the one whose promoter was Wagner supported the interference in all domains of economy according to the economic development, while List was the supporter of the interference in certain periods in order to support the new industries.

The positive (research) or negative (pollution) externalities in the view of the welfare economy supporters (Marshall, Pigou) are only a few of the reasons asserted in order to justify the state interference through taxes. A radical attack of the state and capitalism role may be found in „Marxist theory” which asserted that the state functions must be reduced to the maximum and that it must provide the transition from the capitalist society to the communist one without classes and finally, without state.

Supporting the economic development and the encouragement of the full labour force occupation by the state are necessary in Keynes opinion, because market does not have self-adjusting mechanisms which should be capable to provide the optimal resource allocation. As opposed to the neo-classicists who consider that disequilibria are due to the external interferences disturbing the spontaneous market adjustment, the Keynesian supporters assert that these are due to a structural crisis of demand and accordingly, state must interfere in order to relaunch consumership and investments, using as instruments the rate of interest in order to influence investments, the offered money supply in order to interfere in the saved money supply, inflation in order to act in the unemployment level (influencing the income which in its turn, influence the saving and thus, the investments). Confronting the ideas expressed by Keynes, the economists of the Supply-Side Economics (Laffer, Gilder, Bartlett) stated that companies must be encouraged to enter new markets by decreasing the taxes they pay, must be helped to produce goods and services by granting subventions directed towards certain fields of

interest, and the employee incomes may be increased by reducing the social fees.

Considering state as a whole of individual compromises, “regulation theory” (Aglietta, Lipietz, Boyer) takes over some of Keynes and Marx ideas, stating that crises are generated by either dysfunctionalities of capital accumulation or dysfunctionalities of money constraint management, or the salary proportions, or the way of insertion into international economy, or the type of the state interference. In their opinion, state must do a crises analysis and to interfere in the causes in order to provide the economy stability. The gradation of the state and market role may be found in „neo-institutional theory” (North, Coarse) which identifies its interference, only if it participates to the achievement of an optimal one which should satisfy the individual interests in the conditions of protecting the ownerships and acknowledgement of their structures.

Asserting rationality of the human being and individualism of the companies, but also the market capacity of adjusting the economic activity effectively, as basic truths which appear as obvious, the classical liberal current rejects the state interference since the general interest cannot be place above the private interests, considering that it would generate undesired effects. The classical liberalism states that the economic system based on the economic freedom naturally aspires to balance, without affecting the economic freedoms and the best guarantee of freedom is the private property and the production means.

Starting from the hypothesis of the fellow rationality, the neo-classical liberal current intends to explain the consumer and producer behaviours as well as the economic phenomena. The neo-classical liberalism identifies the existence of four markets (goods and services market, money market, capital market and labour market) among which there are interdependencies and the general balance depends on creating a balance price for each of the markets, taking into account the hypotheses (information circulation and availability to all, the atomicity of demand and offer, the homogeneity of products and the absence of the access barriers) which determine the

behaviour rationality. The only way of assuring the political and economic freedom is the reduction of the state role, according to the vision of the monetarists from the School of Chicago.

It is obvious that there is a close connection between the economic theories and the state-applied policies, the states trying to justify their actions by appealing to the economic theory. The public policies intended to encourage competitiveness have as motivation the achievement of certain purposes consisting in the maximization of welfare and per capita income, the avoidance of sudden poverty and the full use of the labour force.

However, at the European Union level, the economic decisions begin to be no longer of a state competence strictly, but especially of all, such as the case of the competitiveness encouragement. Which is the company place in relation with state and society? It is obviously that in a globalized environment, companies have more possibilities of development and movement, but the competition increases too. We need to show prudence in regard to the states and European institutions role on the regulation line, because it's not very delimited and the effect of the public actions is not very transparent in regard to those of the private environment on the line of the competitiveness increase and providing a social optimum. As a matter of fact, we don't even have the certainty that competitiveness encouragement is easy to be institutionalized. At this phase of the research we consider that the efforts for supporting competitiveness remain in companies' competence, state having rather the role of supporting and encouraging the achievement of the desired goals.

## **2. Building a advantageous environment for the company competitiveness, a priority of the public decision**

If we take into consideration the current dynamics of the economic environment, then it would assert the remark: while the theories regarding the state role were underlain on the traditional model of economy, the globalization process interconnected the national economies in a world multi-

dimensional economy. Globalization takes down the approaches of the Keynesian, neo-Keynesian and Marxist currents, bringing into focus the state functions which are supported by the neoclassical liberal doctrine. This involves the obligation of supervising the big economic balances and building an advantageous climate for the effective private initiative, creating the competitiveness. As a matter of fact, the contemporaneous economists took over the philosophical and scientific theories of Nietzsche (hero's importance), Darwin (natural selection), Spencer (survival of the fittest), Hobbes (man is a wolf to man), ideas for explaining the laws upon which the contemporaneous market economy operates. According to Michael Porter, competitiveness is indivisible, those who have it will pull through, and those who don't have it will disappear, no matter if it's about companies or the economic system on the whole.

In economic theory, competitiveness is but a behaviour method of the economic entities on the competitive market, where every company seek to achieve and maintain competitive positions and advantages, observing the rules established in equally supposed conditions for all. Actually, competitiveness ceased to represent a method of existing, becoming a main goal for companies, state and society on the whole. If on the long-term, profitability remains the reason of existence, on the short-term instead, competitiveness is the main goal aimed by the economic entities.

For any public power, the state competitiveness became a national strategic goal of a primary importance for assuring the sovereignty, independence and autonomy of the country, for its international position, the labour market policy, the access to the global technology, the national solidarity financing and the social peace maintenance.

Gradually, as the economies were entering the structural crisis and unemployment, competitiveness began to be related to privatization, liberalization, deregulation, flexibility, mobility and excellence. Notwithstanding, the measures taken towards the adaptation to the new rules of the market economy neither led to the economic growth nor to the unemployment reduction. But we notice that the

internationalization and globalization processes of the companies and economies, the internal organization of the companies and the global and local relations between businesses – network were disturbed by the cooperation under the shape of alliances and strategic agreements concluded in order to support competitiveness. In the current context, in which the grant of resources is done at the international level, states lost their capacity of being able to act on the processes of grant restructuring due to the strategies and powers of the big economic and financial companies action on the world level. The state power decline in the countries of origin or implantation of the large corporations represents a threat for the national independence. State ceased to be the political expression of the public interest, being degraded to the role of actor being responsible for building an advantageous environment for the companies' competitiveness.

Globalization structurally changed the way of approaching the national and foreign investors. Discrimination applied in favour of the national investors in order to protect the national sovereignty by establishing the forbidden activities, limiting the participation to share capital, compensating imports through exports in different proportions, ensuring the transfers of technology to the national companies and research institutions started to prove itself ineffectual for the foreign investors due to the costs increase and competitiveness reduction generated by the total administrative restraints with negative impact on their performance. As integrating on the implantation markets, the national providers invested on the foreign implanted companies and the foreign investors began to request a protection against other foreign competitor companies, so that states became their partners without wanting it.

In the current global economy the investors' nationality and the place of implantation ceases to be relevant anymore, necessitating to give up to the temptation of promoting discriminating policies encouraging either the national sectors being deemed as strategic, or the foreign investments exclusively, in favour of ensuring an economic, social and politic

environment being able to attract investments bringing new technological capacities and work places. No matter if the spatial reference has a national or regional character, the priority has two major coordinates. The first one needs to settle the permanent flows as much as possible; consisting in the transfer of activities, and the second one concerns the provision of the conditions encouraging the best investment decisions. There is obviously coming the question related to the state role and if this one, by means of the applied policies, may contribute to the building of an advantageous environment for the competitiveness encouragement.

If we take as reference the approach of nations competitiveness suggested by Porter, then in order to settle the companies on a market, no matter if it is a national one or the consequence of the regional integration, the following requirements should be provided: to exist a solvable and sophisticated demand which should force the manufacturers to permanently increase goods and services quality and their diversification, the large companies to be capable to cope with competition, the industrial structure to consist of a large number of small and medium effective enterprises which should efficiently respond to the controls coming from the large companies, to ensure the offer of qualified labour force, the necessary communication systems and infrastructures so that the environment in which companies operate be productive.

Which would be the counterarguments for those who support the protection of the new industries and the large national business groups? Such policies are no longer timely because the protection for the new activities should be temporary, and the large business groups which dominate in the developed economies, being confronted with the market saturation and costs increase in the countries of origin, have already built international networks as a result of the delocalization strategies at the global level. While certain companies delocate the large labour force consumer activities, others, through implantation, try to get close to the commodity markets or to eliminate certain tax costs. Governments in the implantation countries try to grant tax exonerations and/or subsidies to foreign investors, wishing to

maintain the market attractiveness and avoid their departure. However such practices are not deprived of side effects from the member states of the Union or those from OMC. Globalization eliminated the hierarchy between national and international, carrying an accelerated decline of the states power of governing the economic policy from the moment of activities deregulation and public companies privatization. Consequently, the question arises concerning the level to which we should act in order to bring under regulation the economic environment in the globalization age and which instruments would we use to ensure the optimal allocation of the resources, the increase of the economic environment attractiveness and the corporations' stabilization.

A possible solution would be regionalization as an intermediate level between the global and the national economy. The multiplication of regional integration forms corresponds and has an effect on the determinant factors of the competitive advantage, which were stated by Porter. In the present moment globalization confronts European Union and the member states with a new reality because of the geographic polarization of the direct foreign investment flows, the competition development and the primacy of the financial strategies over the productive strategies.

The economic disequilibria have compromised the achievement of a balanced and lasting development model based on competitiveness making the European Union the most competitive economy in the world. The measures taken (based on White Paper and Lisbon Declaration of the head of states and prime ministers) have determined the reduction of the salary costs, activities of privatization and deregulation of economy, the reduction of the public expenditure intended for social protection and security, the detaxation of the salary bases, the reduction of the state role in infrastructure financing, the building of an advantageous environment for the improvement of the private corporations competitiveness, the encouragement and support of the private investments, and the liberalization of the national markets. The failure of achieving the intended goal determines us to ask ourselves about the usefulness of the taken measures.

In order to consolidate the competitiveness of the European Union economy and the member states economies implicitly in the globalization conditions, these must become attractive.

### 3. Conclusions

Researching the economic theories emphasize two important aspects. The first one is related to the fact that the economic thinking currents approach state interference differently, and the second aspect is related to the impact which the economic environment dynamics has on the economic thinking evolution and the issuance of new approaches.

In the globalization conditions, the consolidation of the member states economies and the European Union economy implicitly needs an increase of their efficiency on the worldwide market. We believe that it's not longer relevant to analyze the balances between the incoming and outgoing flows of the goods and services at the level of a state, as in a globalized environment we must take into account the exports of the national companies' subsidiaries on third countries inclusively, as well as the sales on the implantation markets, the purchases made from other subsidiaries of the group either from the countries of origin or from other countries. In fact, we must take into account the segment of the global market which is controlled by the national companies and the flows within the group of the company subsidiaries. If we aggregate these flows, we may have a real image on the competitiveness of a country which exceeds the national borders and we reach the conclusion according to which delocalization carries the production decrease and the use at the level of field simultaneously with their increase at the level of another field, without existing an equality between the two quantified flows. In order to consolidate their competitiveness through price, companies appeal to delocalizations for minimizing their costs and by adapting the products to the consumers' preferences on the markets where they are implanted they seek to consolidate their competitiveness outside the price. For states and companies, the competitiveness key is now related to the

skill of using together globalization of the financial circuits, production delocalization and goods and services exchanges.

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## European Union Concerns Regarding the Modernizing of the European Customs Legislation

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### Abstract

*Customs taxes are indirect taxation having an important share within the European Union budget and implicitly within the budget of each component state. Due to this reason there is a permanent preoccupation from the part of the European Union Council to modernize the customs legislation for the communitarian area. In order to prevent the tax evasion and in order to enlarge collections, the European Union Council imposed a system of customs tax exemptions for the imports and exports capable to facilitate the circulation of goods inside the communitarian area. The customs tax exemption was settled by the Regulation (CE) no.1186/2009 of the European Union Council and refers to a multitude of groups of products, solving thus many problems linked to the circulation of goods inside the communitarian area and the tertiary countries bordering it.*

**Key words:** communitarian area, customs area, customs taxes, submitted products

**J.E.L. Classification:** H26, H30, K34

### 1. Introduction

The customs taxes constitute a field regulated through a multitude of norms of law: internally, European and internationally, due to Romania adhering to the European Union and to the international treaties and conventions. By signing the adhering treaty to the European Union and to the divers international treaties, according to the Romanian Constitution, our country is forced to respect the provisions of these treaties which become sources for the internal law once their ratification have been done by the Parliament. Thus it has been created the European Union customs tariff represented

by a classification of the products submitted to customs taxes and the level of these taxes applied for each product or group of products.

At the same time there has been created the customs regime of the European Union, comprising the specific customs law of this customs territory, needed to be unitary applied by all member states. The constitution of the customs union on the customs territory of European Union has led to dissolution of the customs barriers, the settling of a new common taxation system, and also the settling of a Unitarian trade policy system in connection with the tertiary parts. There has also been settled, by the European Union legal organizations, the customs tariffs, taking into consideration the specificity of each member state.

The basic preoccupations of the European Union materialized in supervising the circulation of goods inside the customs territory especially for the goods submitted to duty, referring to products such as tobacco, alcohol and energetically ones. The modernizing of the customs legislation constitutes a priority objective for the European Union, because it aims to prevent the tax evasion by putting into evidence and collecting to the communitarian budget and implicitly to the budget of the communitarian countries the customs taxes and other taxation and duties.

In order to prevent the tax evasion The European Council adopted the Regulation (CE) no. 1186/2009 which simplifies and exempts from tax some customs operations. By applying the Regulation (CE) no. 1186/2009, the European Union Council did not put a limitation to the respect from the part of the communitarian countries of the provisions existing within the international treaties and conventions to which they are parts. Within the regulation a special attention was given to the customs tax

exemption for the import – export of equipment for the scientific research and for the public education institutions. For each group of products to which Regulation refers, there have been imposed conditions in order to justify the customs tax exemption, the failure to respect them leading to the taxation of such kind of goods.

## **2. The communitarian regime of tax exemption**

Customs taxes are indirect taxation which are generally paid to the customs offices and are generated by some operations linked to the: import, export and the transit of goods. Because customs taxes are a considerable source for incomes to the budget of the European Union and implicitly for the incomes of each member state, there exist permanent preoccupations from the part of the communitarian organisms for the improvement of the customs system. In this direction the European Union has constituted the customs territory and the customs union, where it comprised all the member states. As a result the customs barriers there were dissolved and there was introduced a common taxation system, and in the relations with the tertiary parts there was settled a common commercial policy and an external common tariff.

The main preoccupation of the European Union Council is the actualization of the customs tariff and regime. Referring to the customs tariff, the nomenclature is permanently re-actualized for the products suffering customs taxes, and also the level of such taxes in order to exist a harmonizing of the European Union customs policy in accordance with the specific norms which regulates the customs policy of the member states.

In order to simplify the customs activity and preventing tax evasion, the European Union Council has adopted the Regulation (CE) no. 1186/2009 through which there is settled communitarian regime of tax exemption, both goods import and export. As a general rule, tax exemption is applied to goods having free circulation, which are then exported outside the customs territory of the Community.

Imports customs exemptions refer to:

- Personal goods imported by private persons moving location from a tertiary country on the customs territory of the Community on condition the respective goods be at least six months in the possession of the respective person at his/her ancient address. The respective tax exemption is conditioned by the intention and the existence of a period of at least 12 months, when the person lived in a tertiary state of the European Community. As well as, the exemption is conditioned by the putting into circulation of the respective goods during a period of at least 12 months and by the interdiction that the goods be freely transferred or sold to other persons. The goods submitted to the customs tax exemptions regime can not be lent, rented or be a guarantee in different situations.
- Goods imported on the occasion of a wedding, constituted from trousseau and household goods belonging to a person who transfer his/her usual residence from a tertiary country on the European Union customs territory. The condition of approving import customs tax exemptions is imposed by the fact the respective person make the proof of his/her marriage, and the usual residence from the tertiary country be held minimum 12 months. The goods having customs tax exemption be entered in a regime of free circulation at least two months before the marriage and not late than four months from the date of the wedding. As well as these goods can not be lent, transferred with payment or for free, rented or constitute guarantees for a period of at least 12 months.
- The personal goods acquired on a heritage way, except the commercial means of transport and the articles used in exercising different jobs or professions, others the portable instruments used in the applied or liberal arts, which where necessary in exercising the job or the profession of the dead person. He respective goods can be imported in many transports, but the condition of approving customs tax exemptions is determined by the entrance of the goods in free circulation in maximum two years.

- The means of production and other imported equipments in the same time with the transfer of the activity from a tertiary state inside the Community, if they are used for similar activities on the communitarian customs territory. The granting of the exemption is conditioned by the use of means of production and equipments at least 12 months at the company that ceased its activity within the tertiary state. There exists no tax exemption for the enterprises of which transfer on the customs territory of the Community is the result of a merger or acquisition from the part of an enterprise set up on the customs territory of the Community, without changing the style of activity. As in the previous situations, granting customs tax exemptions is conditioned by the free circulation of the respective goods. As well as in the case when these goods can not transferred by paying or for free or be lent or standing as a guarantee at least 12 months from their entry on the customs territory.
- Products obtained by the communitarian farmers out of their properties situated in a tertiary country, materialized in agricultural, zootechnical, bee, horticulture, or forest products. The products must be harvested from their own properties situated in tertiary countries bordering the communitarian customs territory. In order to apply the customs tax exemption the zootechnical products must be derivatives from the animals originated within the communitarian countries or have already entered in free circulation on its territory. The exemption also applies if the respective products did not suffered special treatments, but only the ones necessary for the harvesting or production and are brought in the customs territory of the Community by the agricultural producer or their representatives.
- The seeds, fertilizers and products used for soil treatment and imported harvests from the tertiary countries in order to be used on neighborhood properties. The customs tax exemption applies only to the quantity of seeds, fertilizers and other products necessary for the exploitation of the property and must be imported on the communitarian

customs territory by the agricultural producer or their representatives.

- The educational, scientific or cultural materials, the instruments and scientific equipments are exempted from the payment of customs taxes if they are used by the organizations or the educational, scientific or cultural institutions or other public institutions having as main responsibility the teaching or research activity. The same regime is applied to spare parts, accessories and the measuring equipment used for the quality control of the educational, scientifically or cultural materials on the condition they have the approval of the beneficiary state realizing the import in order to be customs tax exempted. The imported products submitted to customs tax exemption can not constitute the object of any lent, paid or free transfer, renting or guarantee, without informing the legal authorities.
- Instruments or apparatus meant to the medical research, sting up diagnosis or realizing medical treatments are also exempted from the import customs taxes, if they are offered as donation by a health organism having a charitable or philanthropic character or by a private person to the health organizations, hospital services or medical research institutions designated by the legal authorities of the member states to receive such kind of objects or which are bought under the above mentioned circumstances exclusively with funds of the supplying organism having the philanthropic or charity character or by voluntary contributions. The customs tax exemption is conditioned by the fact that the respective donation does not constitute the object of a commercial transaction or there must not exist a link between the producer of such a product and the donator.
- Goods for the charity organizations or philanthropic ones: articles for the blind or for other people with handicap, are exempted of import customs taxes. These goods must be distributed freely by the state organizations or other philanthropic organisms and associations legally authorized. Such kind of goods can not constitute the object of any commercial transaction, paid or free

transfer or guarantee. It is the same procedure in the case of products used by handicapped persons or of the victims of a catastrophe.

- The carburetors and the lubricants existing on board of vehicles, on land and on containers having special destinations, under the conditions they be stored in normal reservoirs or portable ones, and the automobiles be used for tourism. The respective fuel must be used that only purpose its trade or storing being forbidden. By the Regulation (CE) no. 1186/2009 of the European Union Council there has also been set up other facilities for the automobiles of persons having their residence in a border area.

The materials used for the building up, maintaining or ornamenting memorials or war victims cemeteries, if they are imported by legally authorized organizations and consisting of: coffins containing bodies or urns with ashes of some dead people, and also flowers, wreaths and other ornamental objects brought by persons having their domicile in a tertiary state but taking part to a funeral or to the decoration of a monument situated on the European Union customs territory.

Within the regulation (CE) no. 1186/2009 of the European Union Council there have been settled other fields for the application of the customs tax exemption for the import of goods, such as: alcoholic, tobacco or their derivatives and means of transport.

The European Council through its Regulation (CE) no. 1186/2009 has mentioned customs tax exemption for the export of goods as follows:

- Sends with no significant value by mail or parcel post containing goods of a total value not bigger than 10 Euros.
- Domestic animals component parts of cattle farm which stopped functioning on the customs territory of the community and transfers its activity in another tertiary country. The condition applies for a certain number of domestic animals adequate to the nature or dimension of the agricultural enterprise.
- Products obtained by the agricultural producers with activities on properties situated in the Community, on properties bordering a tertiary country, led by persons having the quality of owners or

concessionaires having their main enterprise in a tertiary country, bordering the customs territory of the Community. The condition of export customs tax exemption being that the respective products be obtain as derivatives of the animals which are originally of the tertiary country to the customs community territory or satisfy the requirements for free circulation in the tertiary country. Customs tax exemption is also applied if the respective products did not suffered any treatment, except those that follows normally the harvesting or their producing.

- Seeds exported by the agricultural producers for the use on the properties situated in tertiary counties are exempted of export customs taxes if they are used in countries bordering the customs territory of the Community by the owners or concessionaires of the respective grounds. At the same time the respective products must be exported in the name or directly by the agricultural producer and their main enterprise be situated in the immediate proximity of the customs territory of the European Community.

The application of the Regulation (CE) no. 1186/2009 of the European Union Council does not prevent the member states from customs tax exemptions settled by:

- Viena Convention regarding the diplomatic relations from April 18 1961;
- Viena Convention regarding the consular relations from April 24 1963 or other consular conventions;
- New York convention regarding the special missions from December 16 1969;
- The provisions of the international conventions or the agreements regarding the settlement of headquarters at which they are contracting parts or a tertiary country or international organization where the component countries of the European Union obtained privileges;
- Cultural, scientific or technical cooperation agreements at which the member states of the European Union are parts, for the obtained privileges;
- Agreement settled with the tertiary countries stipulating common measures for the protection of persons or the environment, for the obtained privileges;

- Chicago Convention regarding the agreements settled on a mutual basis regarding the international civil aviation from 1944.

The modernizing measurements of the customs legislation, settled by the European Union Council are influenced by the customs policy of each member state. Thus, each component state is obliged to inform the European Union Council about the settled conventions and treaties in order to take into consideration the settling of the communitarian customs policy.

### **3. Romania's preoccupations for modernizing the customs system and the control of tax evasion**

Romania as European Union member state is obliged to respect the provisions of the Regulation (CE) no. 1186/2009, especially due to the fact that it is situated at the border of a customs territory. In order to prevent the tax fraud by The Emergency Ordinance no. 54/2010, the Romanian Government has settled a series of measures for the control of tax evasion and collecting to the budget of the state of customs taxes, of the value added tax and of the excise duties of the merchandise resulting from the imports or intra-community transfers.

In this direction there has been settled the introduction of the intra-community Operators Register comprising all the persons submitted to taxation and the juridical persons which are not submitted to taxation and which make intra-community operations. In the absence of registration in Register these persons do not have a valid VAT code for intra-community supplies. There have also been settled extra rules for the inverse taxation regarding the value added tax of some categories of products such as: cereals, technical plants, vegetables, fruits, meat sugar etc., and the level of the excise duties for cigarettes.

By the normative act mentioned above there have been made some specifications concerning the trade of merchandise in a duty-free regime, thus obliging economic operators to introduce goods into the shops in order to be sold, only after the payment of the excise duty, value added tax and customs taxes, according to the situation of the respective products.

### **4. Conclusions**

The preoccupation of the European Union for tax evasion control by modernizing the customs legislation leads to the growth of the incomes to the budget of the Union and implicitly to the budget of the member states. Because customs taxes, the value added tax and the excise duties are consistent sources to the budget of the member states, the decisional boards of the European Union have considered that the applied measures lead to their growth and implicitly to the control of tax evasion. Romania in its quality of member state of the European Union, being geographically situated to the border of the customs territory of the Union, has the obligation to apply the respective legislation and prevent tax evasion.

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## From Basel II to Basel III — Changes, Improvements and Proposals

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### Abstract

*BASEL III is a global regulatory standard on bank capital adequacy, stress testing and market liquidity risk agreed upon by the members of the Basel Committee on Banking Supervision in 2010-11. [1]*

*The third installment of the Basel Accords was developed in response to the deficiencies in financial regulation revealed by the late-2000s financial crisis. Basel III strengthens bank capital requirements and introduces new regulatory requirements on bank liquidity and bank leverage.*

*For instance, the change in the calculation of loan risk in Basel II which some consider a causal factor in the credit bubble prior to the 2007-8 collapse: in Basel II one of the principal factors of financial risk management was out-sourced to companies that were not subject to supervision, credit rating agencies. Ratings of creditworthiness and of bonds, financial bundles and various other financial instruments were conducted without supervision by official agencies, leading to AAA ratings on mortgage-backed securities, credit default swaps, and other instruments that proved in practice to be extremely bad credit risks. In Basel III, a more formal scenario analysis is applied (three official scenarios from regulators, with ratings agencies and firms urged to apply more extreme ones).*

**Cuvinte cheie:** banking regulation, liquidity requirements, bank capital requirements, interest rates

**Clasificare J.E.L.:** G21; G28

### 1. Introduction

The Basel Committee on Banking Supervision (BCBS)[2] is a committee of banking supervisory authorities that was

established by the central bank governors of the Group of Ten countries in 1974.[2] It provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. The Committee also frames guidelines and standards in different areas - some of the better known among them are the international standards on capital adequacy, the Core Principles for Effective Banking Supervision and the Concordat on cross-border banking supervision.

The Committee's members come from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The Committee's Secretariat is located at the Bank for International Settlements (BIS) in Basel, Switzerland. However, the BIS and the Basel Committee remain two distinct entities.[3]

### 2. Basel II, 2.5 and III

Basel II is the second of the Basel Accords, (now extended and effectively superseded by Basel III), which are recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision.

Basel II, initially published in June 2004, was intended to create an international standard for banking regulators to control how much capital banks need to put aside to guard against the types of financial and operational risks banks (and the whole economy) face.

One focus was to maintain sufficient consistency of regulations so that this does not become a source of competitive

inequality amongst internationally active banks. Advocates of Basel II believed that such an international standard could help protect the international financial system from the types of problems that might arise should a major bank or a series of banks collapse. In theory, Basel II attempted to accomplish this by setting up risk and capital management requirements designed to ensure that a bank has adequate capital for the risk the bank exposes itself to through its lending and investment practices.

Generally speaking, these rules mean that the greater risk to which the bank is exposed, the greater the amount of capital the bank needs to hold to safeguard its solvency and overall economic stability.

Politically, it was difficult to implement Basel II in the regulatory environment prior to 2008, and progress was generally slow until that year's major banking crisis caused mostly by credit default swaps, mortgage-backed security markets and similar derivatives. As Basel III was negotiated, this was top of mind, and accordingly much more stringent standards were contemplated, and quickly adopted in some key countries including the USA.

The Financial Stability Institute (FSI) has conducted surveys in the past on subjects of supervisory interest and shared the findings with the supervisory community. The FSI conducted a survey on Basel II implementation in 2004, which was followed by updates in 2006, 2008 and 2010.

In 2012, the FSI carried out a survey on the implementation of Basel II, 2.5 and III in jurisdictions that are neither members of the Basel Committee on Banking Supervision (BCBS) nor members of the European Union. The methodology used in this survey is similar to the one adopted by the BCBS in October 2011 for its progress report on Basel III implementation. The FSI sent out an email to banking supervisory authorities in selected jurisdictions asking them to submit their responses to the enclosed questionnaire.

In line with the BCBS's approach, the FSI is publishing the results of its survey by disclosing the information received from 70 countries. Therefore, the results of this survey are being treated differently from those of past surveys, where the FSI published only the aggregated results.

The FSI will be updating the results of this survey every year from March 2013 onwards so that the jurisdictions (which are not members of the BCBS and/or the European Union) can provide up-to-date information regarding the status of their implementation of Basel II, 2.5 and III.

### **3. From Basel II to Basel III – Changes and Proposals**

Calendar of major decisions that led to the transition from Basel II to Basel III is:

#### **June 30, 2006**

- Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version

#### **July 13, 2009 – Package**

- Enhancements to the Basel II framework, “Enhancements”
- Revisions to the Basel II market risk framework, “Market Risk Revisions”
- Guidelines for computing capital for incremental risk in the trading book, “IRC Guidelines”

#### **December 17, 2009 – Proposals**

- Strengthening the resilience of the banking sector, “Capital Proposals”
- International framework for liquidity risk measurement, standards and monitoring, “Liquidity Proposals”

#### **June 18, 2010**

- Adjustments to the Basel II market risk framework announced by the Basel Committee

#### **July 16, 2010 – Proposals**

- Countercyclical capital proposal, “Countercyclical Capital”

#### **July 26, 2010 – Agreement**

- Capital and liquidity agreements

#### **August 19, 2010 – Proposals**

- Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability

#### **September 12, 2010**

- Group of Governors and Heads of Supervision announces higher global minimum capital standards

#### **October 18, 2010**

- The Basel Committee’s response to the financial crisis: report to the G20

#### **November 10 – 11, 2010**

- G-20 Meetings in Korea

#### **December 16, 2010**

- Comprehensive documentation and proposals [4]

#### 4. The new Basel III capital requirements

The new Basel III standards are fundamentally different from the Basel I and Basel II standards in that their scope is much broader and the measures they propose are both micro-prudential (addressing bank-level risks) and macro-prudential (system-wide risks that can build up across the banking sector) in nature. [5]

Micro-prudential standards refer to [6]:

(i) raising the quality of the capital base by increasing the regulatory equity requirement (common stock and retained earnings) and the required ratio of Tier 1 equity (own capital and hybrid instruments), as well as by introducing stricter eligibility criteria for the instruments that may be taken into consideration upon determining Tier 1 equity;

(ii) enhancing risk coverage, with a focus on the risks highlighted by the crisis, such as trading book exposures, counterparty credit risk (CCR), securitisation exposures and securitisation positions;

(iii) supplementing the risk-based capital requirement with a leverage ratio;

(iv) introducing global liquidity standards meant to ensure short-term (30 days) resilience to shocks/liquidity disruptions and to address longer-term (1 year) structural liquidity mismatches (by funding long-term assets with at least a minimum amount of stable liabilities).

Basel III will require banks to hold 4.5% of common equity (up from 2% in Basel II) and 6% of Tier I capital (up from 4% in Basel II) of risk-weighted assets (RWA).

Basel III also introduces additional capital buffers:

(i) a mandatory capital conservation buffer of 2.5% and

(ii) a discretionary countercyclical buffer, which allows national regulators to require up to another 2.5% of capital during periods of high credit growth. In addition,

Basel III introduces a minimum 3% leverage ratio and two required liquidity ratios. The Liquidity Coverage Ratio requires a bank to hold sufficient high-quality liquid assets to cover its total net cash outflows over 30 days; the Net Stable Funding Ratio

requires the available amount of stable funding to exceed the required amount of stable funding over a one-year period of extended stress. [7]

The proposals in summary:

- ✓ Tightening the capital requirements
- ✓ Raising the quality, consistency and transparency of the capital base through stricter rules on eligibility of instruments to be included in capital and introduction of a new core Tier 1 ratio, “Common Equity Tier 1” (CET1)
- ✓ Enhancing risk coverage through ‘strengthening’ counterparty credit risk capital requirements arising from derivatives, repurchase transactions and securities financing
- ✓ Supplementing risk-based capital requirements with a non-risk-based leverage ratio Reducing pro-cyclicality and promoting countercyclical capital buffers
- ✓ Introducing a global liquidity standard comprising a stressed liquidity coverage ratio and a longer-term structural liquidity ratio
- ✓ Addressing systemic risk and interconnectedness, with more specific proposals promised.

#### 5. Conclusions

The Basel Committee on Banking Supervision has received a number of interpretation questions related to the December 2010 publication of the Basel III regulatory frameworks for capital and liquidity and the 13 January 2011 press release on the loss absorbency of capital at the point of non-viability.

As regards the global nature of the \_ nancial system, banks are internationally active, supervisory authorities are con\_ ned to national jurisdictions, while risks in a particular country are not necessarily linked to risks in another country, even assuming similar competitiveness conditions among banks.

For these reasons, it was decided to comply with national authorities’ decisions on the measures to maintain \_ nancial stability at a national level. Thus, the level of the countercyclical buffer will be set by the supervisory authorities in the jurisdictions where the obligors are located, irrespective of

the creditor’s country of origin. The decision on the capital buffer level taken by the authorities in the host country shall be binding upon banks and supervisory authorities in the country of origin (up to 2.5 percent). The buffer that will apply to each bank will reflect the geographic composition of its portfolio of credit exposures. Internationally active banks will calculate their countercyclical capital buffer requirement as a weighted average of the buffers that are being applied in jurisdictions to which they have an exposure.

For an internationally active bank, the reliance on its geographic exposure and the elimination of the arbitrage risk are key components of an effective protection mechanism of the European financial system, since they allow stability to be preserved even within a financial system characterised by relatively high volatility of capital flows (as is the case of Romania). Furthermore, the countercyclical capital buffer needs to be determined and held at individual, sub-consolidated and consolidated level. [8]

The OECD estimates that the implementation of Basel III will decrease annual GDP growth by 0.05-0.15%. Outside the banking industry itself, criticism was muted. Bank directors would be required to know market liquidity conditions for major asset holdings to strengthen accountability for any major losses. [9]

The companies is not looking forward to the year 2013—when banks start complying with strict new Basel III banking rules that will require them to dramatically increase their capital over several years.

The expectation is that this is going to increase overall costs for corporates and companies. To the extent that banks are being asked for a lot more capital, they only have two choices at the end of the day—either accept lower returns or find ways to increase their pricing to offset some of those costs.

The dilemma that all corporate treasurers face is in anticipating which particular financial services they will wind up paying more for—or earning less from. The Basel Committee of the Bank for International Settlements’ new rules will require all banks—including the 23 that IP does business with—to more than triple their core Tier 1 capital from 2% of risk-weighted assets to a minimum of 7% by 2019. Made up of

common equity and disclosed reserves—or retained earnings—core Tier 1 is “the most expensive” type of capital that a bank hold. As a result, it predicts that banks will stop looking at profitability per transaction and start looking more closely at overall profitability per client. [10]

The new rules are intended to shore up the global financial system and prevent a repeat of the debacles that brought down Lehman Brothers and Bear Stearns in 2008. But rather than rejoice at rules that are intended to reduce overall risk in the global financial system, senior managers of banks around the globe that are starting to comply with Basel III are quick to identify a litany of brutal impact points for their corporate clients, ranging from a drop in already-low interest rates on deposits to dramatic increases in interest rates on loans.

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## The Leasing Market in Romania

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### Abstract

*The leasing market in Romania is made up of thousands of businesses that meet the two conditions required by law for operators in this market, namely: inclusion of "leasing activity" in the subject of activity and social a capital of RON 50.000, more than 270 companies are active 39 and have notified the National Bank of Romania (NBR) as being finance leases, and of these 34 members ASLR, holding a market share of approx. 48%.*

*The leasing market in Romania is structured (and percentage in the ASLR): (i) leasing companies affiliated to banks (30%); (ii) leasing companies affiliated to producers or suppliers of products (15%); (iii) independent leasing companies (55%).*

*Recent legislative changes have led to cancellation of tax incentives for leasing operations. The paper captured the effects on the leasing market in Romania.*

**Cuvinte cheie:** leasing, leasing market, loan

**Clasificare J.E.L.:** G10; G21

### 1. Introduction

Leasing is a process by which a firm can obtain the use of a certain fixed assets for which it must pay a series of contractual, periodic, tax deductible payments.

The lessee is the receiver of the services or the assets under the lease contract and the lessor is the owner of the assets. The relationship between the tenant and the landlord is called a tenancy, and can be for a fixed or an indefinite period of time (called the term of the lease). The consideration for the lease is called rent. A gross lease is when the tenant pays a flat rental amount and the landlord pays for all property charges

regularly incurred by the ownership from lawnmowers and washing machines to handbags and jewelry.[1]

Under normal circumstances, a freehold owner of property is at liberty to do what they want with their property, including destroy it or hand over possession of the property to a tenant. However, if the owner has surrendered possession to another (the tenant) then any interference with the quiet enjoyment of the property by the tenant in lawful possession is unlawful.

Similar principles apply to real property as well as to personal property, though the terminology would be different. Similar principles apply to sub-leasing, that is the leasing by a tenant in possession to a sub-tenant. The right to sub-lease can be expressly prohibited by the main lease.

In Romania, the lease is regulated by Government Ordinance no. 51/1997, republished in the M.O.R. no. 9 / 12.01.2000, leasing operations into a new category of acts of trade which adds to the provisions of art. 3 Commercial Code.

Leasing operations subject it may be real estate, durable movable under the civil circuit, except the audio tape recordings and videos, plays, manuscripts, patents and copyright. Statistically, the leased it formed special computer equipment, devices and instrumentation, vehicles, machine tools, agricultural machines. The user can choose to purchase the property before the end of the lease, if the parties so agree and if the user pays all obligations under the contract.

### 2. Leasing companies- Non-bank financial institutions

The activity carried out by NBFIs in Romania focus on \_ nancial leasing operations, which account for about 75 percent of total loans extended by this sector.

The worsening macroeconomic conditions had a negative impact on financial leasing operations in the EU, most member states reporting a lower volume of loans granted. The depth of the financial leasing market in Romania is similar to that of Poland, France or Greece, yet below that of Hungary and Austria.

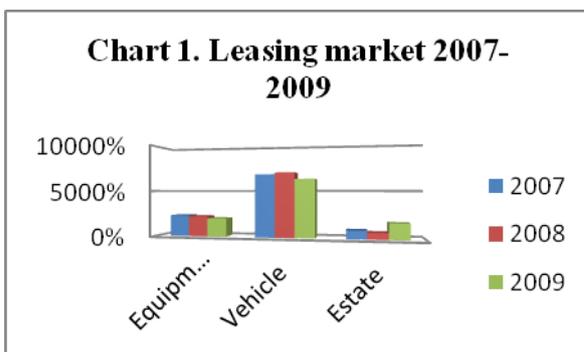
The loans granted by NBFIs are particularly channelled to non-financial corporations that hold a share of roughly 75 percent of total. With regard to the concentration of NBFi loans by economic sector, the exposure to companies in the services sector is prevalent. (52.2%).

Considering the specific activity, credit risk is the main challenge for the undertakings in this sector. Recent macroeconomic developments made a significant contribution to the rise in non-performing loan ratio of NBFIs. However, as compared with 2009, loan portfolio quality deteriorated at a slower pace, following a trend similar to that of credit institutions. As a result, provisioning costs were further high, but provisioning was slower, the quarterly costs related to new provisions standing below those recorded in the same periods of 2009.

### 3. The structure of the leasing market

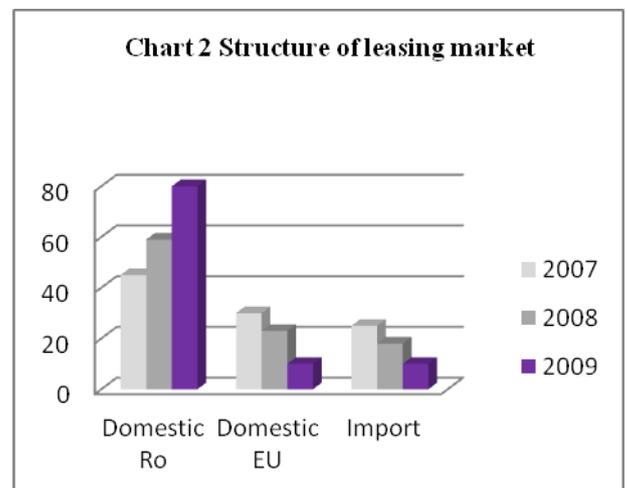
Leasing as a means of financing registered a downward trend in recent years.

The leasing market in Romania recorded in 2009 a volume decrease funding by 25-30% compared to 2008, mainly due to reduced auto and real estate transactions segments and amid international turmoil. In 2008, auto reached 3.38 billion euros, equipment and funds totaled 1.082 billion euros.



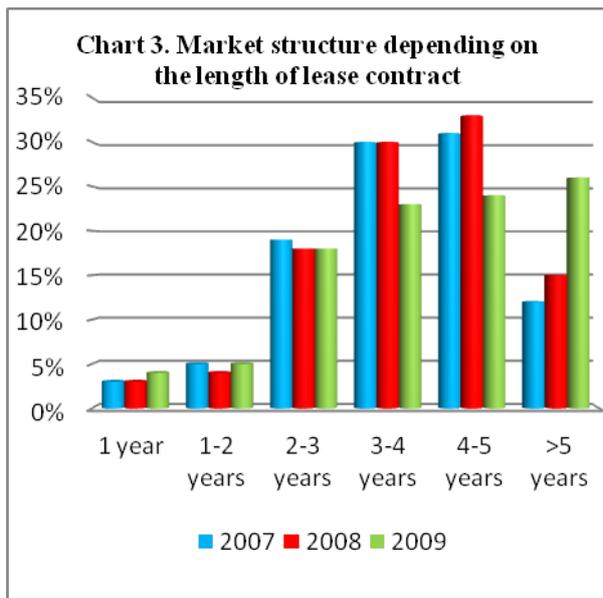
Auto leasing segment in 2008 remained the main business profile companies, accounting for 71% of the market, equipment leasing represented 22%, while real estate segment deleasing weighed 7% of the overall market (Chart 1)

Funding for the purchase of vehicles fell last year more than the market average, 75.2% respectively at 839.58 million euros. Also, equipment segment fell by 75.9%, to 261.15 million euros. The real estate segment was 34% lower at 232.64 million euros. In financing transport vehicles have a share of 61%, 21% heavy commercial vehicles, 16% vans and other vehicles a rate of 2% of the total. Funding of transport recorded a decline of about 72% in the cars and light commercial vehicles. Largest decrease, 81% occurred in the heavy commercial vehicles. Auto leasing market used to revived in 2009, as leasing companies have turned to leasing segment car used for business in 2009, while the volumes of sales in this segment increased. In the first half of 2008, auto leasing market used 5% of the total auto financing. [3].Auto leasing market reached 2.1 billion at the end of June 2009, accounting for 80% of total leasing market (chart 2)



The contract period is longer with the monthly rate is lower and the customer can easily pay. A long period of funding usually results in the accumulation of larger amounts to be reimbursed.

In terms of the lease term, the most common period is 4-5 years years (33%), followed by 3-4 years (28%) 2-3 years (18%), over 5 years (13%) 1-2 years (5%) and 1 year (3%).



#### 4. Leasing for vehicle vs. loans in 2011

In 2011, only leases on vehicles on an increase over the previous year, but in a very low level of only 0.67%.

Total value of leasing contracts in 2011 is 4817.654 thousand euros, of which the vehicle is financed through leasing 3383.806 thousand euros of equipment 1082.011 thousand euros, and the property financed by leasing 351,837 thousand euros.

Looking in more detail on the financing structure leases vehicles for 2011, they note that car leasing financing remains the main client application (to an extent of 55%), followed by demand for heavy commercial vehicles in a much smaller, only 27%, and light commercial vehicles (15%), the remaining 3% being the other devehicule.

In terms of the duration of the lease in Romania in 2011, the largest share of 33% o have carried out contracts lasting 4-5 years, followed by contracts with duration of 3-4 years (28%) and that the contracts with duration of 2-3 years 18%. But less were the contracts for more than five years (only 13%) and those 1-2 years (5%) or 1 year, holding the other, the monkey represents only 3% .

In 2011, leasing and auto loans had annual percentage rates of about 13-14% per year. Both the loans and leasing, the cost of borrowing in domestic currency loans equaled that of the euro and often meet in local currency loans that are even cheaper than the currency. Instead, leverage low and

high feed make a product more disadvantageous lease for residential customers than bank credit.

So, who plans to buy a car and have no savings can not access a product leasing. Minimum down payment charged by lenders in the industry is about 10-15% and can go up to 50% of the purchased vehicle.

Banks usually do not charge advance personal loans. For auto loans, banks require advance, but there are players in the market who are willing to finance their property without any input from the client.

One is the Romanian Commercial Bank. An impediment to purchasing a car lease could be low level of debt (share of income customer rate) allowed companies.

If a commercial bank if it can climb to 40-50% of the eligible income of the debtor, the most leasing companies can be more than 30-35% of income. Times, a loan is granted usually leased for a period not exceeding four to five years.

#### 5. Conclusions

It finds that leasing companies have subsidiary banks throughout the period analyzed the largest share, while recording a permanent upward trend, until 2010, in contrast to captive companies, whose share of total assets financed continues to decline.

In 2011, however, is a decrease of 1% at the expense of captive leasing companies, plant whose contribution to total assets increased by 2%, while independent companies share equally decreased, reaching 18%.

Thus, the end of 2011, the market is dominated by companies belonging to large financial and banking groups (63%), followed by captive producers (19%) and independent companies (18%).

This concentration of volume in most dominated by companies belonging to banking groups is part of the classical dynamics of the leasing market development.

The main sources of funding in recent years calling Romanians, to purchase car leasing cars are the loan. Each one of the two options has advantages and disadvantages, significant differences between the two versions is the cost you.

To determine the costs involved by the two types of funding, is necessary to compare

the values and lesingului auto loan based on common criteria.

If the funding type option lease or loan the most important indicator of cost efficiency is the annual percentage rate (APR), because it offers a high degree of comparability between apparently similar financial products.

APR expressing total costs of a loan, accumulating interest, commissions and / or other fees. Funding advantage realized by leasing costs lower than for personal loan, being comparable with those for auto loans. Regarding the loan currency, while finance lease is offered predominant type in euro, personal loans and the car are offered both in domestic and foreign.

To obtain a lease is required but an advance of at least 15-20%, and by the agreement of the leasing company is the sole owner of the car. However, insurance is concluded by the insurance company agreed list and pay the legal costs.

In 2012 it expected a 10-15 percent growth, last year, but fortunately the leasing market went up 20 percent. We believe the leasing market is to see a 10-15 percent rise, this year, as it benefits from all required investments, and there is demand for leasing products on the Romanian market.

There are postponed projects in the infrastructure, whose negotiations unfortunately were not reached, but we hope they will be unblocked.

We are trying to switch the offer to lei, but clients prefer euros, because they make family budgets in euros. As far as the phone bills or other bills are calculated according to the euro's exchange rates, automatically everything is calculated in euro.

The Romanian leasing market grew from 1.121 billion euros, in 2010 to 1.349 billion euros, in 2011. The leasing market for cars increased by 29 percent, namely from 712 million euros, in 2010, to 917 million euros, in 2011, whilst that for equipment advanced 43 percent, namely from 238 million euros, in 2010, to 339 million euros, last year.

On the other hand, the real estate market dropped 46 percent, namely to 93 million euros. As much as 68 percent of the leasing market means car leasing, 7 percent of it stands for the real estate financing and 25 percent for the equipment leasing.

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12.03.2012

## Implications of Financial Crisis on the Savings Plan for a Family in Romania

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### Abstract:

*Some of the effects of the financial crisis are obvious when you open the wallet or going to the Bank, but the crisis may have a powerful impact on the lives of the couple. In difficult times, decrease in income can affect profoundly the life of couple and family. For married couples, the crisis could mean loss of revenue can affect intending to children.*

**Keywords:** crisis, savings, financial, resource

**JEL:** M21 - Business Economics

### “1. Introduction”

Lack of money or the desire to reach more easily they can be reasons to protect them not to have to go through the same negative experiences of professional parents were subjected. Lost sight of the fact that you can only work performance in any area and only in circumstances in which you have the skills necessary for that trade or profession. Reduced costs for the family budget adjustment must be made in consensus by both partners. Decreased revenues may lead to lifestyle changes a couple times in the relations of interest are more likely to fall apart.

A country's economic development takes place in two stages, depending on the motivation of this development, namely:

- A necessary first step is the transition from poverty to a decent standard of living generally. This means that each family to succeed to secure cash income to cover his needs for food, clothing, housing, education, health, etc., that those needs that

are common to all individuals, regardless of origin, culture, gender or race.

The size of these needs depends, of course, from person to person, so the development of society, and the level of individual development;

- In a second phase transition is needed to complement the qualitative standards of living secured in the first stage, and by meeting other necessities - in culture, education, individual transport, informatics, health services, tourism, sports, entertainment, recreation, maintenance, repairs, etc., and improving the social climate, political, labor, family, etc.. All these needs evolve naturally as society and individual development.

Given the above, we can say that the first priority of economic development of Romania is organizing a mass production of consumer goods and infrastructure, to ensure higher standards of living of all citizens of the country.

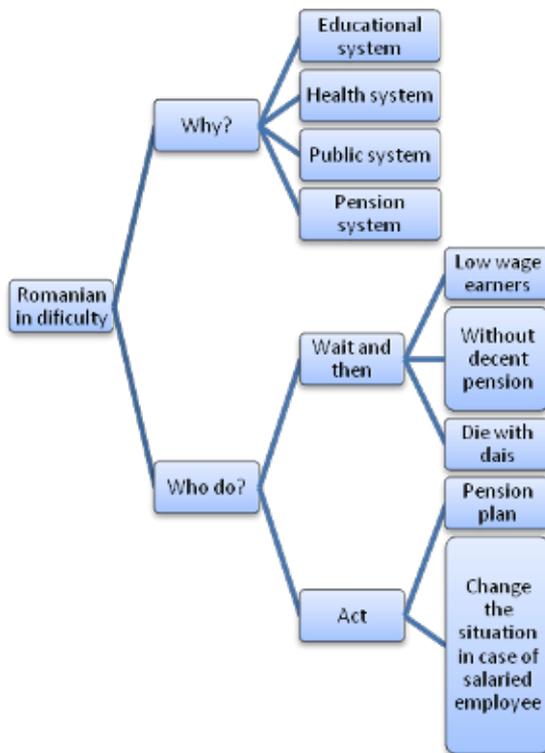
Romanians who have participated ideal body and soul since 1989 was the transition from a centrally planned social dictatorship, to a capitalist economic and social system, characterized by democracy and freedoms.

This goal was realized, in general, could make the transition from central plan economy based only on an economy based on free market only. If the socialist economic mechanism was based on planning, but did not exclude market, capitalist economic mechanism is based on the market, but does not preclude planning. Being not understand this fact, in former socialist countries, so also in Romania, was dropped completely in planning macroeconomic actually gave meaning to a modern and effective management tool to Socio-economic imperative in transition from socialism to capitalism.

Financial crisis in 2008 in Romania has resulted in lower revenues for each family,

with devastating consequences for elderly people, unless they take precautions during the active life. It is obvious that Romania is currently experiencing a difficult period and if no action is taken, Romania, the country is likely to fail and then disappear as a country (Figure 1):

Figure no. 1: Romania likely to fail



Source: Own contribution

Romania's population decrease in 2012 compared to 2000 by about 2 million people, gives a signal to the active population that will have difficulties at the age of III, because the current pension system is not credible. In these circumstances, the principle of "peasant car makes its winter and summer sled", each of us must have a different approach to the concept of spending the income. I will propose a distribution of savings by 4-saving systems on a "go to market when eggs are put in several baskets" namely[1]:

- 7.5% in lei deposits with monthly capitalization, land, houses or jewelry;
- 7.5% shares or bonds to mutual funds with a history of five years the rate of

gain was higher than the inflation rate 10%;

- 7.5% pure gold bullion purchases of 24 carats;
- 7.5% background risk, in starting a business.

## "2. The human resource"

Human resources can be measured by net income during active indicator. Assuming that a man has 40 years working life and earn on average 1,500 Euro when its value is:  $40 \text{ years} \times 1500 \text{ E / month} \times 12 \text{ months / year} = 720,000\text{Euro}$

In a more pessimistic assumption (but closer to the truth) if a man earns on average 500 euros per month throughout the active, then its value is:

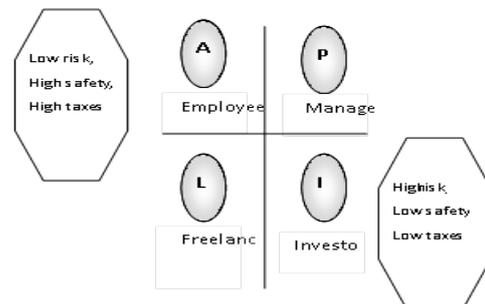
$500\text{E/lună} \times 40 \text{ years} \times 12 \text{ months / year} = 240,000\text{Euro}$

The conclusion resulting from these calculations is that one can not live decently, especially single parents, from a salary. Consequently, it became a necessity to earn money from several activities [2].

## "3. Money Quadrant"

Robert Kiyosaki has shown that there are four quadrants in which a man can earn money: employee, self-employed, employer, investor (figure no. 2).

Figure no. 2: Money Quadrant



Source: Own contribution

In my opinion, after 2008, entrepreneurial skills have become a necessity for all of us and no longer a luxury for people with specific skills [3].

Need for entrepreneurial knowledge [4] is true conception machine, vacuum cleaner, computer or mobile phone (Figure no. 3)

Figure no. 3: *Luxury or necessity*

Year, conception, movable	Year	Conception
Car	1960	Luxury
	1990	Need
Vacuum cleaner	1970	Luxury
	1995	Need
Computer	1990	Luxury
	2000	Need
Mobile phone	1995	Luxury
	2006	Need
Entrepreneurial	2000	Luxury
	2008	Need

#### "4. Conclusion"

Each family in Romania suffered financial contract, meaning that after 2008, family incomes have declined significantly in terms of purchasing power. Increased incidence of loan payment due from banks, reducing wages and pensions and increase VAT from 19% to 24%, confirming the downward trend in the purchasing power of families in Romania.

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## A Review on the Assessment of Public Debt Sustainability

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### Abstract

*In light of the growing public debt, the issue of debt sustainability has increasingly attracted attention. At least half of the EU countries will have to implement stringent fiscal consolidation programmes over the next few years in order to prevent already high public-debt-to-GDP ratios from a further significant rise, also the case of Romania. However, drastic fiscal policy adjustment may be not feasible in the short term and hence public debt is likely to grow further.*

**Key words:** public debt, fiscal policy, fiscal sustainability, GDP, fiscal consolidation.

**J.E.L. Classification:** H63, H30, H69, H60, H59.

### 1. Introduction

Sustainability can be assessed in other terms but the size of the accumulated stock of public debt. Even with an indebtedness degree of 20%, budget and fiscal policies may be unsustainable if, for example, that State is unable to pay its obligations arising from the contracted public loans, so if it is not creditworthy.

Public debt's sustainability can be represented as a relationship between the budgetary balance (surplus or deficit and public debt, for any annual GDP growth rate. There are two versions of the mentioned relationship, depending on considering the consolidated or primary budgetary surplus/deficit.

### 2. A review on the assessment of public debt sustainability

For some time, the recent rise in government budget deficits and debts worried mainly academics, policy makers

and politicians. In the beginning of 2010 the financial markets questioned the solvability of some member states, leading again rising to sovereign bonds spreads and finally to urgent and drastic actions of the EU and IMF to support Greece and other threatened member states.

From the literature review on sustainable debt levels we derive four indicators that appear to be useful for the assessment of debt sustainability. (Lejour et. al., 2010). [1]

First, the forward looking sustainability gap indicator which shows the distance in terms of primary surplus as a percentage of GDP from a stable debt-ratio.

Second, the backward looking sustainability gap indicator which indicates whether the current debt level is commensurate with the debt-ratio that would be sustainable if augmented primary surpluses, interest rates and GDP growth rates would remain at their average level of the recent past.

Third, the debt-to-government revenue indicator that was on average 350% for emerging market economies that defaulted since 1998 and 250% for non-defaulting countries (Callen et al., 2003). [2]

And finally, the debt-to-GDP ratio for which a threshold value of 90% can be associated with below-median GDP-growth (Reinhart and Rogoff, 2010) [3]; hence, it is likely that maintaining debt-ratio's around 90% or higher is more difficult and thus less sustainable than debt-ratio's at a more modest level.

In Europe, government debt and budget deficits are not only considered as a national issue, but also as a European matter. Our article takes into account the international dimensions of government debt in particular in the EU member states. Many of the spill over channels between countries are also apparent between countries outside the Euro zone, but they are more intensive in a common currency area.

Identifying these spills over channels is also a first step to assess the probability of a debt crisis and to understand the mechanisms of such a crisis. (Lejour et. al., 2010). [1]

The first externality is higher inflation expectations in the euro zone. The argument is that high debt in one country could only be recovered with inflation such that the central bank is urged to raise the overall inflation rate in the union and affecting price stability in other EMU countries.

Fischer et al. (2002) [4] show that larger budget deficits exert an upward pressure on inflation in developing countries in cross sections and panel regressions. However, these effects are insignificant in developed countries. Canzoneri et al. (2001) [5] confirm these results by showing that government debt in Europe and the US is not a significant determinant of the price level.

The second externality is a higher rate of interest on government debt. Every Euro zone country issues its own bonds with a national rate of interest. However, the high interest rate of a particular country could exert an upward pressure on the interest rates in other countries (perceptions of investors). This could even be the case for non-EMU countries, in particular if they have plans to join. This is closely connected to contagion and reputation issues which played a role in the Latino debt crisis and the Asia crisis.

Ardagna et al. (2007) [6] estimate for 16 OECD countries the effect of primary deficits and government debt on the nominal interest rate on 10-year government bonds in the period 1960 to 2002. In their preferred specification a one percentage point increase in the primary deficit to GDP ratio leads to a 10-basis point rise in the nominal interest rate. On the longer term a permanent increase in the primary deficit ratio has much larger effects: the nominal interest rate could increase by 70 basis points after five years and 150 basis points after ten years. The European Commission (2004) [7] reports in its literature overview a 20 to 100 basis points increase in the long-term nominal interest rates of government bonds, after having removed the insignificant results, suggesting that the Ardagna results are at the lower range. However they include the deficit and government debt simultaneously as explanatory variables while others do not.

Faini (2006) [8] focuses exclusively on the

EMU countries between 1979 and 2002 and distinguishes an EMU and national interest rates. An increase in the budget surplus of the EMU lowers the EMU interest rate with 41 basis points. The analogous effect at the country level is much smaller, only 3 basis points. The latter effect corresponds to the results of Chalk, N. and R. Hemming (2000). [9] Similar effects were found on the EMU interest rate for the US. This suggests that the quantitative impact of an expansionary fiscal policy in a member states on the EMU interest rates is much bigger than on the country spreads. Faini (2006) [8] concludes that there are substantial spill overs of national fiscal policies on the interest rate. The literature provides however a broad range of estimates on the size of the spill overs.

The effect of higher government debt (as ratio of GDP) on the interest rate is nonlinear. If debt increases, bonds become more risky. Ardagna et al. (2007) [6] conclude that if government debt is lower than (about) 60% of GDP an increase in debt could exert a downward pressure on the interest rate, but the direction of this effects switches if the debt is larger.

On the other hand, Faini (2006) [8] does not find strong evidence that the spill over effects of high debts on the interest rate and the country spread are larger than for low debts.

A third externality is that many European financial institutions hold bonds of other EU members. The data of the Bank of International Settlement (BIS) show that these cross-border holdings have increased substantially in the last decades. If there is a chance that the high debt country (partially) defaults, the assets of government bond holders will plummet. In uncertain times this could trigger a chain reaction. Currently banks hold a significant share of Euro zone debt and it is uncertain whether a breach in bank balance sheets caused by a sovereign default will lead to a chain reaction in the form of another banking crisis. Assessing the impact of such an event is crucial in determining whether such a spill over is significant.

A fourth externality is the stability of the euro vis-à-vis non-euro countries. Exporters benefit from a weaker euro, but imports become more expensive. The net economic

effect is not always clear and depends on the economic structure of a country. A deterioration of the euro in response to high debts in one or two member states has certainly an effect on the trading behaviour of euro members with non members. Moreover, financial markets interpret depreciation of currencies often as a sign of weakness of the economic development having adverse effects on stocks markets. A fifth externality is the transmission via the real economy due to budgetary decisions on the economies in other countries. Reinhart and Rogoff (2010) [3] argue that high government debt is often related to poor economic performance, although the causality is not heavily discussed.

Subsequently, poor economic performance affects other EMU economies, in particular via trade, FDI and R&D spill overs. The empirical literature estimates the spill over effects of trade (export and import) with VAR regression techniques. As an example, Giuliodori and Beetsma (2005) [10] estimate that a net tax reduction of 1% of GDP in Germany leads to a maximum 0.7% GDP increase in the Netherlands after seven quarters. After about four years the effect dies out.

We conclude that the long term effects are small although the short term effects are larger.

Concluding, there are that four methods available to assess sustainability of government debt:

- a) The sustainability gap indicators (Blanchard gap, over borrowing ratio);
- b) Benchmark indicator set of defaulting countries;
- c) Consideration of debt-to-GDP ratios in view of underperformance of GDP-growth once they exceed 90%;
- d) Primary surplus to debt feedback rule.

### 3. Conclusions

In many DMs and a few EMs, one should not forget that expansionary policies mitigated the adverse effects of the global crisis and very likely prevented a collapse of the global financial system and the world economy.

At the moment, it appears that a fiscal exit can take place only gradually. Future scenarios as well as debt target analysis

highlight that public debt has become, or is at least at the risk of becoming, unsustainable in many DMs but only in a few EMs. At least in theory, most EMs could afford to run looser fiscal policies, for instance by extending counter-cyclical fiscal policies in order to smooth the fall-out from the global crisis.

Moreover, moderate initial debt levels put them in a relatively comfortable position to stabilise or even outgrow their debt-to-GDP ratios. Only austere and bold fiscal policy adjustments after the worst of the crisis is over, which may lay the foundations for higher potential real GDP growth, lower real interest rates and improved fiscal accounts, would significantly alter the presented public debt dynamics. For some countries the permanent primary balances required to stabilise or even reduce public-debt-to-GDP ratios look very ambitious.

Nevertheless, the required economic and political efforts to consolidate public finances might be much greater than in the past. Overall, medium-term fiscal consolidation is more likely to occur in a supportive macroeconomic environment. During an economic downturn or recession, rising tax rates may not suffice to substantially increase the tax-to-GDP ratio.

Should consolidation fail policymakers in DMs and some EMs, one may be tempted to look for other ways to fix the fiscal damage. Either they could tolerate a substantial acceleration in CPI inflation to inflate public debt and/or they risk severe adjustments in the real effective exchange rate. Such adverse scenarios should not be disregarded. The assumption that major macro issues cannot go wrong in the DM world (including EMU) has to be scrapped in the aftermath of the global crisis while this time EM, not DM, economies are the ones in the lead to keep public indebtedness sustainable.

### Acknowledgement

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## Considerations about the Informational Efficiency of Financial Markets

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### Abstract

*The paper proposes a critical analysis, based on consistency criteria, regarding the controversial current state of the informational efficiency theory of the capital market (Efficient Market Hypothesis).*

*Nowadays, after several decades of research and thousands of studies, economists have not yet reached a consensus about the existence of efficient financial markets in terms of information. In the problematized approaches regarding the treated subject, one can find the inquiries on the validity of assumptions underlying the concept of informational efficient market and the informational efficiency theory of the financial market. In this sense, the critical approach is one that highlights the weaknesses, the vulnerable aspects that characterize the classical form of EMH theory, in order to exclude a cumulative process, achieved by extending or articulating the methodological and instrumental existing premises (based on optimality criteria - the current paradigm of economics), aiming their reconsideration and reconstruction.*

**Key words:** efficient market hypothesis, information, rationality, price

**J.E.L. Classification:** G14, D8, G00

### 1. Introduction: market efficiency, in light of the classical EMH theories

Considerations concerning the efficiency of financial markets lay under two theories: random walk and the theory of efficient markets. The first theory, “random walk”, is the theory of random movement of the financial assets. Elaborated during the 6<sup>th</sup> decade of the 20<sup>th</sup> century, it supports the

idea that the future movement of an asset is independent from past movements of assets on a market. In 1900, in a theoretical study, Louis Bachelier anticipates the theory of efficient markets, stating that *stock market speculation* is a fair game, in which neither the sellers, nor the buyers, do not gain a net profit overall. We can thus say that the idea of an efficient market, as it is understood in today's literature, has its origins with Bachelier, which postulated the model of random steps: “Random Walk”, or “Fair Game”, reprinted in English in 1964's paper by Paul Cootner: “The Random Character of Stock Market Prices”. The origins of the EMH are also found with Paul Samuelson (1965) whose contribution is summarized by the title of its article “*proof that properly anticipated prices fluctuate randomly*”. In an informational efficient market, price movements are unpredictable, because they encompass the information and expectations of all market participants.

The second theory, which refers to the hypothesis of efficient markets, was established in the early 60s and assumes that asset markets process with great sensitivity the economic intelligence which they receive and react quickly to adjust the course of financial assets. The theory of efficient markets justifies the need of balanced markets. Roberts (1967) and Fama (1970) have operationalized this hypothesis. In his famous study, which will definitively mark the theory of efficient markets, *Efficient Capital Markets: A Review of Theory and Empirical Work*, written by Fama in 1970, he gives the following definition: “A market in which prices always reflect the available information is called an efficient market”. In this paper, he realizes a synthesis of previous research concerning the predictability of capital markets, the notions of *fair game* and *random walk* becoming well formulated. The

distinction between the three forms of efficiency is being made: efficiency in its hard form, semi-hard efficiency and weak efficiency.

The weak efficiency form sustains the hypothesis that the current price of stocks fully reflects all the informations concerning the stock market, such as: past prices, exchange rates, volumes of transactions and any other information concerning the markets. This involves the fact that there will be no correlations between past and future exchanges of stock rates: the rates of exchange are independent. Thus, any rule for their transaction depends on the past changes of information flows will not be useful. In an efficient market, past prices of the titles cannot be used to beat the market or to obtain adjusted rentabilities for a superior risk. In such a context, the chartist or technical analysis is useless.

Semi-hard efficiency look, in addition, to the immediate integration within the new course of any new information with a public character, concerning the firms wealth, its results, dividends, the distribution of free stocks, stock market introduction, etc. the evolution of the course is random, and eventual variations are determined by unpredictable factors, others than the history of courses and publicly broadcasted information. In an efficient market, in its semi-hard form, fundamental analysis, founded on public information, is useless.

Hard efficiency implies, more than that, the quick integration within the market prices, of all available information about the traded asset, including privileged information. On such a market, superior performances cannot be made even by people who own all the informations available on the transacted asset. Thus, nobody, not even the initiated ones, can thoroughly anticipate the future evolution of the courses, as they have already recorded all the existent information about the intrinsic value of the title, and any new information will be transparent and thus, will immediately be integrated in the price of the title. So, such efficiency (as the semi-hard one) puts into discussion the validity of the entire fundamental value analysis, as the intrinsic value is the market price itself.

The more efficient the market, the more the evolution of the price is random, and the most efficient market accounts for

completely random price movements, totally unpredictable. And this is the result of the fact that market agents try to take advantage of available information, and thus, by using them quickly, they are rapidly incorporated in prices and thus they cancel the gaining opportunities of arbitration. If this is done instantly (which is doable only in a market which lacks transaction costs), then prices will always reflect all the available information. Thus, extra-profits can not be generated from having information, because such profits have already been incorporated.

## **2. The critical analysis – the main criteria**

In order to reflect lack of concordances reflected by the economic reality as related to the theory of informational efficiency of the financial market, one needs, as a first step, to establish at a conceptual level how we can define the informational efficiency. Informational efficiency looks at integrating fundamental intelligence in stock market courses, concerning the intrinsic value of the quoted assets (the historical evolution of stock market courses, publicly available information, concerning the financial execution and economic perspective of the issuing company, privileged information, accessible only to the initiated ones: managers, stock holders, etc.).

The main traits of the efficient market (which represent the correspondent of the market with the pure and perfect) and refers to the following:

- Transaction costs have a null value;
- Free and instantaneous access of all the investors to all available information;
- All participants are rational agents which make homogenous estimates on future trends.

We can rephrase these theoretical traits, purely idealistic, which can be found in practice, in an efficient market, in a weaker form, as such:

- Transaction costs are not null, but acceptable;
- Free access to available information is allowed to a great number of investors;
- There is not a systematic dominant position for either of the transaction participants.

In a market characterized by the traits

mentioned above, all the financial assets have the same risk characteristics, and must offer the same income. The financial market is efficient; if the price of each financial asset is equal to its intrinsic value of the respective title, at any time, ergo the equilibrium price in the pure and perfect conditions. Actually, the “aligning” of the equilibrium price is not instantaneous. There is always a non-null time span, because one reaches equilibrium via lacks of equilibrium. An efficient market however shortens this time span considerably.

In the following, the critical analysis concerning the theory of informational efficiency of the financial markets will be realized considering three criteria, as follows: according to the concept of informational efficiency of the financial market; according to the typology of information and their integration within the price; after the propositions of relaxation of the classical hypotheses of the EMH theory.

*Criterion 1: according to the concept of informational efficiency of the financial market*

Eugene Fama (January 1965: “The behavior of stock market prices”), stated that an efficient market for the financial assets is a market in which, considering the available information, prices represent an accurate intrinsic value estimate at all times. The same author (September – October 1965 : Random walks in stock market prices) mentions that an efficient market is a market where there is a great number of rational competitors which actively follow profit maximization, each trying to forecast the future values of their financial titles, and where current information is available to participants almost free. Four years later, Fama specifies the fact that an efficient market is the one that quickly adjusts to any new information, and in 1970 he stated that a market in which prices always reflects available information is, as a whole, an efficient market.

The formal definition of efficiency as related with a series of information is given in 1978 by Jensen: a market is efficient as related to the  $\theta_t$  if it is impossible to obtain a profit if one makes transactions on the basis of that multitude of information.

In 1991, Eugene Fama writes his second synthesis paper on efficient capital markets (Efficient Capital Markets: II) in which he

makes a passage in effect if the main results concerning the testing of the hypothesis of an efficient market, introducing, for the first time in the literature, the concept of yield predictability, in stead of the weak efficiency formula.

Malkiel (1992) stated the fact that a capital market is efficient if it fully and correctly reflects all the relevant information for the assets prices. In a formal manner, the market is efficient in ratio with several relevant information of the prices of the assets will not be affected by the knowledge of that information by all the participants. Moreover, the efficiency in relation with the  $\theta_t$  involves the fact that it is impossible to obtain a profit by trading on the basis of this information lot.

A new direction of research will take into account the materialization of a new definition of the concept of informational efficiency of the financial market, which will be required to generate additional epistemological consequences as compared to classical definitions, mentioned above. In relation with the consequences generated by the ancient definitions, from a cognitive perspective, the new definition will have to produce new consequences, which are revealed from the new approach. An example for a new approach to the concept of informational efficiency of the financial market is presented below, although it requires the further definitivation through the rethinking of the mentioned aspects and through the establishment of required and sufficient attributes: a market is efficient from an informational perspective if, in the context of the existence of a certain informational set, of certain identification methods of the new information, but also in the conditions of availability for certain methods of modelling based on existing information, it is not possible to realize extra profits by linking the three sets of data.

*Criterion 2: according to the classification of informations and their integration within the price*

The concept of market efficiency refers to information: at a certain moment, prices reflect all available information. This involves the fact that no processing, no matter how deep, can predict future trends. The interest of every investor is to obtain informations about the actions of the quoted

companies. These informations will allow it to evaluate the perspective of each investment opportunity and to invest in the portfolio which has the best perspectives. All information channels are efficient if they spread intelligence quickly and if every new information becomes public very quickly.

Many practical observations concerning the reaction of investors to new intelligence, but also the mechanisms for their encompassing in the price of stocks, come to highlight the aspects of “market inefficiency” and refer, among others, to:

1. The appearance of time gaps in incorporating information – certain financial investors can present a defensive attitude concerning important public informations, which they hesitate to use, so as not to “fall pray” to better informed agents;
2. There is a quickness of reaction which is not the same for all additional or unpredictable information;
3. Investors have a different perception, more or less profound, or selective, concerning information;
4. The appearance of action inertia – some investor imitates those who react first to intelligence. This phenomenon, of bringing new and new investors in the “professionals net” continues, until the first, considering the course is over-evaluated, retire from the market. The contrary movement carries the same inertia.

An important argument concerning the impossibility of the existence of a perfectly efficient informational market is that information has a price and it is not available to all investors in the market at a given moment (Grossman, Stiglitz, 1980). So, the price reflected within the informations of professional investors (the informed), by only partially; as these informed investors pay to obtain information, it is normal that the price does not fully reflect the informations which they own, because on the contrary it would not be possible for them to cover the costs of obtaining the information in the first place. As a result, any model of capital market equilibrium must take information costs into account.

As an alternate research direction, with the purpose of studying information integration mechanisms within the price of market assets, one must classify informations according to Fama (past intelligence – public

intelligence – privileged intelligence) by realizing a new parametric type classification of the informations with the impact on financial decisions, criteria such as: the origin of information (x), type of information (y), type of financial impact of the information (z), credibility of information (t), the truth value of the information (p), the legitimacy of the information (authority level r):  $I(x,y,z,t,p,r)$ .

*Criterion 3: after the relaxation proposals of the prerequisites of the classical EMH variant*

As a synthesis of the most important premise of the informational efficiency concept concerning financial markets, these are:

- Investors are rational. Investors have risk aversion and only desire actives which have the highest yield for a certain degree of risk. Still, contrary to the general perception, EMH does not imply that all market participants are rational. Indeed, markets can become efficient if a group of investors have an irrational behaviour and are correlated in behaviour, as long as there are rational investors looking for arbitrary opportunities (Shleifer, 2000).

- Markets are efficient, meaning that current courses reflect all public and available information.

- Yields are independent. The exchange of courses can be determined only by new information. The yield in day t is not correlated with the yield in day t+1.

- Markets have a “random walk”. The probability of yield distribution is the same with the normal distribution (Gauss bell).

But, in reality, the prerequisites which lay at the basis of the theory of efficient markets are not real. The hypothesis that investors are fully rational agents which instantaneously process information in a correct manner in most unrealistic, and rationality is hard to define, human behaviour is often unpredictable. The rationality of investors appears as a result of the fact that orthodox economic science still remains the prisoner of the mechanical paradigm, in which values, irrationality, lack of direct interest, intuition, are not considered valuables of the economic process (Dinga, 2009). Information can be difficult to interpret, technology and institutions are constantly changing, and also, the gathering and processing of information,

as well as the realization of transactions require significant costs.

Investors will always have a risk aversion and also, they do not react to immediate informations, but in most cases, they react late, guiding themselves to the trend (which implies past intelligence) in the reaction of present strategies. We presented, in the above, several practical observations concerning the reaction of investors to the new information, but also mechanisms of incorporating them in the price of assets, which come to highlight aspects of market “inefficiency” and refers to: the occurrence of time gaps in incorporating information; the quickness of reaction is unequally distributed to any additional or unpredicted information; action inertia. One can distinguish between two categories of participants on the stock market, which obtain various portfolio investments, as they are either rational investors (“*smart money*”) which operate with relevant information, but also with regular participants (“*noise traders*”) which react to rumours and fashion.

People will not always behave in a linear way to new information, encompassing them immediately, as the EMH requires; people behave non-linear. Because of this, the prerequisite that investors are rational and thus, the modifications of courses is independent and that markets have a random step movement can not be accepted. The irregular assimilation of information, as it happens in reality, could lead to a tendency of random movement – “biased random walk”, called a fractal time series.

Most EMH criteria refer to the preferences and behavior of market participants. Several strays have been identified from the classical paradigm of EMH bound by investor behavior, of which we mention: *over-confidence* (supreme trust) (Gervais and Odean, 2001); *overreaction* (DeBondt and Thaler, 1986: they revealed that when assets are ordered by their rentability in the last 3 – 5 years, assets which during the past period had a high yield tend to have a low yield during the following time span and vice-versa. They attribute these anomalies to the over-reactions to information. In the formation of expectations, investor grant a high importance on past performances of companies and a low importance to the fact

that these performances can be inversed; *loss aversion* (which refers to the tendency of people to strongly avoid loss as they lack to seek gains), *herding*, *regret* (the theory of the late Bell, 1982). These critics of the EMH argument the fact that investors are often irrational.

### 3. Conclusions

Orthodox economic science considers three external methodological premises which are debatable: the rationality of the individual, the idea that the methodological anchor in economic science is globally efficient (minimization of opportunity costs), the idea that the economic process must be cast away, at least as a tendency, towards equilibrium (Dinga, 2009). But, in reality, the prerequisites which lay at the basis of the theory of efficient markets are not real. The hypothesis that investors are completely rational and they always process instantaneously and correctly all the available information which is surely unrealistic, as rationality is hard to define and human behaviour is unpredictable at many times. The more and more important influence of information factors, but also the acknowledgement – which became an axiom – is in general non-linear and even more so in human behaviour, economic processes and stock market activity have lead to the non-linear approach of stock market processes.

In order to succeed as a theory of efficient information of the financial markets, and thus, operational, we must consider certain additional structures, except for the way in which the price of a stock completely reflects available information, which have not been considered by the classical version of the theory, such as: investor preferences, their will, their attitude concerning risk, the structure of impact information of stock prices, the conditions of the economic environment, the state of the economy, etc. However, in this new context, it becomes an issue to test efficient market hypotheses, because it will also become a test for auxiliary hypotheses, and a non-confirmation of this mix of hypotheses will not state a great deal of things on the aspects which are not linked to existent data.

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# Financial Performance - an Approach from the Public Sector Perspective

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## Abstract

*The accounting standard settings for the public sector entities go through a process of adaptation, on one hand the international accounting standards and, on the other hand, the particularities of this sector. Initiated by the European Commission and professional bodies, this process led to a series of changes in the Romanian specific legislation. Application of accrual accounting increased confidence and transparency of financial reports prepared by governments and their agencies. A special importance in financial reporting of public sector entities is given to financial performance and, more recently, to the performance of services provided by them. Problems encountered in recent years due to the global financial crisis require improving management control in the public institutions to increase performance, efficiency and effectiveness in public spending of funds. In this article we aim to point out some of the concerns of the setters regarding reporting performance information of public sector.*

**Key-words:** setting, public sector, performance, financial management

**J.E.L. classification:** H83, M48

## 1. Introduction

Ever since 2005, the European Union questioned the adoption of measures to enable better management information on spending public funds, ensuring increased transparency and better control of these expenses. As a measure regarding this respect, the European Commission and the International Federation of Accountants (IFAC) has promoted the application of accrual accounting and prepared financial statements of public institutions based on the International Public Sector Accounting

Standards (IPSAS). Other professional bodies such as the Federation of European Accountants (FEE), recommended the use of accrual accounting by public sector entities because it provides greater accountability and transparency of financial reporting and provides better quality information to planning and management of public funds. Applying this reporting basis is situated at different stages in the European Union member states and it still generates debates about the degree of adaptation to the specific of public sector.

## 2. Features in Public Sector Financial Reporting

In one of the documents subjected to public consultation by the International Public Sector Accounting Standards Board (IPSASB) of IFAC website ([www.ifac.org](http://www.ifac.org), Exposure Draft, April 29, 2011), there have been identified and presented a number of key features of the public sector that influence financial reporting and distinguish the public sector from the private one [3]. These features are:

a) the volume and financial significance of non-exchange transactions (taxes and fees, on one hand, free services, on the other);

b) the importance of budget and its legal status (as opposed to the private sector, the budget is a public document required by law and the activity of public institutions is judged on budget implementation; this feature regarding the budget raises the question of introducing in the General Accounts Plan of accounts for recording of the amounts approved in the budget and their spending, which involving the cash accounting application);

c) the nature of fixed assets (there may interfere problems related to their age assessment or difficulties of evaluation);

d) responsibility for management and preservation of public heritage (national and local);

e) longevity of the public sector;

f) the regulatory role of government, which can radically change the regulations and specific norms;

g) ownership or control of rights to natural resources and phenomena;

h) relations with national statistics (the purpose of an accounting report having statistical basis is to provide aggregated information for analysis and modelling at a macroeconomic level, these standing further at the basis of state tax analysis).

Such features should be taken into account by setters when they "build" the regulatory framework for public sector entities.

### **3. IPSAS Implementation in National Accounting Regulation**

In Romania, accounting regulations for public institutions have undergone significant changes since 2006, introducing accrual accounting and taking over some elements of IPSAS. These accounting regulations [5] have been harmonized to a certain extent with the regulations of the private sector, both in the structure of the General Accounts Plan and content of financial statements. The setter of Romania, the Ministry of Finance, was supported in its efforts to modernize the accounting regulations by the Body of Expert and Licensed Accountants of Romania (CECCAR), as the body of the accounting profession in our country. CECCAR translated into Romanian the Accounting Standards for the Public Sector IFAC 2005 and 2009 editions, issued by the International Public Sector Accounting Standards Board (IPSASB) [4].

Prior to this major changes in accounting regulations for of public institutions, in the reform process there have been taken some steps that can be summarized as follows [2]:

✓ engagement, liquidation, authorization and payment of expenses of public institutions (OMPF nr.1792/2002, [11]), the four phases of the budgetary implementation of expenditure are being completed by all of the public institutions, regardless of subordination and financing, in compliance with mandatory procedures;

✓ revaluation and depreciation of fixed assets owned by the public institutions (OG nr.81/2003 and OMPF nr.1487/2003 [7], [9]) are introduced for the first time in the history of public administration in Romania (meantime OMPF 1487/2003 was abrogated and new methodological rules have been approved by OMPF 3471/2008 [8]);

✓ organization and management of revenue accounting (OMPF nr.520/2003 [10]), according to the Accounting Law, which requires the obligation of the accounting registration of rights and obligations of public institutions at the moment of their ascertain (the order was abrogated upon the approval of new accounting regulations for public institutions, approved by OMPF 1917/2005);

✓ introduction of new budgetary classification (OMPF nr.1025/2005), applicable from 2006, in accordance to the requirements of ESA 95 (European Standard Accounts) regarding the accounting and public debt, helped to complete a significant step in the harmonization of public sector accounting system with the European and international regulations.

According to existing regulations on accounting and public finance, the public accounting in Romania includes the following components:

1) accounting of budgetary revenues and expenses, reflecting the collection of the revenue and payment of the expense for the budgetary year;

2) state treasury accounting;

3) general accounting based on the principle of finding the rights and obligations, to reflect the evolution of the financial and patrimonial situation and patrimonial surplus or deficit;

4) accounting designed for cost analysis of approved programs.

In regard to component 4), only certain public institutions (ministries, specialized bodies of the central public administration, other public authorities) are required to prepare and attach to the annual financial statements the performance reports in which they present the objectives, expected results and obtained, indicators and the costs associated with publicly funded programs.

To implement the provisions of points 1) and 3), the General Accounts Plan of public

entities has in its structure two types of accounts:

a) budgetary accounts - to reflect the revenue collection and payment of expense and determining budgetary result (surplus or deficit). Accounting of budgetary revenues and expenses are made with special accounts, opened to the budget classification structure. These accounts ensure the registration of received revenues and paid expenses under the approved budget and provide the information necessary for compiling the budgetary account and setting the budgetary result;

b) general accounts - to reflect the assets, liabilities and equity, expenses and revenues for the year in determining the patrimonial result of the institution. The patrimonial result is an economic result that expresses the financial performance of the public entity, respectively patrimonial surplus or deficit.

Evidence of engagements that the institution may contract, within the limit of the funds approved in the budget (budget appropriations represents the amounts approved in the budget, within which one can make expenditures for the current activity and investment), is held by means of off-balance sheet accounts. These accounts allow tracking of the approved and consumed engagements, separately for each subdivision of the budget classification.

Therefore, the public accounting involves both the application of accrual accounting (for determining the patrimonial result) and the cash accounting (for determining the budgetary result). The two results are reported in quarterly and annual financial statements, which are composed of:

- balance sheet;
- patrimonial result account;
- cash flow statement;
- statement of changes in the structure of assets/capital;
- annexes to the financial statements, including accounting policies and explanatory notes;
- the budgetary account.

Reporting the public institution performance through the patrimonial result account provides summarized, relevant and understandable information even for those users unfamiliar with budget classifications specific to the public sector.

To point out some similarities and differences regarding the situation of financial performance in the vision of IPSAS and the setter in Romania, we present the following comparative table (adapted from Ștefănescu et al., [1]):

*Table 1. Reporting financial performance through the patrimonial result account*

<b>Elements</b>	<b>IPSAS 1</b>	<b>National regulations</b>
<i>Designation</i>	Situation of financial performance	Patrimonial result account
<i>Objective</i>	[...] to provide information regarding the financial performance [...]	Presents the revenues, funding and expenses during the current year. Patrimonial result, calculated as the difference between revenues and expenses, expresses institution's financial performance.
<i>Format</i>	List	List
<i>Reporting basis</i>	Accrual accounting	Accrual accounting
<i>Revenues</i>	Gross inputs of economic benefits or potential services recorded during the reporting period when those inputs are reflected in increases in net assets / own equity, other than those relating to contributions of the owners.	Revenues represent taxes, fees, contributions and other amounts to be collected under the law, and price of goods sold and services provided, as the case, relating to a period of time.

<i>Expenses</i>	Decreases of the economic benefits or potential services during the reporting period in the form of outputs or consumption of assets or debt occurrences that result in decreases in net assets / own equity, other than those relating to distributions to the owners.	Expenses reflect the cost of goods and services used in order to achieve public services or revenues, as the case, and grants, transfers, social assistance, relating to a period of time.
<i>Classification criteria</i>	Revenues are presented by their nature and expenses can be set by nature or by function and by program or purpose they are made.	Revenues and expenses are presented by their nature, separately for the three categories of activities: operational (basic activity of the institution), financial and extraordinary.
<i>Measuring performance indicator</i>	Surplus/ Deficit Includes all items of revenues and expenses recognized in a period excepting the case when IPSAS provides otherwise.	Patrimonial result (surplus / deficit) The difference between total revenues and expenses during the budgetary year (sums the results of the three activities: operational,

		financial and extraordinary )
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It is noted that in addition to different designation of this financial statement, Romanian setters arranged a presentation of revenues and expenses on activities, similar to the presentation of the financial statements of private entities. This helps to establish the three partial results (results from operating activity, results of financial activity and the result of extraordinary activity). By summing these results it is obtained the patrimonial result of the period. It should be noted here that the extraordinary activity has a more "large" character in the accounting regulations for the public sector, compared to the regulations for the private sector. Thus, in addition to events like natural disasters, the extraordinary activity includes the operations regarding the disposal of fixed assets. Therefore, revenues and expenses related to disposal of fixed assets affect the extraordinary result.

It can also be notice that, unlike IPSAS 1 which presents a definition of revenues and expenses of a general nature (similar to IAS 1), Romanian accounting regulations define revenues and expenses in a manner more tailored to the public sector (revenues usually originating in the amounts collected at the budget as taxes and fees and expenses are made mainly to achieve public services).

Regarding the *reporting basis, format and objective* of this financial statement (i.e. presentation of financial performance, as the difference between total revenue and total expenditure), we can speak of an accordance with the international standards.

For a better track of the spending of public funds, in addition to quarterly and annual financial statements, public institutions in Romania are required to submit a monthly series of reports on revenues received, expenses paid and budget commitments. In addition, the budgetary expenses are separated, both in the forecast and in the execution phase, in the operating expenses and investment expenses. It is wanted a permanent reduction in operating costs and allocation of public funds mainly to investments generating jobs and with multiplier economic effect.

#### **4. Measures to Improve Financial Management and Quality of Public Services**

Changes have occurred in recent years in the law on internal control and audit of public entities (both the internal and external audit, the last being conducted by the Court of Accounts of Romania). All public sector entities are required to implement a control system in conformity to standards of internal control / management (contained in the Internal Control/Management Code, issued by the Ministry of Finance [6]). A modern financial management and appropriate control are considered to be tools that can lead to improved performance of the public entities. In terms of good practice principles that comprise the *communauteaire acquis*, control is seen as a managerial function rather than a verification operation. Through the function of control, management finds deviations of the results from the objectives, analyzes the causes that have determined them and sets the corrective or preventive measures that have to be taken. In order to follow up the progress of implementation of internal control / management standards at the national level there are collected information from all public institution on measures taken and the special problems found. The collection of information is done through the quarterly / annual reports that the public institutions should report to the superior institutions. Reports are then centralized and analyzed at the level of the Government.

A topical issue is currently subjected to public debate that is creating a framework for reporting information regarding services performance for public sector entities (the project was published on in the IFAC website in October 2011). The purpose of the project issued by the IPSASB is to increase public sector accountability and provide information useful to making decision for potential users. Reporting service performance can provide information (financial and non-financial, quantitative and qualitative) on acquisitions for services provided in the current period, as well as future services to be provided and the necessary resources. Users can shape thus an opinion about the efficiency and effectiveness with which public resources are used. Currently, various public sector entities

provide such information on their service performance. However, the way of reporting in various countries of the world is not uniform. Therefore IPSASB project aims at a standardization of these reports and the terminology used, so as to increase the comparability across time and space and understanding of information among users.

#### **5. Conclusions**

In the public sector specific legislation occurred in recent years important changes. The main reasons were better supervision of the distribution and spending of public resources, and implement specific provisions of European legislation. In terms of public sector accounting regulations, the main change occurred with the introduction of accrual. Thus, financial statements provide more reliable information than cash accounting application hypothesis. Romania has opted for gradual takeover provisions of IPSAS into national legislation, which still requires legislative changes. Important changes have been made to legislation on internal control and audit of public entities, as approved code of internal control / management. Also to improve control of public resources is currently seeking public service performance reporting solutions. IPSASB aims to achieve a standardization of these reports in order to ensure the comparability of information.

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# An Overview on Sovereign Debt Evolution in the World

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## Abstract

*Public debts have surged in recent years, in advanced economies, to the levels that have not been recorded since the end of the World War II. The average public debt/GDP ratio for all advanced economies has surpassed the pre-World War II peaks reached during the World War I and subsequently during the Great Depression. This paper attempts to realize both a retrospective of public indebtedness critical moments and an analysis of the current sovereign debt crisis that facing many countries of the world.*

**Keywords:** sovereign debt, debt crisis, debt service, indebtedness degree

**J.E.L. Classification:** F34, H63, H68

## 1. Introduction

Sovereign debts in advanced economies have increased in recent years, as a result of the global economic and financial crisis, to levels not recorded since the end of the World War II, surpassing the heights reached during the First World War and Great Depression. Because of these significant increases in public indebtedness there is a strong, renewed interest in the behavior of public debt, especially in advanced economies.

This paper provides a clear image regarding public indebtedness evolution in the period 1880 – 2010, also making a detailed analysis of the main episodes of sovereign debt crisis.

The rest of paper is organized as follows: Next section presents the episodes of sovereign debt crisis during 1970-2007, detailing the '80s, when have occurred the most indebtedness crises. Section 3 places

the recent surge in government debt in advanced economies in historical perspectives, distinguishing the timing and magnitudes of earlier high-debt episodes. Section 4 presents an analysis of the public debt growth since the trigger of the current global economic and financial crisis until 2010. Section 5 concludes.

## 2. Critical moments of the public indebtedness

Debt problem has known many critical moments, empirical literature identifying 63 episodes of sovereign debt defaults and restructuring for the period 1970-2007, which occurred mainly in the 1980s: seven episodes in the period 1970-1979, 41 between 1980-1989, seven in the period 1990-1999 and eight since 1999 [4].

Early 1980s made known to the whole world dramatic scenarios triggered by the external debt crisis in many indebted countries, distinguishing especially the countries of the Central and South America [2]. Developing regions have experienced a debt crisis due to their inability to cover the debt service. Spark that ignited the debt crisis in the developing states was the inability of Mexico, declared on August 12, 1982, to honor the debt service due on August 16, 1982, worth \$ 80 billion, to U.S. commercial banks and to the other creditors. The situation continued to deteriorate and in October 1983, 27 states that due 239 billion dollars have rescheduled their debts to banks.

The origins of the debt crisis lies mainly in the international expansion of the US banking organizations in the 1950s and 1960s, together with global economic growth. For more than a decade before the oil price to rise four times in 1973-74, the growth rate of real domestic production in developing states was approximately 6% annually. Such an increase has triggered new

US corporate investment in these markets, supported by international banks.

The sharp increase in the price of barrel of oil, which began in 1973 and continued for about a decade, have accelerated lending. Changes in oil prices have imbalanced the external balances of payments in the developing countries, importing oil. These countries have also supported much of the additional cost of oil imported by developed countries that they have transferred it, by raising prices of manufactured products, to the developing countries, importing such products.

In order to meet the additional costs caused by oil and manufactured products price rises, developing countries have contracted substantial loans from private banks in industrialized countries and other financial institutions.

In August 1982, a delegation of Mexican officials went to Washington to inform that the Mexican government ran out of money, being unable to meet payment obligations. Within a few months, the crisis has spread in most of Latin America and beyond.

Once the debt crisis has triggered, foreign banks have stopped lending to these countries incapable to repay debt and started proceedings to recover the amounts borrowed, recycling petrodollars and syndicated loans being completely closed. At this stage, the International Monetary Fund and World Bank intervened, in close connection with the US government, which extended funding to fill “financing gap”, as long as the affected state government take concrete policy adjustment. Paris Club and London Club came also to support states in financial difficulty.

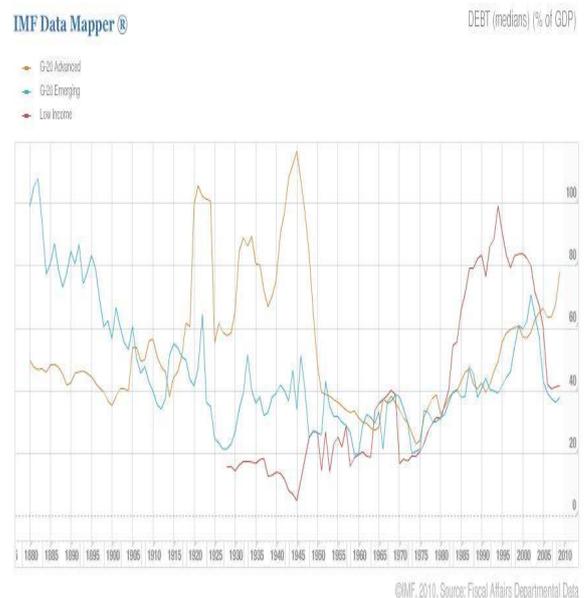
Conditionality for support consisted generally in macroeconomic constraints (budget cuts and slow growth of credit to reduce domestic spending) and structural adjustment (deregulation, privatization, trade liberalization to promote the response of private offer).

### 3. The worldwide evolution of public debt

Abbas, Belhocine, ElGanainy și Horton [1] constructed a complex database (HPDD – Historical Public Debt Database) regarding the evolution of government debt/GDP ratio

in 1880-2009, in 174 IMF member states. HPDD is achieved by combining a number of other databases of individual researchers or institutional bodies and information from official government publications, publications of the League of Nations and United Nations, having the advantage of being regularly updated.

Figure 1. Evolution of the debt/GDP ratio by groups of countries during 1880-2009



Source: HPDD,

<http://www.imf.org/external/ns/cs.aspx?id=262>;

Debt levels in G-20 advanced economies averaged 55% of GDP during 1880-2009, although episodes of much higher debt ratios have been common. During the first period of financial globalization (1880-1913), the debt ratios in both G-20 advanced and emerging economies trended down, World War I and fiscal crises that followed causing a debt spike in advanced economies. Debt reductions through the 1920s were followed by two further spikes linked to Great Depression (early 1930s) and, respectively, during the World War II (1941-1945). In the latter period, many countries were excessive indebted in order to finance war expenses, indebtedness degree in advanced economies increasing to almost 150% of GDP, the highest level recorded. By 1960, however, the advanced G-20 economy average debt

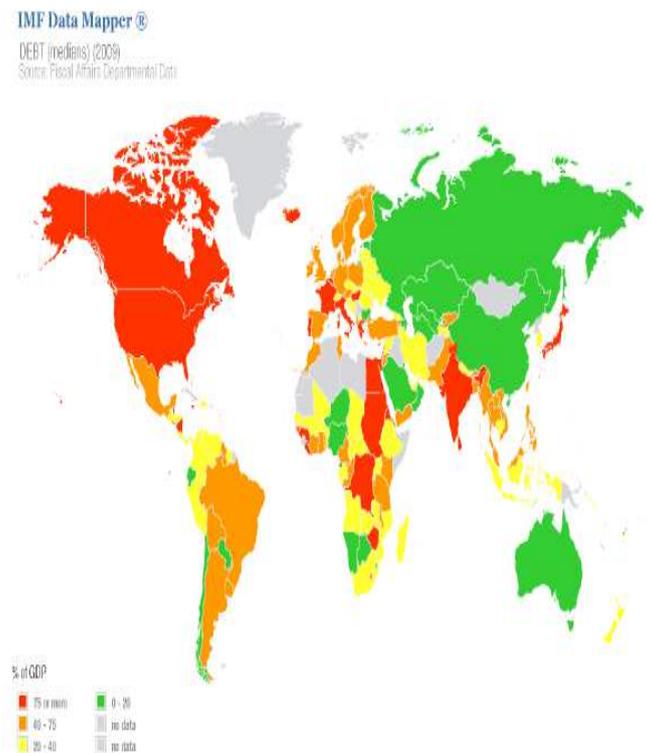
ratio declined to 50% of GDP, due to rapid growth and inflation. Average advanced G-20 economy debt ratios continued to fall until the mid-1970s when, ending of the Bretton Woods system of exchange rates and two oil price shocks led to the accumulation of debt. This trend continued until the current global financial crisis.

Emerging countries and those with LICs have lower rates during the same period, although they were more volatile. Average debt levels for these countries is 44% of GDP during 1880-2009, with 11 percentage points lower than the average in advanced economies. Volatility was particularly pronounced in G-20 emerging economies, noting here the crisis in Latin America in the early 1980s and in Asia in the late 1990s. Model for LICs have a sudden accumulation of debt in the 1980s and a reduction in the last 15 years, in the context of the HIPC Initiative (Highly Indebted Poor Country) and MDRI (Multilateral Debt Relief Initiatives).

The global financial crisis which started in 2007 affected in particular public finances in advanced economies, public debt recording substantial increases. Difficult situation in which advanced economies are due to high levels of public debt is a major change whereas in the last decades emerging economies were in the center of concerns related to sovereign debt crises. Emerging markets have tended to be more sensitive to the debt crisis than advanced economies. High levels of debt in some emerging economies, access to fewer resources to repay debt, volatility of commodity prices and weak political institutions are often mentioned as factors in emerging markets debt crisis. The structure of debt contracted in these countries also contributed to increased vulnerability. Emerging countries debt tends to be denominated in foreign currency and to be contracted on short-term. Loans in foreign currencies make emerging markets vulnerable to exchange rates changes and short-term maturity has implications for the ability to refinance. Since the debt is contracted on short-term, it must be refinanced frequently, which can be difficult if investors lose confidence in government. By contrast, developed economies are able to borrow in local currency and their debt is

predominantly long-term. Thus, sovereign debt in advanced economies was generally more stable than in emerging countries.

Figure 2. The map of public indebtedness in 2009



Source: HPDD,  
<http://www.imf.org/external/ns/cs.aspx?id=262>;

The public debt map related HPDD database updated by the IMF in the year 2009 indicates that the areas most affected by the problem of high levels of debt are: Japan (217.6%), Greece (115.16%), Italy (115.77%), Iceland (99.87%), USA (84.26%), Nicaragua (81.28), Hungary (78.26%), France (78.07%), India (77.69%), Egypt (76.18%) and many low income countries of Africa (Liberia-224.13%, Congo-138.26%, Zimbabwe-89.66%, Sudan-80.60%, Guinea-77.01%). Near the threshold of 75% is also Germany, with public debt/GDP ratio of 73.51%.

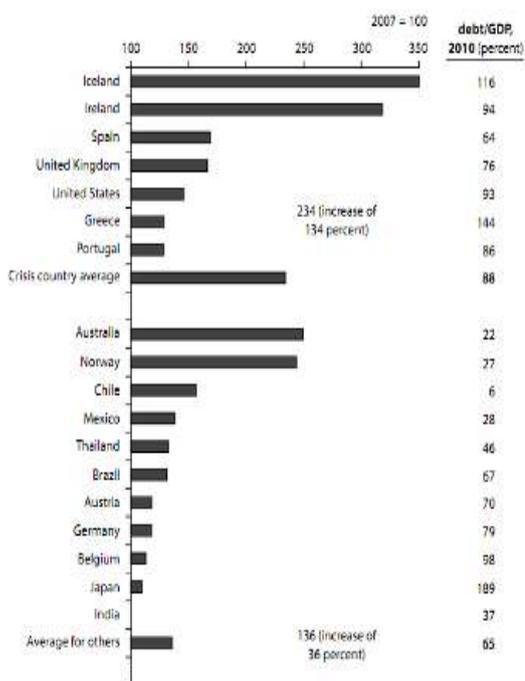
On the opposite side are countries with public debt levels in the range 0%-20% namely: Turkmenistan (2.67%), Chile (6.21%), Russia (10.88%), Kazakhstan (10.93%), Uzbekistan (11.2%), Ecuador

(14.67%), Nigeria (15.49%), Niger (15.78%), Saudi Arabia (15.97%), Australia (17.63%), Paraguay (18.04%), China (18.59%).

#### 4. Public debt growth in the period 2007-2010

After the financial crisis onset, concerns about debt sustainability have moved from emerging markets to advanced economies. In many advanced countries the financial crisis has contributed to increased levels of sovereign debt. Thus, high level of public debt became unsustainable in three states in the Euro Zone: Greece, Ireland and Portugal. These countries have appeal to the International Monetary Fund and other international governments for financial assistance in order to avoid failing to pay their loans. Despite the international financial support, concerns about the sustainability of public finances remains and analysts also follow closely the debt situation in other European countries, including Spain, Italy and Belgium.

Figure 3. Cumulative increase in real public debt since 2007, selected countries



Source: Reinhart C.M., Rogoff K.S. (2011), "A Decade of Debt", *National Bureau of*

*Economic Research Working Paper*, Cambridge, p. 12;

In the countries with systematic financial crises or sovereign debt problems (Greece, Iceland, Ireland, Portugal, Spain, UK, USA), average debt levels have increased in the period 2007-2010 to about 134%, exceeding by a considerable margin the increase of 86% founded by Reinhart and Rogoff [8], as average debt growth during the first three years of financial crisis. Huge debt increases are driven mainly by sharp decrease of tax revenues, due to severe and prolonged recessions in the post-crisis period. In some notable cases (especially in Japan, 1990s), the deterioration of fiscal balances was due increased spending to fight recession.

Returning to the period 2007-2010, we can say that the highest growth rate debt, in Ireland and Iceland is not associated only with the magnitude of the recession in these countries but also with bank debt accumulation before the crisis. Year 2010 is not the final year in which will be recorded increases in public debt. Currently, forecasts for the US indicates increasing levels of debt in the near future; for few other, despite the austerity programs, debt are likely to continue to increase since the economic conditions do not improve and debt service costs go up.

Even in states that have not experienced a major financial crises, debt has increased by an average of about 36% in real terms between 2007 and 2010. Many states have adopted stimulus packages to cope with recession in 2008-2009 and were hit by significant decreases in government revenue. Furthermore, some of the largest increases in debt in countries where the crisis has not been installed (Norway, Australia, Chile) are related to cyclical lowering of commodity prices worldwide, which accompanied the global recession.

#### 5. Conclusions

Public debt issue has known over time many critical moments, empirical literature identifying 63 episodes of sovereign debt crisis in the period 1970-2007, of which 41 in the 1980s.

In the 1980s, the debt crisis has been triggered due to four times increase of the oil barrel price. Sharp climb in oil prices has unbalanced payments balance in developing states, importing oil which, in order to meet the additional costs, have contracted substantial loans from private banks in industrial countries and other financial institutions. Rescheduling and debt reduction, combined with neoclassical conditionality policies had as result the debt crisis overcome in many countries of the world.

Analyzing the evolution of the government debt/GDP ratio between 1880-2009 for 174 IMF member states, based on data provided by HPDD – Historical Public Debt Database, we found that debt levels in G-20 advanced economies reach the average of 55% in GDP while in emerging countries and in those with low income, the average of public debt is 44% in GDP.

During the first era of financial globalisation, the debt rates both in advanced and emerging economies were relatively small, World War I and fiscal crises that followed causing a sharp increase in advanced economies. Debt reductions from the 1920s were followed by two sharp increases in the Great Depression and respectively, during the World War II. In the latter period, many countries were indebted in order to finance war expenses, indebtedness degree in developed economies increasing to approximately 150% of GDP, the highest level recorded. In the 1960s, however, the average debt ratio fell to 50% of GDP due to rapid economic growth and inflation. Average debt rates in G-20 advanced economies have continued to fall until the mid-1970s when, the fall of the Bretton Woods system and the two oil price shocks led to accumulation of debt. This trend continued until the current global financial crisis.

The global economic crisis triggered in 2007 affected especially advanced economies, this situation representing a major change since in the last decades emerging markets were in the center of the concerns about sovereign debt crisis. The structure of debt contracted in these states contributed over time to increased vulnerability, given that debt in emerging countries tend to be denominated in foreign

currency and short-term contracted. Loans in foreign currencies make emerging markets vulnerable to changes in exchange rates and short-term maturity has implications for repayment ability.

In the period 2007-2010 average debt levels have increased, in countries with systemic financial crises and sovereign debt problems, to about 134% surpassing the growth margin of 86% found by Reinhart and Rogoff [8] as being debt average increase in the first three years of financial crisis.

Huge increases in debt are based mainly on both sharp decrease of tax revenues, due to severe and prolonged recessions in the post-crisis period, and increase of the budgetary expenditures incurred in fighting the recession.

### Acknowledgment

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# Eurozone Sovereign Debt Crisis: Causes and Solutions

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## Abstract

*Debt issue is a highly debated topic today since many of the world economies, especially the Eurozone, hit by global financial and economic crisis, faces with high levels of deficits and debt. Credit rating agencies, due to the problems related deficits and public debt have downgraded the credit ratings of these countries, with the immediate impact on financial markets. This paper aims to develop an analysis of the Eurozone sovereign debt crisis and of the measures taken by European leaders to reduce excessive levels of budget deficits and debt.*

**Keywords:** sovereign debt, Eurozone debt crisis, European Fiscal Pact, excessive deficit procedure

**J.E.L. Classification:** F34, H63, H68

## 1. Introduction

The global economy is currently facing with a sovereign debt crisis that is spreading rapidly across the euro region.

The sovereign debt crisis triggering proved the ineffective of the surveillance systems within EMU and of the framework for coordinating economic policies in general. Accumulation of the macroeconomic imbalances in pre-crisis year was not checked sufficiently and their unwinding has since proven very costly for some Eurozone countries and has also contributed to the ongoing sovereign debt crisis, with serious implications for the functioning of the Eurozone as a whole.

This paper provides a clear image regarding the Eurozone sovereign debt crisis by analyzing the causes that led to this situation, the evolution of public indebtedness starting with the year prior to triggering crisis up to the present and, also,

the measures taken to reduce budget deficits and excessive levels of public indebtedness.

The rest of paper is organized as follows: Next section presents the analysis of the causes that led to the Eurozone sovereign debt sharp increase. The dynamics of public debt in the period 2006-2012 is described in Section 3 of this paper followed, in Section 4, by an analysis of measures taken by European leaders in order to overcome the current sovereign debt crisis. Section 5 concludes.

## 2. Causes of indebtedness of Eurozone countries

The global economic crisis has increased the debt in all Eurozone countries due a combination of high fiscal deficits and support measures for the banking sector. While the magnitude of debt varies considerably among states, it is high enough overall to bring the issue of medium and long term sustainability [16].

Massive accumulation of budgetary deficits and unsustainable debt in the Eurozone countries endangers not only the monetary union or the European Union, but also the entire global economy.

In order to expand rapidly Euro Zone, the European Economic Community leaders have allowed the economically less prepared countries to adopt the euro. The new entrants have brought with them many elements of failure, affecting monetary union as a whole, including [6]:

- Inefficient restructuring of the economy;
- Existence of oversized public sectors;
- High social transfers;
- Industries oriented to produce goods with low added value;
- High consumption of raw materials, which make the cost structure to be extremely rigid, almost inflexible;
- Low sustainability of pension systems and public finances;

- Poor developed infrastructure, which shows an increase in transport costs and a reduction in trade;
- Large discrepancies between current and future economic competitiveness between the developed states and new members, due to inefficient labor policies promoted by the authorities.

In order to fit the parameters set by the Maastricht Treaty, countries such as Italy, Spain and Greece have implemented tough fiscal measures without making a comprehensive restructuring. These countries have resisted more than five years in the Eurozone, stimulated by the huge infusions of cash and by an unprecedented access to credit from other member states. At the same time, their productivity was limited due to rigid labor markets and a reduced economic competitiveness.

After the American crisis in the early 2000s that led debt again on an upward trend, Eurozone member states have succeeded, due to the expansion period in the years 2005-2007, to reduce government debt to a minimum of 66.2% in 2007. After this year, however, as a consequence of the economic and financial crisis that led to economic contraction and to the need of government aid for banking system, public indebtedness recorded a worrying trend, reaching 88.5% in 2012, according to the latest forecasts of European Commission.

*Table 1. The amounts allocated by European governments to support the banking system*

	Guarantees	Liquidity injections	Total
UK	460 bil. €	47 bil. €	507 bil. €
DE	400 bil. €	100 bil. €	500 bil. €
FR	320 bil. €	40 bil. €	360 bil. €
DK	200 bil. €		200 bil. €
NO		55.4 bil. €	55.4 bil. €
PT	20 bil. €		20 bil. €

Source: Wehinger, G. (2008), “Lessons from the Financial Market Turmoil: Challenges ahead for the Financial Industry and Policy Makers”, *Financial Market Trends*, OECD, p. 9;

To combat the credit market crisis, European governments have made available to financial system players around 1,870 billion euros in 2008.

Germany has allocated the sum of 400 billion euros for interbank market loans. The government also created a reserve fund of 100 billion euros to make infusions of liquidity into institutions in difficulty and to purchase illiquid assets.

The Paris Executive guaranteed interbank loans of 320 billion euros and provide liquidity reserves of 40 billion to financial institutions in order to increase liquidity index to 9% so that it can compete from the same level with the similar British institutions.

In the same time, the Netherlands, Spain, Italy, Austria, Portugal and Norway have joined this effort, paying 501 billion euros as guarantees and reserve funds. British government made available to three local banks liquidity worth 37 billion pounds (47 billion euros), as part of a financial system rescue plan worth 400 billion pounds (507 billion euros). Norway has offered to the domestic commercial banks credit lines totaling 55.4 billion euros, accepting mortgages hold by them as collateral. The Portuguese authorities have also allocated guarantees worth 20 billion euros for the interbank market operations.

These measures taken to save several European banks from bankruptcy represents one of the main factors that contributed to the current difficult situation in which are the European economies. Although the financial institutions support was necessary, avoiding a bankruptcies series that would have ruined economies, the way it was done has only move the debt from one place to another, leading to an EU countries public over-indebtedness.

### 3. Sovereign debt evolution

Analyzing data on sovereign debt, we observe that, in Eurozone, the most heavily indebted states, Greece and Italy, recorded even before the global financial and economic crisis high levels of public debt. Not the same thing we can say about Ireland and Portugal which, after the outbreak of the crisis, have experienced a sharp rise in debt levels. Thus, Irish presented in 2007, a indebtedness level of 25.9% and today it stands at about 108.1%. The global crisis has also hit the Portugal which recorded a rise of debt from 68.3% in 2007 to 101.6% in 2011.

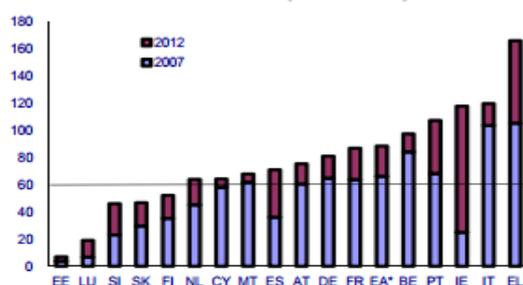
Table 2. The Eurozone government debt evolution in the period 2006-2012 (% in GDP)

	2006	2007	2008	2009	2010	2011*	2012**
Estonia	4.4	3.7	4.6	7.2	6.6	5.8	6.1
Luxemburg	6.7	6.7	13.6	14.6	18.4	19.5	20.2
Slovenia	26.4	23.1	21.9	35.2	38.0	45.5	50.1
Slovakia	30.5	29.6	27.8	35.4	41.0	44.5	47.5
Finland	39.7	35.2	34.1	43.8	48.4	49.1	51.8
Netherlands	47.4	45.3	58.2	60.8	62.7	64.2	64.9
Cyprus	64.6	58.3	48.3	58.0	60.8	64.9	68.4
Malta	64.2	62.0	61.5	67.6	68.0	69.6	70.8
Spain	39.6	36.1	39.8	53.3	60.1	69.6	73.8
Austria	62.1	60.7	63.8	69.6	72.3	72.2	73.3
Germany	67.6	64.9	66.3	73.5	83.2	81.7	81.2
France	63.7	63.9	67.7	78.3	81.7	85.4	89.2
Belgium	88.1	84.2	89.6	96.2	96.8	97.2	99.2
Portugal	63.9	68.3	71.6	83.0	93.0	101.6	111.0
Ireland	24.8	25.0	44.4	65.6	96.2	108.1	117.5
Italy	106.6	103.6	106.3	116.1	119.0	120.5	120.5
Greece	106.1	105.4	110.7	127.1	142.8	162.8	198.3
<i>Eurozone</i>	<i>68.4</i>	<i>66.2</i>	<i>69.9</i>	<i>79.3</i>	<i>85.4</i>	<i>88.0</i>	<i>90.4</i>

\*= estimation; \*\* = forecast; Source: “European Commission (2011), “European economic forecast – Autumn 2011”, *European Economy*, Vol. 6, p. 225;

The Eurozone is not the only faced with large increases in debt levels, as a result of the global crisis. Thus, the United States, with a debt level of 62.3% of GDP in 2007, is expected to arrive in 2012 at a indebtedness level of 102.4% of GDP. In a similar situation of an excessive increase of debt from the outbreak of the global crisis, is also Japan, for this being expected an increase from 167.0% of GDP in 2007 to 215.9% in 2012. The strong growth of public debt in both advanced economies, measured in percentage points of GDP indicates that the debt problem is not just an issue of the euro area.

Figure 1. Debt level in Eurozone countries in 2007 and 2012



Source: European Commission (2011), “Quarterly Report on the Euro Area”, Volume 10 No. 3;

As shown in Figure 1, there is a wide variation in the evolution of the debt in the Eurozone countries. While in countries like Estonia, Cyprus and Malta debt is estimated to have modest increases, in Spain and Portugal are expected increases of over 30 percentage points from 2007 and in Greece and Ireland, over 60 and, respectively, 90 percentage points.

Increasing debt represents a real problem for policy makers. The high levels of debt brings into question the sustainability of an economy, given that the sustainability refers to the ability of government to meet, on long term, its financial obligations related debt contracted. Here we do not refer only to the costs of an increasing debt but also to its side effects that create difficulties. Once exceeded a certain threshold, there is evidence that the debt has a negative effect on growth, while the perceived risk associated with high levels of debt may lead to an increased interest rate for the new debt. Thus, the interest payments increase not only because of the increasing debt levels but also due to higher loan costs. Moreover, higher taxes, required for debt service payment will act as a brake on growth.

#### 4. Emergency measures for sovereign debt crisis resolving

On May 9, 2010, in order to assist countries with financial problems, the Eurozone member states have agreed to create the European Financial Stability Facility (EFSF). EFSF can issue bonds or other debt instruments on market, supported by the German Office of Debt Management in order to raise the necessary funds for providing loans to Eurozone countries in financial difficulty, to recapitalize banks or to redeem sovereign debt. Bond issues are supported by guarantees granted by Eurozone member states, proportional with their share in paid-up capital of the European Central Bank. Borrowing capacity of 440 billion is guaranteed by the Eurozone governments and can be combined with loans up to 60 billion euros from the European Financial Stabilization Mechanism (EFSM) and up to 250 billion euros from the IMF, to obtain a financial safety net up to 750 billion euros.

On November 29, 2011, Finance Ministers of the Member States agreed to extend EFSF by creating certificates that could guarantee up to 30% of Eurozone government new issues and to create investment tools that would increase the power of EFSF to intervene on primary and secondary bond markets.

Fund is scheduled to expire in 2013, running a year in parallel with funding program called the European Stability Mechanism (ESM), which will be launched most likely in July 2012.

On January 5, 2011, European Union created the European Financial Stabilization Mechanism (EFSM), an emergency funding program based in funds obtained from financial markets and guaranteed by the European Commission, using, as guarantee, EU budget. It works under the Commission supervision and aims to maintain stability in Europe by providing financial assistance to EU member states in economic difficulty. EFSM is rated AAA by rating agencies Fitch, Moody's and S&P.

By the EFSM, the EU has successfully placed on the capital markets bonds worth 5 billions euros as part of financial support package agreed for Ireland, at a EFSM borrowing cost of 2.59%.

As European Financial Stability Fund, the European Financial Stabilization Mechanism will be replaced with a permanent program funding named European Stability Mechanism (ESM), which will be launched in July 2012.

To assist states in financial difficulty, the ESM may provide loans, preventive financial assistance, purchase member states bonds on primary and secondary markets and credit in order to recapitalize financial institutions. Loans will be conditioned and reimbursement will be a priority. Volume adequacy of ESM maxim loans will be revised periodically. Current ceiling of common borrowing capacity EFSF/ESM is 500 billion euro.

A key element in the strategy of Euro zone debt crisis overcome is the new *Treaty on stability, coordination and governance in the economic and monetary union*, called also the *European Fiscal Pact*, signed on March 2, 2012 by the all member states, except United Kingdom and the Czech Republic.

The main objective of the Treaty is defined in its first Article as being *promoting fiscal discipline, strengthening economic policy coordination and improving governance in the Eurozone, in order to achieve EU objective of sustained economic growth, employment, competitiveness and social cohesion*.

The Fiscal Pact will come into force on January 1, 2013, subject to ratification by 12 Eurozone member states or on the first day of the month following storage of the last ratification instrument from the 12<sup>th</sup> euro zone member, first of two dates being chosen.

According to Article 3(1), *the budgetary position should be balanced or in surplus*. This rule is considered met if the annual structural balance meet medium-term budgetary objective and does not exceed 0.5% of GDP.

Also in the same article it is mentioned that, *structural deficit may have a higher than specified value, up to maxim 1% of GDP, at market prices, if public debt is significantly below 60% of GDP and risks for long term public finances sustainability are low*. Budget rules are introduced through national provisions with binding legal force and permanent character, preferably constitutional or otherwise guaranteeing the

*full respect and adherence to them throughout the national budgetary processes. Rules must be specified in national law within one year after entry into force of the Treaty.*

Article 8 provides that, *if the state does not include the two rules into national law, the Court of Justice of the European Union must be apprised. If the court decision is not respected, it may entail a lump sum payment or an appropriate situation penalty, which may not exceed 0.1% of Gross Domestic Product. Amounts imposed to a contracting party whose currency is euro are paid to European Stability Mechanism. In other cases, payments are paid to the general budget of the European Union.*

States that are the subject of an excessive deficit procedure establish the binding budgetary and economic partnership programs, monitored by the European Commission and European Union.

International Monetary Fund, through the chief economist Olivier Blanchard proclaims that the new agreement is a step in the right direction but not a complete solution to the sovereign debt crisis [2]. British Prime Minister, David Cameron, shares the same view, believing that the change of treaties does not solve current problems. In his conception, Eurozone member states must become more competitive and European Central Bank should support the euro currency and none of these things involve treaties changing.

By signing the European Fiscal Pact, Romania is committed to a fiscal discipline program, a program that imposes rules on budgetary deficit. It does not fit perfectly to the Romanian economy needs which would need major investments in the coming years in order to increase production capacity and infrastructure, but it is difficult to find a unified way to reduce debt. Fiscal adjustment measures are more appropriate for the UE rich countries than for the developing countries, as Romania. However, we can say that the Pact is, for Romania, a warranty that provides access to international capital markets in order to attract funds for financing budget deficit at reasonable prices.

## 5. Conclusions

The global economic crisis triggered in 2007 affected especially advanced economies, this situation representing a major change since the last decades emerging markets were in the central concerns relating sovereign debt crisis.

Three of the Eurozone countries (Greece, Ireland and Portugal) have received emergency loans in order to prevent entry into default but public debt crisis persists causing a domino effect in the country rating for most nations affected.

The gravity of the Eurozone current debt crisis is that it has potential to cause a massive banking crisis in center of Europe since much of the sovereign debt of the countries in financial difficulty is contracted from the banks of France and Germany.

Undoubtedly, the approximately three years of financial and economic crisis had serious consequences for the Eurozone countries. To assist, the EU has created two temporary instruments that will be replaced in 2012 with the permanent European Stability Mechanism. The first of these, the European Financial Stabilization Mechanism, was established in order to provide financial assistance from the Union with guarantees from the EU budget. The second instrument, the European Financial Stability Fund is designed to assist Eurozone member states with an amount of funds up to 440 billion.

In the strategy of Eurozone sovereign debt crisis overcoming, an important stage is the signing, in March 2012, of the Treaty on stability, coordination and governance in the economic and monetary union (European Fiscal Pact). It provides primarily tax rules for balancing budget and economic policy coordination at European level. European Fiscal Pact requires a commitment from the participating states to a strong fiscal governance, introduction of budget balancing provision in the Constitution, strengthening regulations on the excessive deficit procedure by automating sanctions and submission of the budget projects for European Commission verification.

Through these measures taken to resolve the debt crisis, European economies have exceeded the immediate danger but are in the front of a long period of convalescence. Europe must make further efforts to restart

economic growth while reducing debt in countries with problems. If the end of 2011 there were concerns about the disappearance of the Eurozone and the unique currency, major events in the early 2012 had a great contribution to reassure financial markets.

By signing the European Fiscal Pact, Romania is committed to a fiscal discipline program, a program that imposes rules on budgetary deficit. It is not perfectly fits to the needs of the Romanian economy, which would need major investments in the coming years in order to increase production capacity and infrastructure, but it is difficult to find a unified way to reduce debt. However, we can say that the Pact is, for Romania, a warranty that provides access to international capital markets in order to attract funds to finance the budget deficit at reasonable prices.

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# The Role of Accounting Information in the Decision Making Process

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## Abstract

*The act of management has always had an essential role in human community activities. The efficiency of a company depends on the quality of managerial process. This requires performant management, which means competence and rational decisions. Accountancy can support the decision making process and management activity. The objective of an accounting system is to provide financial information concerning the studied company. The information concerns the financial situation and the performance of a company and there is intended to the users to taking decisions.*

*For taking decisions by the management in order to achieve the objectives of the company it is necessary to know exactly the situation of the company, either compared to other companies that work in the same field or in relation to previous periods, this thing being possible through the accounting information.*

**Key words:** management process, accounting system, decision making process, accounting information.

**J.E.L. Classification:** M40, M41, M49

## 1. Introduction

Under the actual conditions of an information society, the most important resource is the information lying on the basis of any decision making process. In economics, accountancy is the main source of information, both for the economic entity under consideration, and for its partners. Information availability and communication on international level among the organizations developing in different countries are vital for the efficiency of global

market. In order to make direct and indirect investments, to integrate on the global market of goods and services, these enterprises must have access and understand the financial information of partner companies to make correct and fundamental decisions.

The efficiency of each company depends on the managers ability to understand and apply the modern management principles, methods and techniques. A vital condition for companies to get competitive advantages and to resist in competitive mechanisms is represented by the quality of the management process. In the last years it has been demonstrated that the main factor of a company failure is given by the managers incompetence and by a faulty management in taking decisions. That is why the performant management which represents competence and rational decisions is imposing. A performant management can be achieved only by a pertinent information taken in due time.

## 2. Decision and decision - making system

Decision - making, the most representative function of management and in the same time the most effective adapting and selfregulating instrument in a dynamic environment, presupposes the most optimum selection from two or more possible variants. Decision – making represents a social, deliberately and rational act of a person or of a group of persons (managers) by whom are settled the objectives, directions and their achievement, depending on certain current necessities of social – economic life, on the basis of evaluation and analysing process of means and necessary resources and of the consequences of the respective activity.[8]

A decision materializes an idea, an intention or even a project, answering a

certain problem. A decision represents a form of social validity of an action, by moving human, material and financial resources. A decision is a selection made at a given moment, in a certain context, from many possibilities, to stimulate ample and variable lasting actions. It is considered essential the organization survival and development, as it is prior to any action.

Decision – making system consists in the totality of decisions adopted and applied by the managers within an organization. Therefore, a decision can be defined as a deliberate selection out of several possibilities, with the view to settle a problem.

The information system maintains the decision system as the information is considered the raw material essential in decision – making.

The world experience has proved that the main factors which favour the getting of economic resources or of another nature and which differentiate according to their performances, countries, branches of activity, business organizations and other bodies, are the management, the technologies and the ability to wisely use human and information resources. Not any natural or social system can exist without an exchange of information, both within the system, between its components and between the respective system and other external bodies.

In general, a decision represents the conclusion of the process by which a selection is made, an option between two or more alternative, available actions, with the aim to attain one or more objectives. The process of reaching this conclusion or option is known under the name of decision – making process. Decision presupposes a human action which confronted with an external event – an information, must identify the possible acting ways which will lead to the proposed objective.

In management, decision – making plays an important role in organization survival and development. Decision is considered the essence of management, the finishing of any management process, taking into account certain criteria with the view to attain some clear objectives.

Decision making in an organization requires a study and a quantity of information more or less limited, depending on the type

of decision.

The strategic decisions are those decisions on which the organization survival depends, taking such a decision implying a total analysis of the organization and of its environment in order to limit the risk error. In this situation, the decision – making process is very long, resorting to all possible techniques and certain marketing studies, financial plan. The strategic decisions contribute to the achievement of fundamental objectives, integrating into strategies, plans, long or medium term programmes.

The tactical decisions represent a logical sequence of strategic decisions which they can detail and segment. It is about the budget making or supplying policy. These decisions require limited information, but are considered important. Tactical decision deliberately contribute to the attainment of derivative objectives, integrating into annual and semestrial policies, programs and plans.

Operational decisions are the most numerous decisions, they requiring a very small number of information.

A good decision making depends on the quality of the internal or external information available to the company, and therefore on the knowledge of the environment in which it activates and on its internal capacities. The basis of each rational human action is given by the cycle information – decision - action. Therefore, if the objective of this activity is represented by the administration of the evolution of a social or economic system, than it will become a directed system, where the manager and the board of directors will make up the management system.

As an organization actor, the manager is responsible for decision – making, at operational and strategic level, as regards the way in which the limited resources under his control must be used.

At present, the manager has at his disposal an ever greater volume of information, which he has to process in a short period of time. His role is to know how to use this information and to direct the resources and the actions of the company to favourable occasions for getting some significant results from economic point of view.

### **3. Relation between accounting information – decision making process**

Information allows the reduction of an uncertainty and complexity action, facilitates selections, spotlighting the possibilities and limits of alternative solutions.

The decision – making system is closely connected to the information system. The managerial process is primarily understood as a process of using an information, the act of management being achieved within the circuit information – decision - action.

Being within the perimeter of this relation, the utility of accounting information depends on the attributed qualitative characteristics. According to FASB, in order to be useful to its addressee and to have decisional utility, the accounting information must be intelligible and must have two main qualities: pertinence and reliability. Between these there is a quality considered as secondary that is comparability. [10]

The general background for making up and submitting IASB financial standing specifies the fact that the utility of information offered by the synthesis documents is determined by four qualitative characteristics.

Intelligibility – presupposes that accounting information can be easily understood by the users.

Relevance – has in view the information capacity to essentially influence the decision making process.

Reliability – presupposes that information should not contain significant errors, should not be impartial offering enough certainty elements in users decision making. In order to be reliable, it must accurately present the transactions and other events, in accordance with their economic fund and with financial reliability, not only with the juridical form.

Comparability – refers to the information capacity to be compared in time and space and reported to other reference values. The evaluation of the financial standing, of performance and of the modifications of financial situation of a company implicitly presupposes its comparability.

The qualitative characteristics are attributes which determine the utility of accounting information. In order to be useful in the decision – making process, the accounting information must have, even partially, each of the qualities it defines.

The information used in decision – making largely comes from managerial accounting.

Managerial accounting is the main source of information in activities, management and administration. Nevertheless, financial accountancy synthesized by annual financial standing, still supplies the information necessary for managers to administrate relations with third parties, to select investment projects as well as the financial resources.

By means of financial standing there must be supplied an information about the financial situation, about the performances and treasury flows of a company, an information to be useful to a large range of users, when adopting their economic decisions. The purpose of a financial standing is to show the administration results achieved by the company management, inclusively the way in which they used the given resources.

The synthesis documents and the accounting report represent the basic form in the publication of accounting information. They offer the necessary data for establishing the conditions in which a company develops its activity and evolves in time.

The accounting information represents an important factor in establishing results, in achievement of analyses, in decision making and promotion action – all in the financial accounting field with a role both at micro and macro economic level.

Accountancy is considered an essential source of information about the financial standing and performance of a company. By means of accountancy the managers develop their knowledge about the organization in many ways. Some problems may pass unnoticed during the ordinary actions. Thus the accounting information may bring to light these aspects, offering an independent control on operations and helping the managers to keep them abreast of them. By means of accounting information important aspects of the organization are at the manager’s disposal, a fact which allows the decision – maker to determine the sense and significance of all operations.

The accounting information allows the investors, the present or prospective share – holders to formulate a valuable judgement as regards the organization past, present or future events, in this way offering the confirmation or infirmation bases of initial forecast. Also, other partners of the

organization resort to financial standing in order to elaborate some decisions, but the use of accounting information is much greater for the company management.

The decision - making system at the organization level is the result of the managerial act, the company performance depending on its decision. The efficiency of a company depends on the quality of the managerial process. This situation imposes a performant management, which means competence and rational decisions. Accountancy, by the information it offers, sustains the decision – taking process and the managerial activity.

#### 4. Conclusions

The organization is considered the space which allows the elaboration of some decisions of different nature, amplitude and duration. In order to understand a decision, it is necessary to know the stages which led to the endorsement of the respective decision, the behaviour of the implied actors, in other words the analysis of the whole process. Decisions are not taken only from information or reality, but also on the manager's convictions and representations of his own environment.

The quality of the managerial act is a vital condition for the organization to get competitive advantages and to resist on a competitive market. The main factors lying on the basis of a company failure are given by the managers incompetence and by their mismanagement caused by some errors in decision – making.

The accounting information has an essential role in the decision – making process, contributing to the development of the managers knowledge about the organization and to their training for future activities and decisions. The manager is considered the main actor in decision – making process. So, in his quality of leading actor in decision making process, the manager uses the accounting information to establish the organization objectives, the actions to be taken in this respect and the correction measures if necessary.

In the decision – making process, the managers use, as a rule, the information given by the managerial accounting. But in order to substantiate the investment and

financial decisions or to administrate the customers, the suppliers, the information given by financial accounting is useful.

Without accounting information an efficient management is impossible. So, the modern management frequently applies to accountancy informational offer.

The modern management is largely dependant on the accounting information. The managers are among the first users of financial accounting information, their interest being connected to the settlement of an optimum relation cost – benefits at organizational level, in other words the establishment of a balance between getting profits, social costs, reinvestment, self finance. At any level he might be, a manager administrates, in fact his field of responsibility, developing actions with the view to get a maximum effect with a minimum effort. While the administration keeps the balance, the management defines the strategy to obtain this maximum balance with a minimum effort, evidently for a limited period of time. The art of management is to perceive, if it might be anticipated, the moment when the balance risks to be overpassed. Also, he has to quantify the amount of the price paid to achieve the predetermined objective. Finally, all the efforts and actions made at economic level can be expressed precuniary, which impliciteally means the accountancy direct implication.

Therefore, the accountancy represents an important support of organization management, providing information meant to reasonably support the decision made.

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## Importance of Credit Risk and Its Connection with Other Risk Factors

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### Abstract

*The article presents a study which aims to analyze the role of credit risk in banking industry. Nowadays the credit risk is still the most important risk in banking. In recent years, many banks have built new businesses – in particular trading operations and services – that generate fees and interest payments. Although banks’ incomes are less dependent from the performance of the loan portfolio, this type of credit risk – loan risk – is still very important. Badly priced loans can damage banks’ capital base seriously. The new traded instruments related from of credit risk – counterparty risk- can create losses as well.*

**Key word:** credit risk, banking industry, risk management, Basle Capital Accord

**J.E.L. Classification:** G28, G21

### 1. Introduction

The credit risk is oldest in banking. It arises when counterparts are unwilling or unable to fulfill their contractual obligations. These obligations can be the repayment of a loan or the repayment of a traded instruments other delivery of a specified asset.

The credit risk is quite complex and it is difficult to measure precisely. The traditional accounting systems only provide partial information about the on-balance sheet instruments and the trading activities related systems are not always transparent enough to give a clear picture about the sometimes extremely complex off-balance sheet activities either.

### 2. Why the credit risk is important in banking industry?

It is difficult to analyses the credit risk properly, its management is very important for banks, because a vast majority of banking related risks is connected to the credit risk. Traded instruments through the counterparty risk are in close with the credit risk as well. The other important risk factors are also in a very similar situation.

The risk pricing methodologies used by an institution must be based on a comprehensive risk framework that encompasses all types of risk. For correct results the market risk measurement methodology should be fully integrated into the credit risk measurement approach because of its central importance in the integrated risk framework. The assumptions, which are used in the computation of market and credit risk, must be consistent with each other. The credit risk is the key element in this process because of its relation to the other kinds of banking risks.

### 3. Main risk factors in different banking areas

In a modern banking organizations the business activities can be classified into three major groups:

- Asset management division
- Investment banking division
- Retail and commercial banking division.

In these three business divisions the most important risk factors are different and the risk management has to be aware of these differences. Table 1 lists the most important activities and the risk factors typically attached to them [2].

*Table 1. Banking Areas and the Major Volatility Drivers*

Business Line	Major Volatility Drivers	Statistical Modeling
Asset Management/Private Banking	Exposure to change in financial markets (revenues are partly driven off portfolio value)	Yes
	Exposure to financial markets sentiment (greater portfolio activity in bull markets generate more fee income)	No
	Credit risk exposure (loans to private clients)	Yes
Retail and Commercial Banking Division		
Retail Banking	Credit risk exposure	Yes
	Interest rate risk	Partly
Commercial Banking	Credit risk	Yes
	Interest rate risk	Partly
Foreign Exchange Trading and Sales	Market risk exposure (change in value of positions held)	Yes
	Credit risk exposure (mainly derivatives)	Yes
Investment Banking Division		
Securities	Market risk	Yes

s/Derivatives	exposure (change in value of positions held)	
Trading and Sales	Credit risk exposure (primary derivatives)	Yes
Corporate Finance	Market risk exposure (primary positions)	Yes
	Credit risk exposure (e.g. loan products to corporate customers)	Yes

Source: Chris Hatten: Management Banking Capital – Capital Allocation and Performance Measurement, pp. 64.

Legal, operational and business risks are not in the table, they are more general and inherent in all activities. The changes in the regulatory and business environment could be enormous and unpredictable. Those kinds of risks are not measurable with statistical models in an adequate way.

From these different types of banking risks, credit risk is the most important and complex one. Although the separation of different risk factors is necessary, bank managers can not forget that these risk factors are closely connected to each other in several ways in the modern business environment.

#### **4. Fundamental changes in the international business environment**

After the Second World the banking industry was highly protected in every country, because of its strategically important position in the economy. The macroeconomic environment was very stable, which gave a comfortable position for banks. The competition was not too strong and the market was cartelized. Banks simply collected deposits, it gave loans and it made a comfortable living.

During the early seventies however, this environment started to change rapidly. The relative stability of the world economy decreased and the macroeconomic instability with a very high level of inflation became a

permanent factor for the last 30 years. Banks, as well as other businesses, had to cope with this new business environment.

The collapse of the Breton Woods exchange rate system together with the higher level of inflation produced very volatile foreign exchange and interest rates from time to time. The price volatility of such strategically important commodities as oil, further complicated the increasing complexity of the business environment [3].

The stock markets reacted to the fundamental changes with increased priced volatility. Especially the second of the 80' turned out eventful.

New important risks showed up and the governments replied to the new challenges with the deregulation of the financial markets. The deregulation process and the new environment gave inspiration to the financial innovation, and quickly eroded the barriers between the different types of financial firms. With the appearance of the new market participants the competition increased rapidly, therefore the proper risk measurement and pricing became strategic issues.

Banks' earnings structure has changed with the deregulation process. Banks are nowadays less dependent on their loan business and interest rate gap related incomes (difference between the interest rate on deposits and loans) than they were 30 years ago.

Supervision and regulation are needed to reduce the weaknesses that can pose a threat to the banking system of the country. There has been an ongoing debate on supervision as to whether be it productive or counter-productive. There are two views held in this context; the first view is that supervision is counter productive, as it imposes a cost on end users. Also, it results in a less efficient banking system. It is also believed that it undermines market discipline and therefore removes the penalty associated with excessive risk taking; in other words it creates a moral hazard.

The second view held says that supervision is an essential requirement. Since the markets have become completely free of supervision this encourages banks to take excessive risks. With the advances in technology and new financial innovations and new systems being developed, these

factors pose greater risk to the financial stability of the system and therefore supervision is required. Secondly, it brings confidence in the banking system and also reduces the systemic risk.

## 5. Preventive regulation

Preventive regulation can take different forms; some of them are briefly explained below.

- Anti-competitive measures:

- Competition limits: This is done by controlling the number of new entrants in the banking field, also by setting rules for new branches to open. The latter should be justified as a case of public need. It also restrains competition through taking measures that force banks to maintain the profitability of existing banks and existing branches.

- Restrictions on price competition: this is also a form of preventive regulation. Restrictions on price competition can be an interest rate cartel between banks. Banks determine the common interest rate on deposits and loans.

- Administered interest rates: this is also an anti-competitive measure by the government or regulatory authority. In this case the government or regulatory body sets the maximum interest rate that can be used. This was done mostly in US.

- The above-mentioned measures were most common in the developed countries but owing to the financial deregulation many of these measures have automatically vanished.

- Liquidity adequacy:

Specific ratios: this is also a kind of preventive measure where banks are forced to hold a specific certain ratio of liquid assets to their total assets. This is done to ensure that banks have enough cash for unexpected demands. This measure prevents banks from getting into solvency problems.

- Permissible business activities:

In this measure authorities put restraints on what business banks can actually do. These restraints can be min the form of product diversification.

- Loan limits:

Regulators control loan size to a single borrower. This is done mostly by fixing the percentage of the bank's capital base. The

aim of setting loan limits is to encourage diversification.

On-site loan inspections:

Regulatory authorities send outside auditors to assess the quality of the loan book.

- Capital adequacy

The reasons for capital adequacy requirement are:

- To cover setup costs of the bank itself;
- To absorb unexpected losses;
- To maintain confidence in bank through balance sheet strength;
- Capital itself provides a source of lending for a bank's loan portfolio.

The above-mentioned requirements are the form of preventive regulation that stabilizes the banking system and keeps the bank e to an absolute minimum.

## 6. Protective regulation

Protective regulation involves deposit insurance and lender of last resort (LOLR). Both forms of protective regulation are briefly explained below.

- Deposit insurance scheme:

This type of protective regulation exists in many industrial countries. The main aims of such schemes are to:

- Prevent systemic collapse (deals with systemic risk);
- Protect the consumer. The basic assumption made is that the average retailer cannot assess risk so needs some sort of protection.

In some countries deposit insurance schemes are operated under the control of the government (the UK and the US); in other countries the banking industry organizes them (Germany, France). In countries such as France, Japan and the UK it is obligatory to join deposit insurance schemes, whereas in other countries such as Germany and Italy it is voluntary. The amount of protection also varies from country to country and therefore the regulatory authorities set limits for the amount that could be insured. For example, in Germany and Norway deposit insurance is unlimited. These schemes are funded in different ways in different countries. In the UK there is a minimum amount that every bank has to pay, whereas in other countries it is started when needed.

Although deposit insurance schemes protect customers no prevent from systemic collapse they have been blamed for creating a moral hazard among financial institutions.

- Moral hazard problem

Deposit insurance encourages banks to undertake greater risks than they otherwise would undertake. This in consequence undermines the soundness of bank, as the bank believes that the bank would be bailed out with the taxpayers' funds. When the depositors are protected they have no incentive to monitor the bank's activities. The moral hazard problem in the 1980's encouraged authorities to reform the deposit insurance schemes. In the US reforms have been designed to reduce the moral hazard problem by computing deposit insurance premiums on a risk related basis, thereby reducing bank risk-taking.

Narrow banking is also another option available to combat the problems associated with deposit insurance. In narrow banking, insurance with no upper limit would be available if deposits are used for transaction purposes, so any other activity taken by the bank would not be covered by the deposit insurance.

To raise awareness among regulators and banks, the Bank of International Settlement has played a very important role by setting standards of capital adequacy and other issues such as electronic banking; also, the disparities among banking regulations between different countries have also been addressed. Moreover, risks arising from different bank exposures have also been communicated to bank management all over the world.

BIS in 1998 through its Basle we accord provided a level playing field by shifting towards harmonization rather than coordination. The main reason behind this shift was the disparities among the countries over capital adequacy, which in future could be harmful. Banks in the high capital standard countries were less able to compete with low capital standards countries. Similarly capital asset ratios also differed among banks and those banks with less capital/asset ratios were able to expand their balance sheets and thus lend money at a lower margin. This in turn decreased returns for all banks. Banks also began to take higher

risk with high risk lending in order to take the business from other banks [3].

It can be seen from these conditions that the UK and US demanded a level playing field in the global market. They demanded that all the banks should have the same K/A ratio.

## 7. Basle capital accord I

On July the 15<sup>th</sup> 1988 the central bankers from the group of ten countries reached a landmark agreement. The Basle can be summarized by dividing it into five main points.

- Basle was introduced in 1998 and fully implemented by 1993. (From the group of ten countries reached a landmark agreement.). The banking industry with regard to the capital standards was now regulated on a global basis, in other words, equalizes the capital requirements in all banks from G-10 countries. Another 90 countries also agreed and many countries adopted this accord.

- The capital accord strengthened the international banking system by introducing the uniform capital standard in all banks in over 100 countries. This was confined to the Asian financial crisis of 1997 and the 1998 Russian crisis, where as no western bank failed, since these banks had enough capital to prevent themselves from becoming insolvent.

- Accord took account of different categories of risk of the bank assets and it also incorporated on/off balance sheet items. Items such as cash had been given “0%” risk whereas loans were weighted with a risk of “100%”. For the first time banks had to take capital costs into account.

- A common capital to assets ratio was established at 8% for all the banks. This was the minimum requirement and it was up to national regulators to decide what ratio particular banks should operate at.

- Each country applying the capital accord was given some latitude with regard to defining capital accord and was also given some flexibility in risk weights to be applied in certain assets. Some argued this by saying that this point undermines the level playing field; accord has a degree of flexibility so a consensus could be formed, generally a level playing field with some bumps.

## 8. Basle Capital Accord Amendments

Many people complained against the validity of accord and raised questions about it being out of date. For this reason between 1993 and 1995 many consultations and discussions took place among the supervisors and bankers. The main points that were discussed between these bankers and supervisors were:

Netting - National supervisors were prepared to recognize that bilateral arrangements existed between the banks and multiple positions can be reduced to single net obligation. Recognition of this point resulted in less capital required by certain banks.

Interest rate risk – Banks were urged to use the correct method for measuring interest rate risk. Also national supervisors will seek to identify high-risk banks and recommend appropriate actions.

Market risk - Since 1988 banks and other financial institutions have become involved with sophisticated products such as securitization and derivatives. Dealing with such sophisticated products exposed banks to other types of risks that they were not exposed to before.

During the 1990’s there was an increased involvement of banks with new products that had an impact on balance sheets and overall risk position.

Therefore it was decided that capital was to be held against potential market risk; this increase was by 1%. [7]

Choices for banks – Banks were provided with the choice of using their own financial model for measuring value at risk (VAR) according to their strength or using the standard model provided by the Basle Committee.

These banks had to prove that the models they were to use is 99% correct in predicting the maximum amount that banks can lose over a period of a few weeks.  $VAR * 3 = K$ , K over here shows the capital required for market risk and 3 is the multiplier factor subject to the quality of the bank’s risk management system.

Exemption of using their own financial model for calculating VAR was restricted to few big banks, while other banks were forced to use the Basle Committee’s model. [6]

These amendments provided a flexible style of regulation and also banks could ascertain their capital requirements more easily for new products.

The old formula of Basle treated a blue chip company and an unemployed person with an overdraft in exactly same way and made no distinction between a well-diversified portfolio and one where all the risks are concentrated in a particular country or sector. [5]

Apart from J. P. Morgan Bankers Trust a New York based wholesale bank also benefited from these new amendments and adopted its own model for capital needed to cushion the swings in the financial market. Many other banks, including some large international institutions, are still using the BIG's simple capital adequacy formulae, which can distort their perception of how profitable their different business lines are [4].

## 9. Basle capital accord II

There was a broad agreement to update the original 1988 formula for calculating how much capital does the bank needs.

Yet there is also enough disagreement on the philosophy and details of the new proposals to suggest that their implementation will be difficult and expensive, as banks will have to spend heavily on information technology for new systems.

Another disagreement is that it is going to damage a bank's investment in hedge funds. Before the new proposal banks did not have to hold any capital against these funds as they invested through the hedge fund companies and not directly.

Therefore the risks were fairly transferred from bank to the hedge fund companies. But following the near collapse of Long-Term Capital Management where many banks were the investors it was feared that if there is no capital against such funds they could trigger a systemic crisis. [1]

The initial paper by the Basle Committee on banking supervision came out in 1999. Amidst disagreements, the aim of this new report is to strengthen the solvency position of the world's banking system.

The minimum capital asset ratio is to remain the same at 8% as before; however,

there has been a modification for large banks with sophisticated risk management system that can operate on lower capital but still not less than 8%.

## 10. Conclusion

The basic framework is the same for two sets of proposals. Therefore the three-Pillar approach has been retained. There are also some differences to the June 1999 proposal; for example, there is greater detail in every aspect of the package. Secondly, the standardized approach to credit risk measurement will more closely align the various risk buckets to the underlying risk. Thirdly, two options have been provided under the internal ratings-based system approach so that more banks can use it. Finally, the focus of measurement of the risk has been changed with interest rate risk shifted from Pillar 1 to Pillar 2, but operational risk remaining in Pillar 1.

From the above discussion, it is clear that regulatory scene is currently in flux and it is hoped that national regulators along with international organizations will take prompt actions to deal with the problems facing the current regulatory scene. However, once the disparities and problems are over the international financial system will be stable and the number of bank failures and systemic crises will be reduced.

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## Country Risk Rating - Factorial Analysis Method

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### Abstract

*Defining risks and performances is a classical procedure, but also very important, because it is the base in evaluating risks.*

*The patterns of evaluation are the most important instruments of scientific knowledge, a conventional image of the objective that needs to be examined. Those are builder in a way that reflects the characteristics of the object: attributes, reciprocal relationships, structural and functional parameters, needed in researching purpose.*

*The patterns of evaluation are, most of the times, a combination of qualitative and quantitative analysis, using techniques adopted by international firms, but also using techniques adopted by banking institutions. The purpose is to offer clients more exact information's about the risks in order to obtain the best optimization of banking portfolio.*

**Key Words:** country risk, patterns of evaluation, qualitative analysis, quantitative analysis, banking portfolio

**JEL Classification:** G21, G24

### 1. Introduction

Since 1974, private banks have been involving themselves in crediting partner countries, because they were worried about the county risk. Many of these banks founded departments that are specialized in the evaluation of risk. Here, specific methods for country risk are elaborated and applied.

During the activity of international lending, commercial banks are facing the risk of default international obligations arising from foreign loans. [4].

For a commercial bank, country risk analysis is necessary if the bank wants to operate above the average effective

competition. The more accurate will be the risk assessment, the higher will be the bank's performance and level of income from international operations and the smaller will be the losses.

The evaluation method is one of the most important tools of scientific knowledge, a conventional image of the objective that must be researched: attributes, mutual relationships, structural and functional parameters, etc, essential for the research purposes. [3].

### 2. The evaluation method

The evaluation method used is a combination of quantitative and qualitative analysis, using both techniques used by international companies and the ones used by banking institutions. The aim of using this method is to provide customers with accurate information about country risk for good banking portfolio optimization. [7].

The measurement of risk assumed by banks requires taking in consideration several factors, such as:

- the volume of assumed risks, considering that their measurement is made by combining the direct and indirect risks
- including the off-balance sheet commitments and the risk that it this implies
- recipient risk division (public or private sector) splitting risk depending on due dates or nature (loan, credit line).
- reducing the risk. Corporate risk Committee sets the maximum amount of commitments that connote be exceeded according to geographic zones and sovereign states. The limits are determined according to the balance sheet structure of the bank and to the level of own funds and risk policy (aggressive or conservative). [6].

In the model to be presented, we opted for the seven classes of risk (Table 1).

Table 1. Classes of risk

Class	Score	Definition of risk class
Aa	100-76	Payment difficulties appear unlikely
Ab	75-53	(nuances)
Bb	52-47	Payment difficulties are possible
Bc	46-37	(nuances)
Cc	36-24	Several payment problems, including rescheduling
Cd	23-15	(nuances)
Dd	14-0	Appreciable losses

Source: data processed by author

The model includes, in its standardized part, categories and risk elements groups related to fundamental aspects, and in its flexible part, possible ways of interpretation of specific elements. [2].

Thus, the standardized part is as follows:

I. Non-economic risk factors

1.Groups of risk factors related to the international position

2.Groups of risk factors related to the national stability

3.Groups of risk factors related to the international image

II. Economic factors

4.Groups of risk factors related to the macroeconomic management

5.Groups of risk factors related to the economic conjuncture

6.Groups of risk factors related to the balance of payments

7.Groups of risk factors related to the external debt

The proposed model assesses the country risk on short term based on two factors: economic factors and political factors. The weight of the two categories of factors in the final score is 50%.

A).Quantifying the economic factors involved in assessing country risk.

The economic factors which are involved in assessing country risk are

- the development of the country
- real GDP growth rate
- the balance of payments
- inflation rate, dependence on export
- import coverage by export
- the situation of reserves in months of imports

●value of the rapport between short term debt and external debt

●the foreign payments

Country’s development level is expressed by the GDP per capita. It is the economic factor which is expressed in dollars and assessed a maximum of 10 points (Table 2).

Table 2. Country’s development level

Number of points	Country’s development level
0	$0 \leq \text{GDP per capita} \leq 500$
1	$501 \leq \text{GDP per capita} \leq 1000$
2	$1001 \leq \text{GDP per capita} \leq 1500$
3	$1501 \leq \text{GDP per capita} \leq 2000$
4	$2001 \leq \text{GDP per capita} \leq 3000$
5	$3001 \leq \text{GDP per capita} \leq 4000$
6	$4001 \leq \text{GDP per capita} \leq 5000$
7	$5001 \leq \text{GDP per capita} \leq 6000$
8	$6001 \leq \text{GDP per capita} \leq 7000$
9	$8001 \leq \text{GDP per capita} \leq 10000$
10	$\text{GDP per capita} \geq 10001$

Source: data processed by the author

The real growth rate of GDP, is expressed in percentage and is evaluated with up to 10 points like this (Table 3).

Table 3. The real growth rate of GDP

Number of points	The real growth rate of GDP
0	$\text{GDP} \leq -1$
2	$-1 \leq \text{GDP} \leq 0,99$
4	$1 \leq \text{GDP} \leq 2,99$
6	$3 \leq \text{GDP} \leq 4,99$
8	$5 \leq \text{GDP} \leq 7,99$
10	$\text{GDP} \geq 8$

Source: processed data by author

Considering the dimension of the economy, a correction is made this way: with -1 for a GDP less than 3000 \$/inhabitant and with + 1 for a GDP greater than 5000 \$/inhabitant.

The situation of the payments balance is calculated as the ratio of the balance of payments and GDP and is rated with up to 10 points like this (Table 4).

Table 4. The situation of the payments balance

Number of points	Balance of payments situation/GDP
0	Balance of payments situation/GDP $\leq -10$
2	$-10 \leq$ Balance of payments situation/GDP $\leq -4,99$ - $10 \leq$ Balance of payments situation/GDP $\leq -4,99$
4	$-5 \leq$ Balance of payments situation/GDP $\leq -2,99$
6	$-3 \leq$ Balance of payments situation/GDP $\leq -0,99$
8	$-1 \leq$ GDP $\leq 1,99$
10	GDP $\geq 2$

Source: processed data by author

The Inflation rate of the current year, is expressed in percentage and is evaluated with up to 5 points, like this (Table 5).

Table 5. The Inflation rate

Number of points	Inflation rate
0	Inflation rate $\geq 50$
1	$29,9 \leq$ Inflation rate $\leq 50$
2	$19,9 \leq$ Inflation rate $\leq 30$
3	$9,9 \leq$ Inflation rate $\leq 20$
4	$4,9 \leq$ Inflation rate $\leq 10$
5	Inflation rate $\leq 5$

Source: processed data by author

Considering the dynamics of the last four quarters we apply a correction factor of +/-1. The Export dependence  $DE_x$ , is calculated as a percentage ratio between the main export revenues  $IPPE_x$  and the value of the entire export  $TE_x$ .

$$DE_x = (IPPE_x : TE_x) \times 100$$

The scoring scale is just as Lloyds Bank's and the indicator may receive a maximum of 10 points, as follows (Table 6).

Table 6. Export dependence

Number of points	Export dependence
0	Export dependence $> 55$
1	$55 \leq$ Export dependence $\leq 50,1$
2	$50 \leq$ Export dependence $\leq 45,1$
3	$45 \leq$ Export dependence $\leq 40,1$
4	$40 \leq$ Export dependence $\leq 35,1$
5	$35 \leq$ Export dependence $\leq 30,1$
6	$30 \leq$ Export dependence $\leq 25,1$
7	$25 \leq$ Export dependence $\leq 20,1$
8	$20 \leq$ Export dependence $\leq 15,1$
9	$15 \leq$ Export dependence $\leq 10,1$

10	Export dependence $\leq 10$
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Source: processed data by author

Considering the international market situation we apply a correction factor of -1 for unfavorable conditions for export and +1 for favorable conditions for export (for example: a correction of +1 point is made for a product's stable, inelastic export demand such as oil). [1].

The coverage of imports by exports  $G_a I_m E_x$ , is expressed in percentage and is calculated as a percentage ratio between the value of export  $E_x$  and the value of import  $I_m$ .

$$G_a I_m E_x = (E_x : I_m) \times 100$$

The coverage of imports by exports  $G_a I_m E_x$  may receive a maximum of 10 points, as follows (Table 7).

Table 7. The coverage of imports by exports

Number of points	Coverage
0	coverage $< 80$
2	$80 \leq$ coverage $\leq 99,9$
4	$100 \leq$ coverage $\leq 109,9$
6	$110 \leq$ coverage $\leq 119,9$
8	$120 \leq$ coverage $\leq 129,9$
10	coverage $\geq 130$

Source: processed data by author

The situation of reserves in months of imports may have a maximum of 15 points, as follows (Table 8).

Table 8. The situation of reserves

Number of points	Situation of reserves
0	Situation of reserves $< 1$ month
3	$1 \text{ month} \leq$ Situation of reserves $\leq 1,9$ months
6	$2 \text{ months} \leq$ Situation of reserves $\leq 3,9$ months
9	$4 \text{ months} \leq$ Situation of reserves $\leq 5,9$ months
12	$6 \text{ months} \leq$ Situation of reserves $\leq 8,9$ months
15	Situation of reserves $\geq 9$ months

Source: processed data by author

The value of the ratio between the short-term debt and total external debt. The value of the ratio is expressed in percentage and may receive a maximum of 15 points, as follows (Table 9).

Table 9 The value of the ratio between the short-term debt and total external debt.

Number of points	Short-term debt/total external debt
0	Short-term debt/total external debt > 25
3	$19 \leq$ Short-term debt/total external debt $\leq 25$
6	$14 \leq$ Short-term debt/total external debt $\leq 20$
9	$9 \leq$ Short-term debt/total external debt $\leq 15$
12	$4 \leq$ Short-term debt/total external debt $\leq 10$
15	Short-term debt/total external debt < 5

Source: processed data by author

The external payments situation  $SP_{ex}$ , is expressed in percentage and is calculated as a ratio between the external debt  $SD_{dex}$  and exports  $E_{xbs}$

$$SP_{ex} = (SD_{dex} : E_{xbs}) \times 100$$

Receiving a maximum of 15 points, as follows (Table 10).

Table 10. The external payments situation.

Number of point	short term debt/total external debt
0	Debt service/export > 70
3	$59 \leq$ Debt service/export $\leq 70$
5	$49 \leq$ Debt service/export $\leq 60$
7	$39 \leq$ Debt service/export $\leq 50$
9	$29 \leq$ Debt service/export $\leq 40$
11	$19 \leq$ Debt service/export $\leq 30$
13	$9 \leq$ Debt service/export $\leq 20$
15	Debt service/export < 10

Source: data processed by the author

Finally, the score of the economic factors is determined in the following way:

$$SE = \sum PFE_i$$

where,  $PFE_i$  is the score of each economic factor

B).Quantifying the political factors involved in evaluating country risk

Political factors involved and studied in risk country have the following structure:

1. The Current state of the government receives maximum 20 points as follows:

- 0 points for poor governance, frequent changes of government, democratic, high corruption

- 20 points for good governance, and normal regular changes of the government.

A strong democratic system based on broad popular consensus, is an important point in the analysis of credit quality against authoritarian regimes, often linked to a personality whose sequence is uncertain. [8].

2. The economic policy of the current government receives a maximum of 15 points as follows:

- 0 points for an unstable economic policy, inconsistent and unfavorable for the foreign capital;
- 7 points for reasonable coherence, rather restrictive regime regarding the foreign capital;
- 15 points for good coherence and favorable regime for the foreign capital.

3. internal stability receives maximum 15 points as follows:

- 0 points for civil war
- 15 points for social tensions, ethnic, political, racial, cultural, religious.

For each of the factors listed, in case they will not happen, it will be given 2 points

Internal stability allows the knowledge of the game rules, applicable in different circumstances and anticipation, to a certain point, the reactions of governments and the people in case of difficulties. [5].

4. Corruption receives a maximum of 20 points as follows:

- 0 points when corruption is big
- 20 points when corruption is low

5. International position receives a maximum of 20 points as follows:

- 0 points for international sanctions (embargo)
- 5 points for relatively isolation
- 10 points for diverse relationships
- 15 points for good relationships with the major economic powers and international organisms;

- 20 points for preferential economic relations with major economic powers and international organisms.

6. Debt restructuring (external image) is marked by a maximum of 15 points, as follows:

- 0 points for the cessation of payments;
- 3 points for failure in negotiations with the IMF;
- 6 points for the gradual rescheduling;
- 9 points for rescheduling;
- 11 points for delay;

- 15 points for the case without problems.

For the analysis of "debt restructuring" will follow the trend of recent years.

7. The volatility of the electorate, is reaching a maximum of 10 points, as follows:

- 0 points for a low volatility of the electorate;

- 10 points for the high volatility of the electorate.

8. The experience of bilateral relations, is reaching a maximum of 15 points, as follows:

- 0 points for non-payment (refusal, insolvency);

- 1 point for rescheduling difficulties;

- 3 points for rescheduling without problems;

- 5 points for delays;

- 10 points for slight delays;

- 15 points for the case without problems.

Depending on the analyst's assessment that makes this study may be a correction of up to 5% of the scores listed, as follows: C = (0 .. 5).

Finally, policy makers SP score is determined as follows:

$$SE = \sum PFP_j$$

where PFP<sub>j</sub> is the score of each political factor..

### 3. Country risk index calculation

SF final score, which is the country risk index, is calculated as follows:

$$\text{FINAL SCORE} = (\text{ECONOMICAL SCORE} \times \text{POLITICAL SCORE}) / 100 \pm C$$

$$SF = \frac{SE \times SP \pm C}{100}$$

Where C is less than 5% correction that can be added.

In the proposed model of country risk assessment was carried out not only to substantiate their decisions by the bank concerned but also to provide consultancy in this area.

### 4. Conclusions

From the multitude of criteria used to substantiate the bank's strategy only the following were relevant for Romania:

1. Achieve of an acceptable level of global exposure as the level and structure of country risk by choosing as trading partners countries with acceptable risk and potential

and complementary economic and political characteristics;

2. Avoid an excessive dependence of economic relation with countries whose relations with major power are likely to become an object of international sanctions;

3. Avoid a significant dependency both as a source of raw materials and as markets, countries that could put pressure on country's unacceptable;

4. The existence of an positive experience of bilateral relations in the case of solving disputes;

5. The existence, of natural resources, in partner countries for Romanian economy and of the proper operating capacity;

6. Competition assessment that manifests in foreign markets.

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# Fiscal Fraud and the Underground Economy in Romania

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## Abstract

*The fiscal evasion has existed, exists and will exist as long as the state and the tax will continue to exist, but its forms of manifestation are subject to structure changes and they improve over time.*

*The fiscal evasion exists in all the countries, irrespective of their degree of development, manifesting in different ways, depending on the psychological, social, economical and judicial differences specific to every state and creates the underground economy.*

**Key words:** fiscal evasion, underground economy, accounting mechanism, Romania.

**JEL Classification:** E01, H26, M41.

## 1. Introduction

The idea, of fiscal evasion generated by the subjective incapacity, but also a certain tolerance which can be manifested compared with the absentee behaviour of the tax payer, has lead to the concept of creative accountancy.

Basically, the creative accountancy represents a set of techniques or accounting methods (of registration, synthesis, consolidation and communication to the stakeholders) which aims to maximize the results of the company, from the perspective of the company managers' interest.

Therefore, the creative accountancy does not do anything else than to exploit certain imprecision, incompleteness, inconsistency from the legislation afferent to the taxation, so that to minimize the impact of the fiscal sampling on the final results of the organization. And this was the description of the fiscal evasion (licit).

## 2. Exploiting the inconsistency of the fiscal fraud legislation

In other words, the creative accountancy has another advantage, comparying with the orthodox accountancy: that of using the legal fiscal evasion (non-incriminated, as it is known). From this perspective, we think that the term creative accountancy is, in a way, redundant and it is exclusively meant to draw attention on the possibility of legal fiscal evasion, without bringing something new from the conceptual point of view, because, as we can see in the above image, immediately after the orthodox accountancy would use the inconsistency of the fiscal legislation, it will turn into a creative accountancy, while, from the point of view of breaking the fiscal legislation, there is no difference between the two types of accountancies (Hoanta, 1997):

1. *increase in expenses/and reduction of the incomes.* For example, if the reduction of the expenses is wished, one can adopt the method of linear depreciation of fixed capital (although this may endanger, for long time, the refurbishment). If the incomes increase is wanted, then some future incomes can be included (for example the incomes from rents invoiced at the moment of concluding the rent agreement), or the selling at an over valued price of an asset. Regarding the increase of the incomes, one can resort to over dimensioning of the provisions, reduction of the using duration of the fixed capital, acquiring the consumable materials or some inventory objects. If the reduction of the incomes is wanted, then, one can resort to the booking of the current incomes to the category of the incomes registered in advance;

2. *manipulation of the net value of assets,* through the volume of the provisions and of the practiced depreciation system;

3. *reconsideration of the company's debts* with the purpose of influencing the true image of its degree of duty;

4. *elusion of the resorting to the consolidation operation*, in the case of the transactions made between the parent company and its subsidiaries (including the case of assets acquisitions by merging method)

### **3. The accounting mechanism of evasion and fiscal fraud**

The accounting mechanism of the fiscal evasion has as an essential purpose the reduction of the taxable base of the budgetary obligation, regardless the budgetary obligation we may be talking about. Obviously, we are talking about the financial accountancy or, in any case, about the accounting information intended for being used or known by the generic governmental inspector (the one that checks the forming of the budgetary obligation as a debt of the state on the tax payer).

Some conclusions regarding the functioning of the accounting mechanism of the fiscal evasion can be drawn (Clocotici, D., Gheorghiu, 1996):

1) The purpose of the accounting mechanism of fiscal evasion is the reduction of the state rights of sampling, according to the law, from the final incomes (the gross income) of the organization. As a result, the fiscal mechanism of the fiscal evasion will try to reduce the tax base to which the fiscal norms of taxation refer. As the taxation base is the final result of the organization's activity,

2) we will name the fiscal evasion produced by minimizing the entries, *contraction fiscal evasion* and the fiscal evasion generated by the increasing of the expenses *expansion fiscal evasion*. It's obvious that, under the aspect of the ways and the methods used within the fiscal mechanism of fiscal evasion, the contraction fiscal evasion and the expansion fiscal evasion present essential differences. The difference between the two categories of fiscal evasion is obvious from the point of view of the financial and fiscal control procedures of the internal and external audit, intended to detect the fiscal evasion phenomena;

3) Of course, the two procedures do not need to take place simultaneously – of decreasing and increasing the monetary entries – using only one of them being sufficient. The

„experts” that use the accounting mechanism of the fiscal evasion will appreciate, from one case to another, which method will be used or what mix of methods will be used for reaching the established purpose. The election is based on the evaluation made by the authors of the accounting mechanism of the fiscal evasion, regarding the institutional capacity of the governmental inspection of detecting the fraud, as such, they will use the method which seems to be more transparent for the governmental inspection.

4) the reduction of the monetary inputs, respectively the increase of the monetary outputs, with the purpose of illegal reduction of the tax base have their limits. In the first place, it is about the general trend of the organization's activity: there cannot appear visible discrepancies between the indicators that show the development (expansion) of the current activity of the organization and the final results indicators- these discrepancies would constitute, between themselves, clues for the governmental inspectors. In the second place, it is about the functional association between the dynamic of the incomes and the dynamic of the expenses: the expenses cannot increase over a limit that represents the contribution of the expenses to the incomes.

### **4. Fiscal evasion and fraud techniques**

The fiscal evasion techniques depend on several factors: the nature of the organization's activity, the size of the organization, the capacity of the govern to make effective fiscal controls, the magnitude of the fiscal pression, the organizational culture etc.

The main technical categories (methods) of fiscal evasion can be summarized as follows (Saguna D.D., Tutungiu, 1995):

1. in the case of fiscal evasion regarding the profit tax:

\_ reduction of the tax base by including some expenses on costs, without evidence or legal basis (fines, penalties etc.)

\_ registering some over dimensioned expenses or expenses over the limit admitted by law (depreciation, social-cultural expenses, travel costs, protocol costs, etc.);

\_ deduction of some personal expenses of the companies or rates on loans given by the managers to the own organization;

\_ non-registering all the obtained incomes, either by non preparing the primary accounting

documents, or by writing in the documents some delivery prices, lower than the effective ones;

\_ the transfer of the taxable incomes to the newly- created organizations (companies) within the same group (holding), which are in the period of exemption from income tax, concurrent with the registering of some losses by the parent company;

\_ establishing the profit tax by non-corresponding applying of the legal provisions (ex., in the case in which the reinvested profit would be non-taxable)

\_ non-calculation, by the non-profit organizations, of the tax afferent to the economical activities developed according to the law;

\_non-registering in the accountancy the differences established through the fiscal control documents;

\_ non-registering in the accountancy of the budgetary obligations regarding the owed tax profit;

2. In the case of fiscal evasion regarding the VAT(value added tax):

\_ misapplication of the deduction system (VAT deduction on the basis of some documents which do not have the VAT value added, or even deductions or illegal documents, double deductions as a result of repeated registration of a bill in the purchases journal, deductions on the basis of some documents which belong to other organizations, VAT deduction afferent to the operations registered without any right of deduction);

\_ non-inclusion in the calculation basis, of certain operations which are part of VAT sphere, or non-inclusion in the calculation basis of VAT afferent to all the bills;

\_ non-registering and non-delivering VAT afferent to the advances from the clients;

\_ non-registering, as a VAT payer at the moment of exceeding the minimum ceiling which has been on the basis of non-registering as a VAT payer;

\_ avoiding the VAT payment afferent to the goods import, by presenting at the customs some fictional documents of donation, from the external partners, instead of the purchasing documents;

\_ non-inclusion, in deductions of VAT for paying at the customs;

\_ issuing fiscal bills and VAT bills, without the organization in question to be a VAT payer

and, so, without registering in accountancy and transferring the respective VAT;

\_ non-using or defective using of the printed papers, with incomplete registrations in the purchasing journals with repeated registrations in these journals;

\_ „losing” the bills, postponing the drawing-up of the fiscal bills with the purpose of postponing the VAT paying, non-inclusion in the calculation base of VAT of all the elements from the bill (packaging, travel costs etc);

\_ the false declaration of some imports as being temporary (so without being included in the VAT paying);

\_ different deliberate „calculation errors” with the intention of reducing the budgetary obligations referred to VAT;

3. in case of fiscal evasion regarding the salary tax:

\_ non-taxation of the paid amounts to the employees with the title of salaries (aid in cash or kind, other rights, rewards, amounts representing the participation of the employees to the profit, different incentives etc);

\_ incorrect applying of the taxation tables of the remunerations;

\_ non-retention and non-transferring the tax salary owed for the people employed on the basis of civil conventions or for day-labourers;

\_ non-accrual, with the purpose of taxation, of all the salaries;

\_ non-registering in the accountancy the obligations for paying the salary tax;

\_ non-compliance with the legislation regarding the establishment of the tax base of the salaries rights (plurality of offices, exemptions or tax deductions etc.);

\_ generating fictional expenses with the pay of some people (pays in the form of the dividends hidden under the remuneration rights);

\_ creating facilities for the employees, which are not part of the tax sphere of the remuneration rights;

\_ using the micro-enterprises for hiding the budgetary obligations regarding the salaries (consultancy contracts, etc.);

\_ obtaining, by the employees, some documents which can prove their right of being exempt from tax salary: revolutionists certificates, handicapped certificate etc.;

4. in the case of fiscal evasion regarding the excises:

\_ non-inclusion, in the tax base, of all the taxable amounts with excises;

\_ diminishing the tax base by under-evaluation of the imported products, at the customs, by using the double documents (parallel);

\_ non-calculation and non-registration in the accountancy of the afferent modifications of the alcoholic concentration;

\_ non-inclusion of the excises in the selling price of the products for which excises are due;

\_ non-highlighting in the accountancy of the pay obligation of the owed excises;

\_ avoiding to pay the excises by changing the name of the excise products and the their switching to the category of the non-excise or excise products with reduced shares (mineral oils, alcohol, etc.);

5. in the case of fiscal evasion regarding other budgetary obligations

\_ registering in the accountancy some buildings at lower than actual values;

\_ non-deposition, at the fiscal bodies, of the declarations regarding the patrimony buildings, of the means of transport in the possession and the trains held by the organization;

\_ declaring some incorrect, non-updated or false data regarding the tax buildings, the tax on the means of transport, tax for using the state owned lands, etc.;

\_ non-formation and non-transfer of the dividend tax, incorrect calculation of it;

\_ non-retention of the dividends tax afferent to the advances given during the year, which, after obtaining the profit and the approval of the balance, became dividends in the end.

\_ non-declaring the obtained incomes by the natural people, from different activities (private lessons, rents incomes, selling goods in shops, selling poultry goods etc.);

\_ breaking the legal provisions regarding the way of developing and taxation of taxi business, by the authorized people, without going to the fiscal body for presenting the meters or alteration of the information provided by these people in the activity in question;

The fiscal evasion committed according to the above presented techniques (and, of course, to other similar techniques) is, in a way, benign, in the sense that it can be found by the competent fiscal control bodies. The problem gets worse when the evasion amounts are subject to salaries, which determines them

to become “honourable” unlike the fraudulent origin of the amounts in question.

## 5. Fiscal fraud and the submerged economy in Romania

The dimension of the submerged economy differs very much, depending on the calculation method adopted by each institution.

The economists recognized in this field estimate the size of the submerged economy in the new member countries in EU at the level of the following figures: 39.4% of GDP in Latvia, 38.2% in Estonia, 36.5% in Bulgaria and 35.4% in Romania, the highest share; 18.3% of GDP in the Czech Republic and 18.2% Slovakia the lowest levels (Miritoiu, Popescu, 2009).

Estimating the unobserved economy in Romania is made for all the activities made by the family associations and self-employed. The information about these activities come from the Ministry of Economy and Finances. Estimation is not only a under-reporting one, because the method contains also a problem of non-registering and lack of statistic investigations on this segment of the economy.

Another important category of the unobserved economy is represented by the activity made by the non-registered companies from the informal sector. In this category there are: tailors, car mechanics, hairdressers, painters, plumbers, teachers who teach private lessons, people who rent holiday house etc. For this kind of activities different estimations are made, using specific hypothesis and data sources available from the statistic system, as follows:

▪ **Hotels:** it is supposed that the level of the non-registered tourists is 1/3 from the total number of the registered ones. The average value of a night accommodation with a number of non-registered tourists is multiplied with the average number of holiday days from an year, this way being obtained the production of this activity. The intermediate consumption is estimated using the intermediary consumption/production registered in the formal sector for the companies with less than ten employees.

▪ **Constructions:** it is assumed that a number from the total number of workers on their own registered in this area also do an unregistered activity. This number is multiplied with the value of the average gross wages from construction field, obtaining this

way the gross added value. To calculate production one can use the ratio between the gross added value and the production recorded in the small formal sector.

▪ **Education:** It is assumed that some of the students registered in the last year of the secondary schools receive tutoring. Their number, multiplied with the average value of a lesson, the frequency of the private lessons on a week and the number of weeks from an year give the value of this field.

According to studies conducted by the National Statistics Institute, the largest share in the hidden economy have an illegal employment and VAT fraud, the domestic industry being around 8%. The estimation from the first to components is made as follows:

➤ ***Estimating the illegal work***

For this, it is compared the demand and the labor supply at the level of industry. The difference between the number of people who declared that they work in an enterprise and the number of people employed by enterprises is reported as „moonlighting”. The illicit work is evaluated with the same components of the legal situation (average gross wages, social insurance contributions etc). The intermediary consumption is determined by using the same production share as the one obtained by the small enterprises for the respective industry.

➤ ***Estimation of VAT fraud***

In the Romanian national accounts estimations are being made regarding the evasion of VAT. The tax evasion is obtained as a difference between theoretical VAT and VAT levied on the state budget. Theoretical VAT is estimated using elements of intermediate consumption, household final consumption, private and public administration final consumption and VAT charged on the VAT rates on products, established by law.

The period 2005-2007 shows a stabilization of the hidden economy at the share of 17% from official GDP, in decrease from the levels around 22% located in the late 90s. All these represent the effect of the economic development, the mass of the accumulated capital exceeding the absorptive capacity of informal sector and the movement taking place in the opposite sense: rich people on account of their underground activities formalize their new status by entering into legal activities.

By attracting the submerged economy of tax payers, the tax reform of 2005, respectively of implementing a flat tax of 16%, proved to be a

success on attracting additional resources from the state budget. Thus, at the end of the first semester of 2005, the number of employees from the economy grew by almost 180,000 employees compared to the end of 2004, because, at the end of 2005, the increase of the number of workers employed with individual labour contract is over 200,000, according to data published by the National Institute of Statistics. If we consider, on one side, that the increase is higher in the period 1999-2005 it results that this development can be regarded as being the effect of the measures of fiscal loosening.

Since 2006, the number of transfers from the black market on the formal employment declined substantially. The increase in the number of employees comes from creating new jobs and is based on hiring new staff, which is observed in the reduction in the number of unemployed. It is also important the inclination of the tax payer towards tax evasion and the evasion of the tax payer from paying taxes, thus making higher net incomes. In addition, many workers prefer working illegally, without a labour contract that requires the employee obligations, allowing them to rapidly changing workplace if they are offered more elsewhere. In this part should be also included those who work abroad illegally, the estimation being over one million people. The amounts sent to the country by Romanian immigrants in 2007 reached about 5.5 billion euros, mainly from activities in the informal economy.

***The counterfeits*** represent one of the most profitable businesses from the planet. Studies made by international institutions indicate that the turnover of counterfeiting represents over one quarter of the world economy. At the level of Western Europe, one third of software is pirated, and sports equipment companies declare annual losses of 7.5 billion euros. According to the European Commission, counterfeit goods, especially those from China, cause annual losses of around 500 billion.

Also in Romania the counterfeits represent a profitable business, especially their commerce, our country not being a base of production. Is difficult to establish the exact value of losses, in 2006 the damages summing almost a billion euros. The commercialization with counterfeit goods is doubled by the sub evaluation of the imports, which leads to another form of unfair competition.

*The real estate market* is impossible to be evaluated from the point of view of the turnover. The big profits made of real estate investment that until 2007 were of 50% or even higher, have attracted a lot of money. In the present day, especially for the big projects, the profit has been reduced to 20-30%, which does not mean that it is not superior to the other economical activities. Moreover, a great part of the money invested into real estate business represents the profits from other businesses that the bosses redirect. The efficiency of the real estate investment has attracted important amounts of money from the submerged economy.

A great contribution to the business of submerged economy is given by the *tourism*. During the summer, the authorities have announced that the degree of occupancy in the seaside resorts exceeds 100%. The explanation is given by the fact that this study takes into consideration the private bosses who offer “black” accommodation.

## 6. Conclusions

During the last decade has been a growing tendency of law, agencies and intergovernmental organisations to focus upon international evasion and fraud phenomenon. This subject has an increased importance as a direct result of climate of economical recession, which determined the increasing of the tendency of a part of tax payers to reduce their taxes as a source of a new finance, in the same time, for other reasons the governs has continued to retrieve missing tax by fighting against fiscal fraud, by avoiding tax burdens and by modifying national fiscal policies (Din, Meghisan, Diaconu, 2011).

The existence of the submerged economy is a true challenge for the public authorities that, in their essay of limiting or taking over into the official economy, will have to take into consideration its negative effects as well as the positive ones.

The submerged economy has a strong impact in the social plan, as well, this one being on a strong relationship with a series of phenomenon like: corruption, different types of crimes, drug consume, mafia organizations, work exploitation through the black market, money laundering, human rights violation, environmental pollution etc. The increasing of the submerged economy leads to the reduction

of the public incomes. Hereby, the governments will no longer have the financial capacity to improve the administration, the public goods and the infrastructure. The quality and quantity of goods and public services will decrease in time, while the governments will try to prevent this by increasing the taxes. The excessive taxing and the public services and weak infrastructure motivate more and more actors from the official economy to direct their activities towards the submerged economy. This way, a vicious circle appears, being hard to get out of it (Schneider, Fr., Burger, C, 2005).

Taking into consideration all these conclusions and observations we can consider that the biggest challenge for each government is the one of adopting efficient measures to make working in the submerged economy to be less attractive.

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## Discounting and Lumping – Financing Methods for External Commerce Operations in the Current Context of Worldwide Economic Crisis. Accounting Treatment

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### Abstract

*For companies which undertake and manage international business, a problem which needs solving, especially in the context of the current global economic crisis, is related to ensuring the financing of external economic transactions. The accomplishment of this goal has led to the emergence and development, among commercial credit relations - connected to external commerce and not only to it - of some efficient forms of mobilizing trade effects like lumping and discounting.*

*Therefore, this article aims to describe a series of basic aspects which characterize the two types of financing external economic transactions, to present comparatively the major differences between them, and to present a model of reflecting the operations related to discounting and lumping in accounting documents.*

**Key words:** external trade, financing, discount, lumping, accounting.

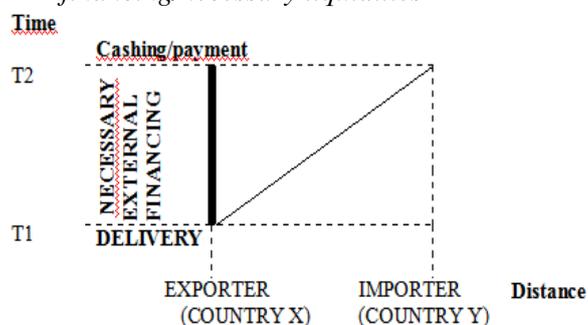
**J.E.L. classification:** M41 - Accounting; P33 - International Trade, Finance, Investment, and Aid;

### Introduction

In the context of the global economic crisis on the one hand, and having in view the conditions of the current level of development related to external trade on the other, we can consider that any economic agent which exceeds the borders of his native country, aiming to obtain a maximum profitability level, will have to run his business so as to maintain his financial stability and to assure the liquidities which are necessary for external financing.

In the context of export operations, the commercial relation is externalized, and hence, it can often entail a series of problems concerning the financial equilibrium of the exporter. This means that, inevitably, there are several situations when the spatial distance can result in a significant temporal delay between the delivery stage/phase and the phase which includes cashing payment for the supplied goods. The direct consequence is that financial resources are blocked, there is a lower liquidity rate, and thus the necessity to finance the enterprise by external means emerges, which is represented in the figure below:

Figure no. 1. Necessary external financing/necessary liquidities



External financing is offered by banks and other financial institutions under the form of credits, but also by means of the financial instruments offers and special financing techniques, such as discounts and lump-sums.

### 1. Commercial discounting – a classical financing method. Accounting treatment

Operating according to the same scheme as in the case of internal trade, discounting specific to export activities represents the technique of mobilizing commercial credits on a short-term basis, by means of which the

exporter (as the importer’s creditor ) benefits from short-term financing from a bank, without any real guarantee.

This does not mean that banks which grant the discount credit/loan do not take preventive measures/security against the risk of not cashing the payment for commercial effects when they are due: they often receive for discount only avalized effects, or on the basis of a banking guarantee, they can often resort, in extreme cases, to the right of appeal against the exporter.

In this case, for the exporting firm, the purpose of discount is – as the beneficiary of a bill of exchange, or of a promissory note – to transform the debt for a third party (importer) in payment/cash against delivery (in liquidities), before the due date.

The discount credit/loan which is given by the bank to the beneficiary (upon receipt of the instrument endorsed in its favour) is determined starting from the equivalent value of the trade effect, and this value is diminished by the discount cost (which is established depending on the conditions of the national credit market), as follows:

$$\text{Discount credit} = V - \frac{V \times Rs \times n}{360 \times 100} - C$$

where:

V- is the value of the title at due date, including interest, if it is the case/the nominal value of the title;

Rs - is the discount rate, expressed in percents per year;

n - is the number of days before the due date (the number of days from discount date to due date);

C - is the bank commission; C = is the nominal value of the title multiplied by the commission percent established by the bank.

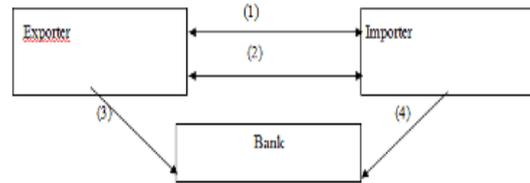
To sum up, we can say that discount at this level presents a series of advantages, among which the mention the following:

- it practically transforms a sale on credit in a sale with payment on delivery, exporters including in their tender price a supplementary margin which could eventually cover the discount cost;

- the considerable reduction and even the disappearance of risks related to the evolution in time of the interest rate, and this is due to the fact that the discount rate is a fixed one.

The figure below presents the simplified mechanism of discount credit:

Figure no. 2. The simplified mechanism of discount credit



where:

(1) – represents the ending of the export contract, and the exporter asks the importer to accept the bill of exchange which is taken over by it;

(2) – delivery of goods and receipt of the accepted trade effect;

(3) – handing in the trade effect, together with the delivery documents at the bank, and then discounting it;

(4) – ulterior settling, either directly or indirectly, of the debt.

When resorting to this type of financing, in the exporter’s bookkeeping records the following data will be registered:

a) the issuing and receipt of the bill of exchange accepted by the importer:

413	=	4111	V
<i>Receivable effects</i>		<i>Clients</i>	

b) handing in the bill of exchange (together with the delivery documents) at the bank, for discount:

5114	=	413	V
<i>Effects submitted for discount</i>		<i>Receivable effects/effects to be received</i>	

c) the exporter cashes the equivalent value for the discounted bill of exchange (including the bank commission and discount):

c1) in case favourable currency differences occur:

5124	=	%	V <sub>1</sub>
<i>Bank accounts in foreign currency</i>		<i>5114 Effects submitted for discount</i>	V
		<i>765 Revenues from currency differences</i>	V <sub>1</sub> -V

c2) in case unfavourable currency differences occur:

%	=	5114	V
5124		<i>Effects submitted for discount</i>	V <sub>1</sub>
<i>Bank accounts in foreign currency</i>			
665			V-
<i>Expenses from currency differences</i>			V <sub>1</sub>

d) recording the bank commission and the discount paid to the bank:

%	=	5114	T + C
667		<i>Effects submitted for discount</i>	T
<i>Expenses with granted discounts</i>			
627			C
<i>Expenses with banking services and assimilated services</i>			

The manner of presenting, in accounting records, the discount methods previously described does not clearly delineate the three phases which form the circuit of trade effects (emitting/issuing the effect, accepting its receipt, and handing it over to the bank for discounting)[1].

Hence, we propose the following solution for bookkeeping:

a) issuing the trade effect:

413	=	4111	V
<i>Receivable effects</i>		<i>Clients</i>	

b) receiving the trade effect for discount at the bank:

5113/x	=	413	V
<i>Cashable effects</i>		<i>Receivable effects</i>	

c) depositing/handing in the effect discount at the bank:

5114	=	5113/x	V
<i>Effects submitted for discount</i>		<i>Cashable effects</i>	

## 2. Lumping – a modern financing method. Accounting treatment

Export lumping represents the transfer of debts (expressed in titles accepted for lumping) – the result of external trade operations undertaken on credit – to a

specialized financial institution, which will pay for them immediately and the factor will get the debt repaid afterward, from the importer, at due date.

In this situation, as compared to discount, the lumping institution does not have the right of appeal upon the seller of the debt in case the importer cannot make the payment, the risks being thus taken over by the lumping institution. As a result, the cost of lumping is much higher than the cost of discount, and it is represented by a fixed interest rate (established depending on the level of the interest of the reference euro currency in which the debt is expressed), to which the commission charged by the lumping institution is added, determined depending on the creditworthiness of the debtor, whether the debt title is avalized or not, the creditworthiness of the referee (avalist), the payment method, or the risk of the operation.

The lumping tax is the result of the lumping basic cost and the global risk margin, and is calculated as follows:

$$TF = \frac{VN \times (D + Mr) \times n}{100 \times 360}$$

where:

VN - is the nominal value of the credit title;

D - is the basic interest;

Mr - is the risk margin;

N - represents the number of days until due date.

Financing external businesses by way of lumping is reflected in the exporter's accounting records as follows:

a) invoicing the importer's merchandise:

4111	%	
<i>Clients</i>	=	707
		<i>Revenues from merchandise sale</i>
		708
		<i>Revenues from various activities</i>
		766
		<i>Revenues from interests</i>

b) emitting/issuing the trade effect (debt title):

413	=	4111	V
<i>Receivable effects</i>		<i>Clients</i>	

c) data outside accounting records/  
documents:

8028 <i>Other engagements received</i>	V
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d) invoicing the lumping institution’s debts,  
simultaneously transmitting/communicating  
the endorsed trade effects:

4111 <i>Clients/Factor</i>	=	413 <i>Receivable effects</i>	V
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e) cashing/collecting the equivalent value for  
the lumping institution’s invoices, including  
the lumping tax and commissions charged:

5124 <i>Bank accounts in quotations</i>	=	4111 <i>Clients/lumping institution</i>	V-TF-C
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**Note:** Possible currency differences can also  
intervene.

f) registering the lumping tax and  
commissions owed to the specialized  
institution:

V1: The lumping institution calculates  
globally the lumping tax and commissions:

668 <i>Other financial expenses</i>	=	4111 <i>Clients/lumping institution</i>	TF + C
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V2: The lumping institution calculates  
separately the lumping tax and commissions:

%	=	4111	TF+C
667 <i>Expenses with granted discounts</i>		<i>Clients/lumping institution</i>	TF
627 <i>Expenses with banking services and assimilated services</i>			C

### Conclusions

In conclusion, it could be interesting to  
present a series of differences between  
discount and lumping:

*Table no. 1. A presentation of the  
differences between discount and lumping [2]*

No.	Segment where differences occur	Discount	Lumping
1.	The non-payment risk	The bank does not take over the non-payment risks generated by the bankruptcy or ill intentions of the importer or guarantor	The lumping institution takes charge of all non-payment risks
2.	Institution performing the discount	It is carried out by commercial banks, on the national credit market	It is carried out at an international level, by a relatively reduced number of specialized institutions
3.	Due date of trade effects	The due date of trade effects, bills of exchange and promissory notes is established at a maximum of 90 days	The due date generally exceeds 90 days, because long-term debt titles are usually negotiated
4.	Financing/re financing source	The bank doing the discount can refinance itself from the central bank	Financing sources are represented by funds collected by lumping institutions from the international markets
5.	Cost/Tax	The discount tax is established on the conditions of the national credit market	The lumping tax results from the interest level on financial markets for the foreign currency in which the debt title is expressed, and is generally higher than the discount tax due to overtaking non-payment risks by the lumping institution
6.	Reference currency	Commercial banks generally discount credit titles in national currency	Lumping institutions receive credit titles in foreign currency
7.	Category of exports to which it is applied	It is generally applied for debt titles with a shorter discount term and even with a slightly lower value.	It is applicable even in case of average-term debts resulting from exports on credit, thus stimulating the export of high-value goods.

In conclusion, exporters, and not only them, resort increasingly to financing by means of the two methods presented in this paper. This is due to the fact that these flexible instruments allow, first of all, a decrease in the duration between carrying out the export and actually recovering the debt, thus ensuring, in time, the necessary amount of liquidity.

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## News on Accounting and Tax Treatment Related to the Activity of Intracommunitarian Goods Transport

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### Abstract

*The economical activity of transport fits within the broad category of services, but in terms of taxation, transport services are treated as an exception, compared to how services are approached in general.*

*Among the categories of transportation services, intracommunitarian transport shows certain particularities. Therefore, we proposed in this work to address from a theoretical point of view a series of news occurred in the tax and accounting treatment of specific business operations of intracommunitarian goods transport.*

*Intracommunitarian goods transport means any kind of transport of goods for which the place of departure and place of destination is located in two different states belonging to the European Union. If over the course of intracommunitarian transport, from the point of departure and the arrival point, a third country outside the European Union is crossed, the quality of intracommunitarian goods transport of that transport is not affected.*

**Key words:** intracommunitarian transport, accounting, fiscality.

**J.E.L. classification:** H3 - Fiscal Policies and Behavior of Economic Agents; M41 - Accounting.

### 1. General aspects regarding intracommunitarian goods transport

The intracommunitarian goods transport means any transport of goods for which:

- Place of departure and place of arrival are situated in two different member states – the *actual intracommunitarian transport*, or
- Place of departure and place of arrival are situated in the same member state but the transport is directly connected with an

intracommunitarian goods transport – *national transport assimilated to intracommunitarian transport.*

We address in the following the issues of the actual intracommunitarian transport.

We recall here that the general rule regarding the place of provision of services provides that:

a) if the services are rendered to a **taxable person** acting as such, the place is where this person, the **beneficiary**, has established the headquarters of his business or has a fixed establishment where the services are rendered; in the absence of such an establishment, the place of provision is where he has his permanent address or habitual residence;

b) if the services are supplied to an **untaxable person**, the place is there where the **provider** has established the headquarters of his business or has a fixed establishment from where the services are supplied or, in the absence of such an establishment, the place of provision is where he has his permanent address or habitual residence, with some exceptions concerning transport:

- the place where transport takes place, proportional to the distances covered, in case of transport of goods services, other than intracommunitarian goods transport, to untaxable persons; methodological rules;
- the place of departure of an intracommunitarian goods transport, for the services of intracommunitarian goods transport provided by untaxable persons.

Summarizing, we are calling into question the following cases:

#### **Case I: The provider and the beneficiary are taxable person established in Romania**

This situation leads to the establishment in Romania of the place of provision for any

intracommunitarian goods transport invoiced between two taxable persons established in Romania. Person liable to pay VAT is the provider who must issue VAT invoice, if any tax exemption does not apply.

**Example:**

A society from Romania provides to another company also established in Romania an intracommunitarian goods transport from France to Italy, the place of provision is in Romania, and the provider has the obligation of paying the fee.

**Note:** According to the latest changes in the Tax Code, the fact that the beneficiary from Romania has a registration code for VAT purposes in another member state is no longer important, unless he has a fixed establishment in that member state.

**Case II: The provider is established in Romania, the beneficiary - taxable person - is established in another member state**

In this situation, the provider is established in Romania and will provide services of intracommunitarian goods transport to taxable persons established in other member states. Therefore, transport services are not considered intracommunitarian services and do not have the place of provision in Romania this, in principle, being considered to be in the member state in which the beneficiary is established (a rule).

To apply the rule from art. 133 Para. (2) of the Tax Code (a rule), the customer must communicate to the provider:

- a valid VAT code from another member state and
- location of the headquarters of its business or of a fixed establishment in the Community.

Intracommunitarian transport services are to be reported by the transporter from Romania in the Recapitulative statement.

If the Romanian provider is not registered for VAT, he will need to apply for registration according to art. 153 of the Tax Code (for intracommunitarian services), before performing this intracommunitarian goods transport.

**Example:**

A company from Romania invoices for the benefit of a company established in Italy a transport of goods from Bucharest to Rome. The place of provision of services is in Italy,

where the beneficiary is established; therefore the transaction is not taxable in Romania in terms of VAT.

The Romanian provider will report this transport in the monthly Recapitulative statement to rd.3 and 3.1 of the VAT Return.

**Note:** The above rule can be applied if the beneficiary is a company with his business headquarters in Romania, but has a fixed establishment in another member state and is registered for VAT in that member state, if the transport is made for that fixed establishment.

**Case III: The provider is established in another member state, the beneficiary - taxable person - is established in Romania**

In this case, the provider is established in another member state and invoices intracommunitarian goods transport to customers that are taxable persons established in Romania. Therefore, transport services are considered intracommunitarian acquisitions of services and the place of provision is in Romania.

The obligation of paying the fee rests with the beneficiary established in Romania that:

- if registered for VAT, reverse charge rule will be applied;
- if not registered for VAT, he needs to apply for registration according to art. 1531 of the Tax Code, before benefiting from this service and will submit a special VAT return (Form 301).

Because it is an intracommunitarian acquisition of services, there is the obligation to declare the transaction in the monthly Recapitulative statement (390).

**Example:**

A Hungarian company performs a transport from Budapest to Bucharest to a company from Romania, normally registered for VAT purposes according to art. 153 of the Tax Code.

Therefore, the place of provision is considered Romania, according to art. 133 Para. (2) of the Tax Code, the service being taxable in Romania - the country where the customer is established. Since the provider is not established in Romania, the client from Romania, normally registered for VAT applies reverse charge and enters the operation in the Recapitulative Statement (390).

## 2. Aspects regarding the accounting of the activity of intracommunitarian goods transport

To substantiate the accounting rules for the activity of intracommunitarian goods transport we will present a series of practical examples.

### A. The reflection of the activity of intracommunitarian goods transport in Romanian accounting provider

We present below some examples of activities of intracommunitarian goods transport and the accounting treatment supported by the Romanian provider.

#### Example 1:

S.C. "A" S.R.L., established and registered for VAT in Romania, transports goods from Romania to Spain for an untaxable Spanish.

- The tax treatment to be applied in this case will be:

According to general rule of the Tax Code, intracommunitarian goods transport takes place in Romania as the place of provision is considered Romania, the beneficiary being an untaxable person. Therefore, the activity of intracommunitarian goods transport is taxable in Romania.

- The accounting treatment to be applied in this case will be:

The invoice issued by the company from Romania will include VAT and the operation of provision of services will reflect in the accounting of SC "A" S.R.L as follows:

4111 „Customers”	=	%
		704 „Income from performed activities and rendered services”
		4427 „Collected VAT”

#### Example 2:

S.C. "B" S.R.L., established and registered for VAT in Romania, transports goods from Romania to Spain for the company "S", taxable person in Spain. The Spanish beneficiary has provided the Romanian carrier its registration code for VAT in Spain.

- The tax treatment to be applied in this case will be:

In this case, because the beneficiary company is a taxable person registered for

VAT in Spain, the place of provision will be considered Spain. Therefore, the activity of intracommunitarian goods transport is taxable in Spain.

- The accounting treatment to be applied in this case will be:

The invoice issued by the company from Romania will not include VAT, the Romanian transporter not being obliged to charge VAT and the activity of intracommunitarian transport (operation untaxable in Romania) will reflect in the accounting of SC "B" S.R.L as follows, whilst maintaining the right to deduct:

4111 „Customers”	=	704 „Income from performed activities and rendered services”
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The Spanish beneficiary will proceed to reverse charge applying VAT rate valid in Spain, at the rate of 18%.

**Note:** Please note that in this case, the carrier must check the validity of the registration code for VAT purposes provided by the beneficiary, using one of the ways laid down by O.M.P.F. no. 1706/2006, published in M.O. no. 894/02.11.2006.

#### Example 3:

S.C. "C" S.R.L., established and registered for VAT in Romania, transports goods from Romania to Italy for the company "T" from Spain, which has a fixed establishment in Italy, establishment that is also the destination of the shipment. The Spanish beneficiary is registered for VAT both in Spain and in Italy, but he provided the Romanian carrier his registration code available in Italy.

- The tax treatment to be applied in this case will be:

In this case, because the beneficiary company owns fixed establishment in another member state, where the intracommunitarian transport was completed, the place of provision will be considered Italy. Therefore, the activity of intracommunitarian goods transport is taxable in Italy.

- The accounting treatment to be applied in this case will be:

The invoice issued by the company from Romania will not include VAT and the

activity of intracommunitarian transport (activity untaxable in Romania) will reflect in the accounting of SC "C" S.R.L as follows, whilst maintaining the right to deduct:

4111 „Customers”	=	704 „Income from performed activities and rendered services”
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### B. The reflection of the activity of intracommunitarian goods transport in Romanian accounting beneficiary

We present below some examples of the activity of intracommunitarian goods transport and the accounting treatment supported by the Romanian beneficiary.

#### Example 1:

Company "F", established and registered for VAT in France, carries goods from France to Romania, for SC "D" S.R.L from Romania, taxable person that communicates to the French carrier a valid registration code for VAT in Romania.

- The tax treatment to be applied in this case will be:

In this case, because the beneficiary company is a taxable person that communicated the VAT code available in Romania, the place of provision will be considered Romania. Therefore, the activity of intracommunitarian goods transport is taxable in Romania.

The provider will issue an invoice without VAT, and the beneficiary shall submit the activity of intracommunitarian goods transport through reverse charge tax.

- The accounting treatment to be applied in this case will be:

Beneficiary, S.C. "D" S.R.L, will receive an invoice without VAT, but will highlight in accounting both the deductible VAT and the collected VAT in the WATT return, based on the accounting note:

624 „Expenses with transport of goods and personnel”	=	401 „Suppliers”
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4426 „Deductible VAT”	=	4427 „Collected VAT”
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#### Example 2:

Company "F", established and registered for VAT in France, carries goods from France to Romania, for an untaxable Romanian.

- The tax treatment to be applied in this case will be:

According to general rule of the Tax Code, intracommunitarian goods transport takes place and will be taxed in France as the place of provision is considered the place where the provider has his business headquarters, respectively France, as the beneficiary is an untaxable person.

- The accounting treatment to be applied in this case will be:

The invoice issued by the French company will include VAT in total value (transport value plus 19.6% VAT) and the activity of intracommunitarian goods transport will reflect in the accounting of the beneficiary as follows:

624 „Expenses with transport of goods and personnel”	=	401 „Suppliers”
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## Intellectual Capital Reporting – Advantages, Disadvantages and Usability’s Related to the Traditional Accounting

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### Abstract

*The accounting as an instrument of information must offer information to different users of exact information. The information concerning the accounting for the intellectual capital of the enterprise, not only that they can be useful for the inside public, but also to the outside one, as well as contributing to the creation of value within the organization by showing to what extent the organization is socially accountable and contributes to the creation of intangible assets. The accounting of the intellectual capital is not quite easy to achieve, because of the assessment difficulties and through the viability within the process of accounting taking into consideration the current legislation. This article aims to show what hidden intangible assets (intellectual capital) are, what their importance and usability in the knowledge economy is, which are the advantages and disadvantages of publishing information regarding them.*

**Keywords:** alternative accounting, intellectual capital, hidden intangible assets, Skandia Navigator

**J.E.L. Classification:** M41 - Accounting

### 1. Introduction

The accounting exists from the beginning of the world while the data regarding the transactions and the financial relations between different parts have been written down from the babilonic civilization. However, the accounting had a long way to

cross until it reached the assembly of coordinated principles within a coherent system of accounting. The system of accounting, 500 years old, which has not suffered massive changes within the past years, is not sufficient in order to capture the economic reality of the organization. In the last years, traditional management – based on the analysis and interpretation of accounting data – has turned out to be incapable to assess and express, in a clear and correct manner, real performance of the entities involved [1]. The traditional financial situations do not provide enough information so that the administrators or the investors could understand how come the resources- the majority of them intangible- could create value for the future. The intellectual capital represents an important promoter for the value of organizations. Very important to mention is the fact that this one affects all the sectors and it doesn't stop just to firms but also the state institutions, universities, and governments and even to churches.

The booking of the intellectual capital begins to be recognized as one of the biggest challenges of the modern accounting. The current accounting is based on the principles of the double match, guaranteeing equilibrium between active and passive. The accounting of the intellectual capital is not based on the system of the double match and does not guarantee the equilibrium between active and passive.

### 2. Intellectual capital – definition and clasification

In the new economy, intellectual capital is

the key factor of company competitiveness and long term value. Nowadays, as we are well aware of, the value is mostly given by intangible assets than physical.

What is intellectual capital? It is, as defined by a company, “what exits the gate at the end of the day”. People? Company’s know how? ... it is the sum of ideas, investments, technologies, general knowledge, computer software, projection, data processing techniques, processes, creativity and company’s publications. Intellectual capital can be easily understood as knowledge turned into benefits [2].

Edvinsson and Malone [3] define intellectual capital as the possession of knowledge, applied experience, organizational technology, customer relationships and professional skills that give a competitive advantage in the market.

Nevado and López [4] talk about intellectual capital as total assets of a firm, even if not reflected in traditional financial statements, generate or will generate value for the company in the future, and consequence of the issues related to human capital and the structural: the capacity of innovation, customer relations, quality of processes, products and services, cultural and communicational capital, which allows a company or organization to take better advantage of opportunities, giving birth to generation of future benefits.

We also find many definitions of intellectual capital that is related to intellectual capital defined as the sum of its components, and definitions that make reference only to the human aspect.

In order to achieve this goal, we consider the most appropriate the classification of intellectual capital in: human capital, structural capital, relational capital.

Human capital is the total amount of staff abilities and concentrates skills (knowledge, skills, talent and know-how), attitude (behavior, satisfaction, motivation, performance and ethics) and intellectual agility (innovation, imitation, adaptation).

Structural capital is the physical and organizational structure, property of the enterprise, which supports human capital and facilitates knowledge transfer. Structural capital consists of internal processes capital and research, development and innovation capital. Internal processes capital is related to

quality of processes, products and services that gives the company its competitive advantages. R&D capital include investments that are made in developing new products, new technologies.

Relational capital includes clients’ portfolio, relations with competitors, suppliers, shareholders, governments and public administrations, other stakeholders and their impact on business. Relational capital is composed by commerce capital and communication capital. Commercial capital includes relationships with customers and suppliers, and their satisfaction, market share, etc. Communication capital includes marketing activities.

### **3. Intellectual capital – an accounting approach**

Most organizations fail to identify, measure and publish data on their most important intangible assets. Non-recognition of internally generated financial assets will lead to an inefficient allocation of resources and will not take advantage of the opportunities offered by business environment by losing to competition. What has to be done is to start managing and presenting situations on the intellectual capital of organizations. Nowadays, organizations do not include in the financial statements information on hidden intangible assets that generate value and “information provided by traditional financial statements do not meet the needs of different stakeholders”. [5]

Although IAS 38 - Intangible Assets encourages the submission of such additional cases on intangible assets that are not reflected in current financial statements [6]: “an entity is encouraged but not forced to report the following information: ... a brief description of significant tangible assets controlled by an entity but not recognized as assets because they did not meet the recognition criteria within this standard”.

The appropriate question is where and when to publish this information on intellectual capital, information that we will treat as “Report on the intellectual capital of the company”. The most appropriate moment to publish this report we believe it would be with the annual financial statements, appearing as an appendix to this binding. For

this and taking into account the specificities of each national sector will be necessary to develop and enact one report model for each of these national sectors.

Thus Skandia, the famous Swedish insurance company paved the way for additional financial statements disclosure, by publishing in 1994 a Report on Intellectual Capital Audit. There many other companies followed. Following the publication of this audit on intellectual capital, share price rose by over 40% of which over 25% due to intellectual capital [7].

#### **4. Skandia: first report on intellectual capital**

Skandia established intellectual capital as one of "the three fundamental stones for building intelligent organizations" [8]. The other two are technology and values.

The first report of intellectual capital that has been published as a supplement to the annual accounts of Skandia in 1994 was the "Intellectual Capital View", followed in 1995 by the "Creative Process Value" and in 1996 by "The Power of Innovation". For Skandia, financial capital and intellectual capital are the 2 elements that define the organization, value which is actually fair value. According to IAS 16 the fair value represents the sum for an asset that might be willing changed between the 2 interested parts within a transaction developed in objectives conditions with objective determinate.

According to the Skandia intellectual capital consists of:

1. Human capital: personal skills, knowledge, skills and experience of employees and staff, organizational culture.

2. Structural capital: "what remains in the office when employees go home" (such as hardware, software, databases, patents), infrastructure that incorporates, forms and sustain human capital:

a. Capital customers: customer relations, their satisfaction and loyalty, longevity, sensitivity to price, long-term welfare clients;

b. Organizational Capital: organizational competence and investment in systems:

- Innovative capital: the capacity for renewal and innovation of new products and services and other intangible assets and used talent for creating and launching new

products and services.

- Processes capital: techniques and programs for employees in order to add value for the enterprise and to increase the efficiency, work processes.

As we can see, Skandia uses both financial elements and non-financial elements in order to establish the market value of a company.

The model has 111 main indicators and 51 auxiliary indicators that are being used. They may be quantitative or percentages indicators.

The model proportionates a balance between the past (financial perspective), present (customer perspective, human perspective and perspective of processes) and future (innovation and development perspective):

1. Financial perspective surprises information stemming from the financial statements;

2. Customer's perspective offer a vision of the degree in which the enterprises satisfies the needs of customers with products and services, being present indicators related to share sales customers, or how loyal are its customers.

3. Human perspective is "the heart of the organization", "that part of the intellectual capital that goes home every night" and "the combination of experience and innovation that are in these employees and the strategies of the enterprises for change and preserve this combination" [9] it presents indicators such as employee satisfaction, their improvement.

4. Process perspective refers to the processes of efficient production of goods and efficient service-oriented to customers.

5. Innovation and development perspective aims to capture the opportunities that define the future of the enterprises - look into the future to prepare for it and to establish lines of action to ensure long term growth and profitability.

Skandia Navigator is a model of organizational planning, oriented to the future, which proportionate a more balanced picture of the organization operations. This is how a balance between past (financial perspective), present (customer, processes and human perspective) and future (renewal and development perspective) is created.

The model allows communicating the

vision and strategic objectives of the organization.

### **5. Advantages and limitations of disclosing information on intellectual capital**

Intellectual capital is a key element in developing a company and thanks to it we can obtain competitive advantages including:

1. Instead of registering intellectual capital as an investment, it is recorded as expense, leading to a distorted price policy. Nevado and Lopez [10] state that this may lead to overestimated production costs because these investments are not spread over several years and hence the two types of behaviors observed in pricing:

- The company continues with higher costs in investment periods and then loses a part of the price competitiveness;
- Or, it continues at lower cost in investment periods but suffers insufficient margins, profitability issues, survival or jobs.

If the company would record investments in intangible assets the same way as in the tangible, depreciating them over several years, it could improve the management analysis through financial statements and development of some more relevant commercial policies.

2. In case of fusions and takeovers, where the real value of companies acquired is much higher than those exposed in the financial statements it is required a report on intangible assets for all users. In most cases these are the ones that, along with tangible and financial assets, establish the real value of the company and to those it must be assigned the difference between the market value and value in financial statements.

3. Allows its use as a marketing tool and provides long-term vision of the company;

4. Regarding strategic choices, the absence of investments accounting in intangible assets involves damaging effects [11].

5. It improves transparency, giving as result a decrease in capital costs and therefore higher prices of shares [12]. This is the case of the famous Swedish company Skandia, the first company that published a statement on intellectual capital where the share price rose by 40% following publication, of which only 25% due

exclusively to intellectual capital.

6. Disclosing information on intellectual capital allows improving relations with customers by informing them of the efforts the company does to meet, attract and maintain them with new innovations, new products and services. Canibaño and Sanchez [13] agree with this, saying that “disclosing such information may help to improve - and not exclusively to describe – the company’s relationship with its customers, employees and owners, and generally, to focus more on those activities that enable knowledge sharing with interested third parties, beyond the limits of the company”.

7. Balanced investment in intangible assets helps to increase the competitiveness, effectiveness and efficiency;

8. Presenting information on intellectual capital is important first of all for large organizations, because within these the number of brands sold is high. In this respect, some of the big Japanese companies (Mitsubishi, Softbank, Toyota) have been forced to define and develop indicators on the prospect of gaining benefits of all their brands, grouping them according to various criteria. Thus, the simple assembly of all these indicators calculated provided to the managers a mechanism to measure the monetary impact on benefits related to each brand, allowing the implantation of a more efficient Target Cost Management [14].

9. If the objective is to increase company’s competitiveness by increasing efficiency and quality, investment in intangible assets implies, according to Nevado and López [15], two types of effects and results:

- On short term, immediate results, recorded in the result accounts of the year, with reduction of obvious cost and/or growth of visible revenue, and with reduction of hidden costs;
- On long term, because the creation of the current economic and human potential is recorded in the revenues account of future years, when speaking about research and development of new product, the negotiation on new markets or improving skills, since these strategic effects are incorrectly identified within information accounting and financial systems of companies.

10. And last but not least it helps acquiring a psychological advantage discouraging competition. Roos [16] agree with this saying that it would make the competition believe that the company dominates the market and will not be willing to enter the same market.

11. Information can influence in a very important way most financial analysts' investment decisions.

Disadvantages of disclosing Information on intellectual capital

Uncertainty, subjectivity, potential abuse, lack of a rigorous generally accepted model and lack of comparisons between existing models are important limitations of models of classification and measurement of intellectual capital.

One of the main reticencies is the strict application of the precautionary principle [17], situation in which, for now, it seems difficult to overcome. Thus, among the main limitations can be highlighted the following:

1. The property nature of intangible investment.
2. These investments are difficult to delimit, meaning that they are hand in hand with tangible investments and, moreover, it is quite complex to determine the funding level and related profitability.
3. The capacity to generate future benefits, meaning that the potential of assets must contribute directly or indirectly in business results.
4. The opportunity of a control for future uses.
5. The assessment opportunity, meaning expressing the value in monetary terms.

The usability of information regarding the intellectual capital

The reports regarding the intellectual capital have a utility for the internal public (owners, managers, employees etc) as well as for the external public (creditors, provisioners, clients and debtors, government and public administrations etc). For each of these ones we will try to analyze which would be the utility to have access to those reports concerning the intellectual capital.

The users at the internal level can be:

1. The owners. These ones are interested in knowing in what manner the obtained results bring stability and profitableness for the organization, the prices of the stocks and the strategic implications which are

generated by the intellectual capital for the organization. Sullivan asserts that the interests of the owners in the case of information regarding the intellectual capital could be:

- The degree of alignment of the resources of intellectual capital with the vision and the strategy of the company;
- The assessment of the competitive position on two fronts:

a) Commercial: routine assessments of the competitiveness of the products, of the processes and of the services of the company on the commercial market;

b) Technological: routine assessments of the competitive position of the company

- Provisions regarding the incomes based in innovation and development;
- The identification of the elements which generates value and reports regarding the activities and reserves which generate value.

2. The employees. These ones are preoccupied by the richness of the company in present as well as in the future as a guarantee for the stability and for the salaries for their work. Nevado and Lopez assert that a report concerning the intellectual capital can stimulate the employees and raise the esteem for the work place, enhancing their competences and, the simple act of reporting this kind of information, will lead to the growing of the qualitative level of the human resources.

3. The managers. The reports regarding the intellectual capital are essential in the decision-making process. The users at the external level can be:

1. The creditors are those who sustain the financing and who are interested by the recapture of the credits, of the interests or the specific commissions.

2. The providers use the reports regarding the intellectual capital for evaluating the necessities and the capacity of production of the enterprise as well as the possibilities of payment.

3. The clients and the debtors will be informed in what concerns the new innovations and the new products, as well as the efforts made by the company for their satisfaction, through pre-selling and post-selling services.

4. The government and the public administrations in order to update the social, economic, monetary and fiscal policies, with the intention of taking care of the protection, the security, the rights and the work guarantees, the social and political competitive policy.

## 6. Conclusions

The big enterprise of the world, whose intellectual capital increases in time, accuses the difficulties of measurement of the human quality, the faithfulness of the clients and the efficacy of the organizational structure. This situation significantly decreases the benefits of the enterprise, through the fact that a great part of its intangible value can not be managed, precisely because of the measurement difficulties. Until the adoption of a general recognized model of measurement and recording of the intellectual capital, the modification of the current situation of accounting is not pursued, but the publications on several complementary situations of the hidden intangible assets (intellectual capital) of an organization which give competitive advantages and which are very difficult to assess and appreciated by the current norms of accounting. It is necessary to have a standard system which could allow the identification of the intellectual capital, some measurement indicators for this one and a standard model of information.

These accounting information's regarding the intellectual capital of the enterprise not only can be useful both internally (for owners, employees, managers) and externally (to potential investors, creditors, suppliers and customers, government and public administration) but also contribute to creating value within the organization showing the extent to which the organization is socially responsible and contribute to the creation of intangible assets. For Skandia, financial capital and intellectual capital are the 2 elements that define the value of an organization. Even if Skandia is one of the most comprehensive models for measuring intellectual capital, it has not according the importance of determining the components to determine the proportion of capital contribution each component separately.

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# The Impact of the Foreign Direct Investments on the Competitiveness and Economic Growth in Central and Eastern European Countries

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## Abstract

*The countries in transition need FDI not just to produce more goods and a higher quality. Foreign capital investments are the most efficient and safe way to integrate into the world economy. Further, we shall examine some structural changes, which had been made, under the influence of FDI, in the economies of new European countries (Czech Republic, Poland, Romania, Bulgaria), drawing attention also upon the changes in the export potential of that country. We examine the impact of FDIs on economic growth in the short-run and in the long-run in the above mentioned countries, Poland and Czech Republic being one of the most developed CEE countries that attracted most of FDIs in the region for the last two decades and Bulgaria and Romania being from the second wave of EU accession.*

**Keywords:** foreign direct investments, multinational companies, economic growth.

**JEL Classification:** E22, E52, E58, F21, F23, O11, O16, O23, O24, O33.

## 1. Introduction

The growth of international production is driven by economic and technological forces. It is also driven by the ongoing liberalization of Foreign Direct Investment (FDI) and trade policies. In this context, globalization offers an unprecedented opportunity for developing countries to achieve faster economic growth through trade and investment. In the period 1970s, international trade grew more rapidly than FDI, and thus international trade was by far than most other important international economic activities.

Foreign direct investment has long been seen – and strongly recommended – as a crucial instrument in the process of

transforming the former centrally planned economies of Eastern Europe and the former Soviet Union into vibrant market systems. This paper looks at the actual performance of FDI in promoting economic growth and restructuring in the transition economies since 1990. In the transition economies since 1990 has largely flowed to just a few central European countries, which are also the leading candidates for EU membership. These have indeed benefited from significant FDI financing of the balance of payments, and enterprises with foreign investment, not surprisingly, have had high rates of growth of output, productivity and exports.

## 2. FDIs and Economic Growth in CEE Countries

The FDI inflow in the CEE economies has been a vital factor in the first stage of the privatization process during the transition period. Currently, the main reasons to pursue FDI are to boost productivity, encourage employment, stimulate innovation and technology transfer, and enhance economic growth (Mueller & Goic, 2002). The CEE countries have identified the positive effects of FDI on the transformation process of their economies.

The most important economic reason for attracting FDI at the beginning of the transformation process was to facilitate the privatization and restructuring of the central planning economies. At present as the privatization and reconstructing processes come to an end, the main reason to pursue FDI is to enhance sustained economic growth (Gao, 2005).

The size and increasing FDI inflows to transitioning CEE countries has been impressive. Poland, Hungary, and the Czech Republic have become the most attractive destination for foreign investments.

Important factor influencing business environment in the CEE countries is their membership in the EU. The EU policies and the national incentive based FDI policies are two driving forces influencing business environment in the CEE countries. During the preparation period of CEE countries to become members of the EU (2003-2004) the FDI inflows in the Czech Republic increased by 186.3% (from USD 1.863 to 3.596 million), in Hungary by 176.3% (from USD 1.909 to 3.365 million), in Poland by 133.7% (from USD 3.660 to 4.892 million), in Slovakia 142.1% (from USD 636 to 904 million) and in Slovenia by 141.1% (from USD 299 to 422 million).

Recent inflows can be attributed to the positive impact of the EU enlargement in May of 2004. For example the value of FDI located in Poland in 2006 (USD 22. 123 million) was higher by 81.9% when compared to the previous year (USD 12. 162 million). The greatest amount of FDI inflow in 2006 was invested in real estate and other business activities (USD 7. 197 million), manufacturing (USD 5.241 million), trade and repairs (USD 3.150 million), financial intermediation (USD 2.448 million), and buying and selling of real estate by nonresidents (USD 1.336 million).

New EU countries have improved the business environment and introduced policy measures aimed at liberalizing their economies (Witkowska, 2007).

Poland became the main destination of FDI in 1996. An acceleration of flows into Latvia and, with a lag, into Lithuania (second wave countries), but their cumulative flows continue to lag behind those of Estonia. FDI in the Czech Republic surged following the passage of a new investment law in 1998 and accelerated privatization. For two years the country has received FDI amounting to around 10 per cent of GDP, one of the highest ratios in the CEE region. Accelerated privatization in Bulgaria and Romania significantly boosted inflows in 1996-1999. The sale of the national telecom companies in the latter two countries markedly raised FDI in 1998 and 1999, respectively.

The experiences of Hungary and Estonia indicate that the winding down of privatization programs results in a fall of receipts. In most east European and Baltic states, these programs are due to be completed in 2001-2002, but in other countries the process is much further behind.

In 1999, the ratio of the cumulated inflows to GDP, a measure of the penetration of FDI in the host economy, was in the range of 30-40 per cent in the Czech Republic, Hungary, Estonia compared with around 10-16 per cent or less in many other countries.

The FDI inflow in transition CEE countries constitutes a relatively high percentage of GDP. The inward FDI inflow in 2005, in the Czech Republic and Hungary accounted for 8.5% and 6.1% of GDP in 2005. Poland is aiming for 5% FDI inflow as a percentage of GDP (Tables 1 and 2).

The share of foreign stock as a percentage of GDP has been very high in Hungary, the Czech Republic, Slovenia and Slovakia, and constitutes respectively 43%, 34%, 24%, and 22% of each country's GDP (2004). In Poland, the share of foreign stock as a percentage of GDP is much lower and amounts to 19% of GDP (Table 2).

In Hungary and Estonia, for example, early privatization-related FDI inflows helped to boost foreign exchange reserves and/or reduce external debt (net debt reduction). Indeed, reducing the high debt burden was a consideration determining Hungary's particular privatization strategy.

Despite periods of sizeable current account deficits in the 1990s, the Czech Republic and Poland were able to forgo sovereign borrowing and hold down their external debt. On the other hand, there was a marked increase in the foreign indebtedness of several countries with large current account deficits and relatively low levels of inward FDI (Croatia, Romania, Slovakia). FDI-related privatizations proved to be an attractive financing option for several countries nearing their debt ceiling. In the transition economies, Hungary and Estonia showed early signs of FDI-led growth.

*Table 1. FDI in percentage of GDP during 1990-2000 (%).*

<b>Country</b>		<b>1990</b>	<b>1991</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
Bulgaria	Flow	0,01	0,73	0,48	0,36	1,08	0,69	1,1	4,87	4,22	6,32	7,95
	Stock	0,54	2,20	2,43	2,30	3,65	3,4	5,6	10,22	12,54	16,86	21,46
Czech Republic	Flow	-	-	-	1,75	1,99	4,64	2,3	2,28	6,01	10,51	8,79
	Stock	-	-	-	9,21	10,42	13,30	13,82	16,16	23,24	29,16	38,16
Estonia	Flow	-	-	1,92	3,96	5,28	4,59	3,18	5,26	10,25	5,30	6,89
	Stock	-	-	2,16	6,21	11,48	15,35	17,44	22,72	32,56	43,19	46,56
Hungary	Flow	1,51	4,29	3,87	6,18	2,69	11,12	7,11	8,87	6,90	6,71	5,76
	Stock	1,55	6,15	8,97	14,11	16,68	24,64	28,63	38,26	42,91	47,14	47,70
Latvia	Flow	-	-	0,57	0,94	4,38	3,62	6,71	8,35	5,28	4,75	5,27
	Stock	-	-	3,21	4,64	8,90	12,41	16,47	20,33	23,12	24,63	26,60
Lithuania	Flow	-	-	0,12	0,44	0,49	1,07	1,80	3,498,22	4,43	3,31	3,66
	Stock	-	-	1,30	1,96	5,02	5,22	8,31	10,27	14,44	18,80	20,41
Poland	Flow	0,13	0,42	0,73	1,82	1,72	2,63	2,87	3,12	3,68	4,33	5,45
	Stock	0,16	0,50	1,48	2,45	3,49	5,64	7,32	9,28	12,99	15,54	19,98
Romania	Flow	0,026	0,13	0,39	0,35	1,12	1,17	0,74	3,42	4,82	2,89	2,85
	Stock	0,026	0,15	0,61	0,80	1,32	2,30	3,09	6,80	10,75	15,37	18,78
Slovakia	Flow	-	-	-	1,33	1,64	13,12	1,73	1,07	3,23	2,08	9,45
	Stock	-	-	-	4,80	5,79	6,58	9,57	9,75	13,02	15,48	23,21
Slovenia	Flow	-	-	0,85	0,85	0,77	0,73	0,84	1,67	1,01	0,49	0,70
	Stock	-	-	13,95	14,64	8,85	12,73	13,16	11,04	13,04	12,28	14,76

Source: UNCTAD, FDI database, annual data, 1990-2010.

*Table 2. FDI in percentage of GDP during 2001-2010 (%).*

<b>Country</b>		<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Bulgaria	Flow	5,98	5,8	10,49	14,01	14,43	24,35	29,4	19,02	6,88	4,53
	Stock	21,66	26,12	31,88	41,01	50,95	74,06	90,08	84,89	100,95	100,22
Czech Republic	Flow	9,12	11,28	2,21	4,55	9,3	3,82	5,99	2,99	1,54	3,53
	Stock	43,81	51,37	49,57	52,28	48,64	55,83	64,52	52,37	66,15	67,64
Estonia	Flow	8,64	3,94	9,43	7,95	20,63	10,69	12,57	7,34	9,54	8,01
	Stock	50,63	57,70	71,11	83,60	81,38	75,55	77,45	69,53	87,14	85,63
Hungary	Flow	7,38	4,49	2,53	4,41	6,97	6,67	2,87	4,75	1,59	1,84

	Stock	51,42	54,37	57,25	61,25	56,08	72,7	69,23	56,95	76,7	71,02
Latvia	Flow	1,58	2,71	2,72	4,62	4,40	8,34	8,07	3,74	0,36	1,45
	Stock	28,00	29,53	29,29	32,90	30,72	37,50	37,68	34,26	44,83	45,17
Lithuania	Flow	3,66	5,11	0,96	3,43	3,95	6,03	5,15	4,32	0,46	1,73
	Stock	21,92	28,11	26,65	28,33	31,60	36,55	38,52	27,64	38,02	37,06
Poland	Flow	3,00	2,08	2,25	5,05	3,37	5,75	5,54	2,8	3,18	2,07
	Stock	21,66	24,38	26,68	34,27	29,86	36,84	41,97	31,04	43,22	41,22
Romania	Flow	2,88	2,49	3,69	8,52	6,55	9,27	5,82	6,81	3,01	2,24
	Stock	20,75	17,12	20,51	27,13	26,10	37,06	36,9	33,23	44,69	43,94
Slovakia	Flow	7,5	16,89	6,55	7,21	5,12	8,52	4,77	4,96	-0,06	0,6
	Stock	26,45	34,78	44,2	52,07	49,88	61,01	56,86	54	60,1	58,09
Slovenia	Flow	1,83	7,14	1,07	2,49	1,67	1,69	3,2	3,56	-1,18	1,75
	Stock	12,87	18,24	22,29	22,87	20,6	23,52	30,38	28,62	30,77	31,47

Source: UNCTAD, FDI database, annual data, 1990-2010.

In both cases, the governments' strategies involved an early infusion of FDI through the sale of strategic state assets. On the other hand, in Poland an economic recovery (starting in 1992) preceded the surge in FDI by several years. Due to its size, location etc., Poland was from the very beginning of the transition considered one of the most attractive countries for foreign investment.

As regards indirect evidence, in Hungary, FDI-driven export growth appears to have been largely responsible for the improvement in economic performance in the second half of the 1990s. Exports were by far the most dynamic component of final demand, far exceeding the combined contribution of consumption and investment. This was also the case in the Czech Republic although GDP actually contracted due to falling domestic absorption. In all the countries in this sample, GDP and export growth were nearly always positively related and, given the role of foreign companies in exports, FDI is likely to have contributed significantly to this outcome.

The volume of FDI inflows has grown rapidly, as the Governments of the CEE countries have officially encouraged FDI and

developed a formal FDI promotion programs providing substantial incentives for foreign companies. Table 1 presents FDI inflows into the CEE between 1990 and 2010. The last decade has made it clear that foreign direct investment created employment, increased productivity and exports, and led to transfers of knowledge and technology to the CEE host countries.

The share of foreign stock as a percentage of GDP has been very high in Hungary, the Czech Republic, Slovenia and Slovakia, and constitutes respectively 43%, 34%, 24% and 22% of each country's GDP (2004). In Poland, the share of foreign stock as a percentage of GDP was much lower and amounted to 19% of GDP (Tables 1 and 2).

### 3. Conclusion

Like most developing countries, CEE countries have been actively seeking FDI inflows to invigorate growth in their economies and transform them to true market systems. The empiric evidence found a compelling positive and statistically significant effect of FDI inflows on growth in

the case of EU accession countries of the CEE region. EU accession countries have generally faced stronger pressures and stricter performance requirements compared to other countries. Also, the relatively large size of FDI inflows to EU accession countries could also explain that.

FDI inflows contributed to higher supply capacity in all those countries, leading to more exports, but the period of time to produce effects is different among CEE countries. On the other hand, evidence for FDI-specific effects is mixed. The results suggest that this effect has been present mainly for the new EU member states, reflecting, among other things, the higher amount of FDI inflows received by these countries relative to Southeast European countries (Romania and Bulgaria), as well as the potentially higher initial productivity of domestic companies acquired by TNCs. Still, if we consider the dimension of underground economy in Bulgaria (36,5% of GDP) and Romania (35,4% of GDP), we can explain the lower economic growth rates against Czech Republic (with an underground economy of 18,3% of GDP) and Poland (18,2% of GDP). (Miritoiu and Popescu, 2009).

The inward FDI has increased in the CEE in the past twenty years to become the most common type of capital flow. Most of the time Poland was the leader in FDI compared to the other CEE countries. As Poland is the largest economy among the CEE countries FDI as a percentage of GDP in Poland is relatively lower than in other CEE countries.

Poland, coming from the most backward position, experienced the strongest growth in capital endowment. Traditionally more focused on agriculture, it is now adopting new technologies and raising industrial production. Poland might be able to close gaps with Hungary within the next years. However, the Czech Republic maintains its leading position among the transition countries and is quickly approaching the level of capital endowment in the EU-12 (Apergis et al., 2004).

In Poland, GDP per capita, level of capital formation, openness to trade, corporate income tax rate, labor cost and productivity, quick introduction of market reforms at the

beginning of '90s have been the key determinants that influenced greatly the FDI inflows in the last two decades and made Poland the greatest recipient for FDIs. However, the initial success was not fully exploited in the recent years and Poland is not anymore the leader among CEE countries and it need to exploit more its size and potential. Today, Poland is recognized as a large, stable country with good prospects for growth. EU membership imposed several changes in the Polish legislation which led to an improvement in the business climate in Poland. Poland should exploit its size potential and focus on the economic policies which will further sustain the growth of the market. It should work on creating favorable conditions for foreign investors, especially in terms of the simplification of existing law and effectiveness of the juridical system, in particular law enforcement. It should work to increase the domestic expenditure on R&D and on infrastructure that will allow the dissemination of knowledge into the Polish economy. Once the crisis erupted and the fiscal deficits increased, Poland couldn't base on its low corporate income tax that attracted FDIs in the past. So, it should focus on reducing other tax burden and on simplifying the tax system regulations and procedures for investors. Moreover, Poland should work on its trade liberalization, because the trade openness is one of the strong factor that influenced FDIs inflows in Poland (Kornecki and Rhoades, 2007).

What started as a global financial crisis but grew into economic recession has hit the emerging market economies in CEE with acute harshness only some twenty years after they first embarked on the path of economic policy overhaul. Amongst them, the Baltic states (Latvia, in particular), Hungary and Poland have perished. Impressive GDP growth rates over the past few years were achieved in part through heavy borrowing from Western banks, giving them easy access to foreign currency denominated loans. Now that credit lines are in halt and uncharacteristically high interest rates prevail, huge debt loads have accumulated to repay,

leaving many Eastern European currencies in free fall.

The relative ‘poverty’ of Bulgaria left its economy oblivious to the direct impact of the global financial crisis of 2007-2008. Although this incidence is itself not an isolated case amongst the CEE countries, the causality of it is in large part founded in the particular structure of the Bulgarian economy. The shortage of liquidity on the market intensified by the sharp withdrawal of foreign direct investments where Bulgaria had become the most FDI reliant economy in CEE by 2009. At the same time the current account deficit stands at more than 24% of GDP to be entirely financed by FDI capital flows. Although Bulgaria is the poorest of the EU-27 member states today, the low GDP base has allowed for robust real GDP growth rates between 2000 and 2008, before the crisis. The Bulgarian economy is heavily reliant on FDI capital-inflows than other CEE countries. The gap is significant, primarily reflecting the smaller GDP of Bulgaria than that of other CEE countries. The disparity in real growth outlook between Bulgaria and the majority of the CEE countries is on account of two factors in the main: (1) an over-reliance of the national economy on FDI; (2) a large volume of speculative investments in the total FDI stock that failed to generate significant absorptive capacities in the country’s industrial base.

However, it is clear that FDI to the industrial sector has received much less attention than the services sector, chief amongst which the real estate market and financial intermediation. In the last decade, foreign investors in Bulgaria preferred in greater extent to work with foreign suppliers or foreign-controlled Bulgarian suppliers.

Relatively low institutional quality in Bulgaria and Romania would be the major reason for a modest increase in this region. On the basis of the analysis on the role of foreign direct investments in stimulating economic growth in Romania during 2000-2010, the relatively important linear relationship between the dynamics inflow of foreign direct investment and the dynamics of economic growth in Romania was confirmed. FDI by

themselves induce a false effect of growth. The Romanian level of development is not sufficient to enhance a positive effect of the FDI, exports and imports on the economic growth of the country (Jude and Silaghi, 2010).

FDI in Romania is a source of implementing new technologies needed to overcome the current crisis, especially since foreign direct investments in Romania have been directed towards sectors that have led to increased imports and implicitly to the current account deficit. Obtaining the desired results is achieved by directing investment to areas with an innovative character and which use modern technology, to areas where sustainable economic growth is achieved.

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## Monetary Policy and Financial Stability: Recent Approaches and New Guidelines

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### Abstract

*Recent international financial crisis has highlighted the crucial importance of financial stability and showed clearly that ensuring price stability as an objective of monetary policy is a necessary but not a sufficient condition to ensure financial stability. In this context, there have been intensified debate among researchers and policy makers on how monetary policy can bring a major contribution to financial stability and even on the award of a clear mandate for financial stability.*

*Our paper aims to highlight the challenges that arise for central banks and their monetary policy when they try to ensure the financial stability. Also, our study highlights the vital need for price stability on medium to long term to remain the primary objective of the monetary policy and that the financial stability to be the primary responsibility of macro-prudential policies that can prevent and limit the buildup of vulnerabilities in the financial system.*

**Keywords:** monetary policy, price stability, financial stability, central banks, financial crises

**J.E.L. classification:** E52, E58, G01

### 1. Introduction

Internationally there is a consensus among economists and policy makers regarding the fundamental objective of monetary policy, namely price stability over medium term. By achieving this objective is considered that the

monetary policy can make its most important contribution to the stabilization of output and to increase social welfare.

In recent years, leading up to the recent global crisis, the decrease of inflation and of interest rates in international economic environment have led to excessive risk taking in the financial system and to significantly increase of the leverage ratio in non-financial private sector but also in the banking sector. In this context, there was a credit boom and an excessive rise in financial asset prices, which have led to the financial system instability, proving that price stability is a necessary but not sufficient condition to ensure financial stability.

The major negative effects of the recent financial crisis on the financial system but also on real economy led to intensifying debate among researchers and policy makers on how monetary policy can bring a major contribution to financial stability and even on the award of a clear mandate for monetary policy on financial stability.

Although there is no consensus yet on how monetary policy can contribute more efficiently to ensuring the financial stability, we can appreciate that, by its complex and extremely serious implications, the financial crisis represents the most important challenge for central banks and monetary policy, since the Great Depression from 1929-1933.

Our paper it is structured as follow: *section two* is devoted to highlighting the role of central banks in ensuring financial stability; *the third section* reflects the relationship between price stability and financial stability, as well as the problems faced by the central banks and by the

monetary policy due to the major adverse effects of the recent financial crisis; *the fourth section* includes the conclusions of our research.

## 2. The role of central banks in promoting financial stability

In the last two decades, prior to recent international financial crisis, in most countries, achieving price stability was considered one of the most significant achievements of central banks. Such an achievement was attributed to the monetary policy framework adopted, which was based on two pillars, namely *central banks independence* and *price stability*, seen as a fundamental objective of monetary policy [12]. Also, the central banks have played an important role in ensuring financial stability, in particular through the surveillance over the system of payments, but also through their involvement in the supervision and regulation of the Financial Sector. Therefore, although the problem of the role of central banks in financial stability it is not new, the serious implications of the recent international financial crisis have brought into focus the issue of the important role of central banks in ensuring financial stability.

According to the studies of The Bank for International Settlements [2], the vital necessity of central banks involvement in ensuring financial stability would result from three main reasons, namely: financial instability can influence macroeconomic environment with major implications on the economic activity, price stability and on the transmission of monetary policy; the central banks are the ultimate source of liquidity for the economy, and providing appropriate liquidity is crucial for financial stability; also in achieving the functions related to monetary policy the central banks have a macro view and an understanding of financial markets, institutions and infrastructure, which enable them to perform a macro-prudential function.

The national financial stability frameworks and the place of central banks, show differences from country to country, but in most states is to note that the law makes clear that the financial stability is a goal or a task of central banks, as shown in table 1.

Table 1. The exemplification of the role of central banks in ensuring financial stability

	Law explicitly states financial stability (1)	The central bank's function in financial stability (2)	
		Regulation	Supervision
Argentina	x	x	x
Brazil	x	x	x
Canada	x		
China	x		#
ECB	x		
France	x	x	x
Germany	x	#	#
India		x	x
Indonesia	x	x	x
Italy	x	x	x
Japan	x		*
Korea			*
Mexico	x		
Russia	x	x	x
Saudi Arabia	x	x	x
South Africa	x	x	x
Turkey	x		
England	x		
USA	x	#	#

(1): x- indicates that there is an explicit reference in the law. In some cases a financial stability objective may be referred to outside of the law, for example in memoranda of understanding;

(2): x- indicates that the central bank has a lead responsibility; # indicates a function is shared with other agencies, and \* indicates that the central bank does not have a responsibility, but can conduct or participate in supervision activities.

Source: [17]

The very serious effects of the recent crisis caused unprecedented reactions of central banks, resulting in particular through interventions in financial markets so as to avoid the collapse of the global financial system. In this context we observe, an extension of the role of central banks in ensuring financial stability (see table 2), as evidenced by the development and implementation of innovative tools of

monetary policy, known as unconventional instruments of monetary policy (such as, for example, measures of „quantitative support” - quantitative easing-and measures of „credit support” - credit easing). By applying these measures, central banks have aimed to avoid the collapse of the financial markets and to bring their contribution to support lending to businesses and households.

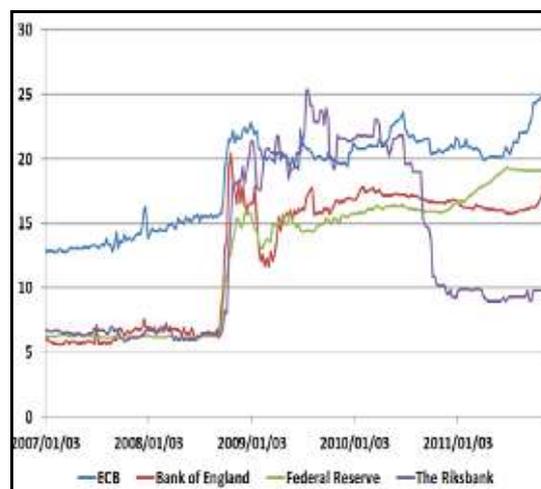
Table 2. Enhancing the role of central banks from the hard-hit countries

conventional	Monetary policy tools	Prudential policy tools
Focus on prices	Policy interest rate	Capital requirements
Indirect approach to influencing financial conditions and asset prices	Reserve requirements	Liquidity requirements
Direct influence on the very short-term interbank market only		
Unconventional	Central bank balance sheet tools	
	Intervention in domestic financial markets	Intervention in FX markets
Focus shifted from prices to quantities	Term interbank market Sovereign bond markets	FX intervention Reserve accumulation
Direct intervention in financial markets	Credit markets Mortgage markets	Currency swap arrangements

Source: [5]

It is also worth noting that, the significant interventions of central banks in the developed countries hard-hit by the financial markets crisis led to a significant enhancement in the size of their balance sheets (see figure 1), which highlights their increased role in financial intermediation, but also generates some concerns about the possible inflationary impact of the measures taken by central banks [12].

Figure 1. The evolution of the size of some central banks' balance sheets (percentage of GDP)



Source: [14]

### 3. Price stability versus financial stability and new guidelines for the monetary policy

In the years preceding the recent international financial crisis, the international economic environment was characterized by low and stable inflation rates which have coincided, for a period of time, with significant economic growth and low volatility of GDP, a period known as “The Great Moderation” [11]. From the monetary policy perspective, was considered that by maintaining a low and stable inflation, the monetary policy could make its largest contribution to ensuring the financial stability.

However, paradoxically, the recent financial crisis shows that price stability is a necessary but not sufficient condition to maintain financial stability. On the other hand, price stability is a prerequisite condition for financial stability, in the sense that a high and volatile inflation threatens the foundations of the financial system because it leads to an unpredicted redistribution of wealth between debtors and creditors. Backward, the financial stability is indispensable to price stability because by preserving the stability of the financial system there are avoided the risks regarding price stability [11].

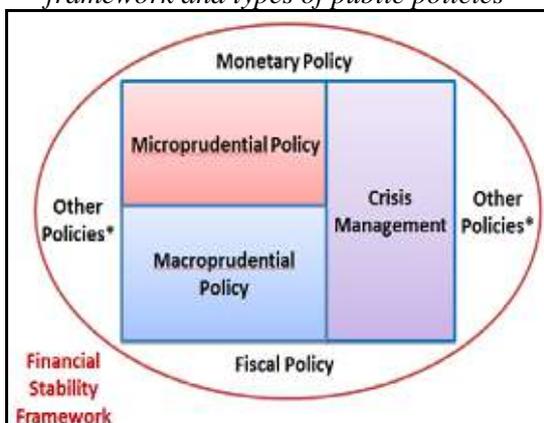
For example, prior to the global economic crisis, in some countries the very rapid credit growth, especially of those granted to

households, led to a significant increase in domestic demand, which in the conditions of a sufficient offer has led to an increase in inflation.

The two dimensions of stability, namely price stability and financial stability, as the main objectives of central banks raise the problem of identifying the instruments necessary to achieve them. In general, central banks use short-term interest rates as the primary instrument to determine the monetary policy orientation. However, the policy rates have an impact on the whole economy, and their use to achieve those two objectives can lead to adverse effects [18]. As highlighted by the recent period before the financial crisis, the optimum interest rate level which allows the achievement of price stability under conditions of full employment may be different from the optimal level that would allow the financial market stability. According to „Tinbergen Rule“, the same tool can be used only to achieve a single objective. Therefore, if for price stability the interest rate it is used, as the primary tool, there is required a second instrument, often a macro-prudential instrument to ensure the financial stability.

Financial stability is a shared responsibility of several types of public policies (see figure 2), including monetary policy; but the primary responsibility lies on the macro-prudential policy, which specifically focuses its content directly on the stability of the financial system as a whole.

Figure 2. The financial stability framework and types of public policies



\* Other policies involve, e.g., policies related to business conduct, consumer protection, accounting rules and competition.

Source: [7]

The importance of the financial stability requires that all public policies - prudential (micro and macro-prudential), monetary and fiscal - to contribute to ensure the financial stability, as shown in table 3.

Table 3. The contribution of public policies in ensuring financial stability

Existing paradigm	New paradigm
Monetary policy focused on inflation	The monetary policy focused on inflation having the role to counter the financial imbalances
Micro-prudential policy focused on individual banks	Micro-prudential policy combined with the macro-prudential policy focused on systemic risk
Reliance on internal risk management, self-regulation and market discipline	Higher bank capital, better governance, and expanded perimeter of regulation
The fiscal policy does not take account of financial stability issues	Countercyclical fiscal policy (fiscal buffers)
Domestic focus	More global coordination

Source: [6]

From the monetary policy perspective and with reference to its role in ensuring financial stability, the severe effects of the financial crisis have led to increased debates on the award of a clear mandate for financial stability. Although until now there is not a consensus on this issue, many views argue that by adopting an additional explicitly objective by the monetary policy, it would be an over-burden and there will be the risk to trigger a loss of credibility. It is also argued that the monetary policy should focus on maintaining price stability over the medium term as a fundamental objective and that ensuring financial stability should be the primary objective of the macro-prudential policies, which generally focus on systemic risk. This approach takes into account both the principle of Tinbergen (cited above) and the Mundell's principle according to which to achieve an objective it must be used the tool

that presents the greatest efficacy compared to other instruments.

Besides the inclusion of the financial stability as an explicit secondary objective of monetary policy, the debate between researchers and decision makers focus on other important aspects such as [9]: taking into account explicitly as monetary policy targets the prices of certain assets or some developments on credit markets; extending the horizon of time to achieve the primary objective of monetary policy on the grounds that, for example, the current inflation targets are covering a shorter time horizon (usually two years) while the financial imbalances take longer to build up.

The serious implications of the crisis on the financial system and indirectly on the real economy call for outlining some lessons for the future. Thus, from the perspective of central banks and monetary policy, Viñals [17] highlights three important lessons offered by the recent crisis, namely: the financial stability must be addressed mainly through macro-prudential policies, because they can alleviate the systemic risk and accumulation of structural vulnerabilities; price stability remains, the main objective of monetary policy; the necessity of changing the operations of central banks and providing some frameworks of crisis management.

In the light of the responsibilities of central banks, the recent financial crisis highlights the need that the central banks responsibility to provide and maintain financial stability to be as important as the responsibility to use monetary policy to pursue macroeconomic objectives [3].

#### 4. Conclusions

Recent international financial crisis has highlighted the crucial importance of financial stability and showed clearly that price stability as an objective of monetary policy is a necessary but not a sufficient condition to ensure financial stability. In this context, the main challenge for the central banks is to identify the tools needed to achieve both price stability and financial stability. To this end, the central banks should take into account both the “Tinbergen Rule”, which says that a tool can be used only to achieve a single objective, and the Mundell's rule according to which to achieve

an objective it must be used that tool that presents the greatest efficacy compared to other instruments. From these considerations it is argued that the primary objective of the monetary policy it must be ensuring and maintaining price stability on medium and long term and the primary objective of the macro-prudential policies has to be the financial stability.

Although currently there is no consensus regarding the effective contribution of the monetary policy to ensure financial stability, the fact is that the financial systems of all countries of the world know profound transformations, materialized in the implementation of significant financial and regulatory reforms for preventing new crises in the future. All these changes have repercussions on the role of central banks and monetary policy whose priority objective we consider that should remain price stability.

Also, we agree with the view that central banks responsibility to ensure financial stability should be as important as the responsibility to use monetary policy to pursue price stability.

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# Innovation Impact on EU Countries Economy

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## Abstract

*Science has begun to play an increasing role in industrial development not only as a major source of knowledge for new technological activities or scientointensive industries (medicine industry, chemistry, electronics), but also as essential input in testing, evaluation and quality control. Innovation is one of the activities that can generate economic and social progress. Therefore, this paper also approaches the significance of innovative information dissemination, as well as the objectives of this activity in view of the EU Member States. The European Union has prepared two funding programs for innovation activity, Europe 2020 and Horizon 2020.*

**Key words:** R & D and innovation, finance, technology dissemination

**JEL Code:** G28, G29, O30,O31

## 1. Introduction

Innovative activity is as old as human history. From his earliest attempts to change and adapt nature to his needs, man has never ceased to innovate, that is to introduce something new into his material or spiritual existence. Metallurgy, the mirror, porcelain, the gear, suspension bridges, the loom, the scales, the calculating machines, cartography, the clock, the compass, the decimal system, geometry, the square root, the sterilization system, vaccines are just a few of the findings of anonymous inventors of antiquity in Babylon, Mesopotamia or China.

Innovation's main goal is not only to improve the stock of knowledge, inventions and patents, but also to disseminate them on a large scale, in other words the dissemination stage of new and improved knowledge, products, technologies and services. This

process is becoming more and more interesting area of study for the understanding, influencing and adjusting of the competitive market mechanisms market economy countries or in countries in transition to such economy.

## 2. Technology dissemination

Technology dissemination has gained increasing importance in the policy goals of science and technology due to the fact that financial support in this area is increasingly conditioned by rigorous and pragmatic evaluations in terms of real economic effects.

A series of aspects concerning micro and macroeconomic efficiency (increase in capital efficiency, labor productivity and competitiveness, operation of structural adjustment) are related to high hopes, especially for developing countries, for programs with consistent objectives of technological diffusion.

Technology dissemination is narrowly considered as a large-scale application of any available technology. The area of dissemination of these technologies may refer to various fields and sectors and, of course, to both public and private sectors. Technology dissemination doesn't only pursue goals directly related to improving the parameters of productive process efficiency, but also the elimination of duplication in innovative activities that would discover things already known in another part of the country or in other institutions.

Technology dissemination is also dependant on economy's, and especially industry's structural characteristic, on their complexity and intensity. In this respect it is worth noting the role that large companies (machinery constructions, electrical, electronics, metallurgy, chemistry, etc.) that have greater opportunities to invest and operate machinery, equipment and new equipment, have. Close connections between the various companies in supply, production and marketing, horizontal

cooperation, involving sales and purchases of intermediate goods, create a proper framework for encouraging the expansion of technical progress for all participants. [1]

Profitable achievements in technology dissemination are however conditioned by the level of the employees' professional qualification, their competent and adherent responsiveness, trade unions includes, to technological and organizational novelties. For adopting superior technologies, the level and structure of wage costs, as well as other statutory obligations of the company have a significant importance. In case of high productivity and wages, of effective operation of labor relations systems, of the labor market and information fluxes, technological diffusion rate can benefit from considerable human support.

### **3. Knowledge and technology transfer from research to industry**

Theoretical studies approaching the variety of aspects in business life conducted in the academic environment are circumscribed to the subject known in the specialized literature as „Academy-Industry Relations”, area of research that theorizes particular or common aspects of the concrete forms of manifestation of research interest, especially in universities, to develop efficient contacts with economy in general and industry in particular. Most of these papers describe or analyze in detail the causes and factors of success or failure of various initiatives that have occurred locally or regionally, evaluate their performance and impact, perform statistical and sociological surveys and forecasts etc., being less concerned with conceptualization, theoretical debates or semantic controversies.

Therefore, the notions used by this area of research, like business incubation center or incubator, science park, spin-off, technology transfer center, research park, technology center, etc., don't have a clear conceptual distinction, being used in practice without too much exigency and rigor, often being considered as substitutable, complementary or synonyms.

The specialized literature has a variety of definitions of the same concepts. Thus, the *Science Park* is characterized by its territorial vicinity to a, institution of higher education or an advanced research center, with which it has

close relations. It aims to: supporting the development of companies, facilitating technology transfer from research and education to companies and organizations within the park or surrounding areas, encouraging businesses based on research results of R&D university departments or research institutes. The main objective of these parks is researching and designing new products and their development to prototype stage, production for market being achieved in separate units.

*The Research Park* is usually located within a university or research institute and has a predominantly scientific activity in which students and academics are working together. Production concerns are usually excluded.

The *Technology Center* helps develop an enterprise engaged in applying advanced technologies based on research that should not necessarily be carried out within the university, offering also a range of facilities and services, including the sale of products. It is distinguished from *the Science Park* by accentuating aspects concerning production and by the optional involvement of academic research. The selection of “residents” uses rigorous criteria concerning the inclination to use research or products requiring a high technological level.

*The Innovation Center* provides a range of facilities to new small and medium companies that engage in high technological level products (by taking a large risk to their market launch): office equipment, different services, access to considerable network of research, consulting and financing institutions etc. They can often be part of Science Parks.

*Business incubators* concentrate in a limited space a number of newly-created companies for the purpose of helping them increase their chances of survival by providing them with modular construction, shared facilities (telephone, computer, secretarial, etc.) and with managerial support and other support services. Their main goal is both the orientation towards new technologies, as well as local development and the creation of new jobs.

*Industrial or business parks* provide an environment of high qualification, suitable for a wide range of activities including manufacturing, sales, exhibitions, etc., without necessarily having to be in the vicinity of academic institutions.

*The Managerial Workshop* provides a multitude of consultancy and financing services to industrial business activities, taking place in new or existing units. By dealing with improving the quality of common services and imposing strict admission and output rules, a series of managerial workshops have become innovation centers or business incubators. [2]

#### 4. Strategies for stimulating the innovation process

Strategies in R&D and innovation evolved after a trajectory described by combining in different proportions two different types of policies, namely the policies of science and industry, sensibly influenced by the company’s behavior. Innovation strategies relied on the explicit recognition of the fact that the success of creating and marketing new products is due to a set of factors, far more numerous than the R&D activity that was, until recently, taking all the credit. Of these factors, the market of products and technologies plays a significant role. [3]

Provided that economic competitiveness has become a major focus, increasing attention has been given to research conducted in industry, reflected in increased collaboration between industry and universities, as well as to the development of human resources potential for research. Maintaining a high quality in basic research remains an important objective, regardless of the levels of economic development of different European Union Member States.

A special attention is paid to participation in international research and development programs (particularly the Community Framework Programme for R & D) and to increasing the number of networks, consisting of public and private participants of the EU Member States. Another series of objectives in research and development tend to be shared in a growing number of EU Member States. [4]

The issue of public interest research has been treated, in the last few years, both in theory and in the practice of the developed European countries, with much more nuance and flexibility, observing a sensitive mutation from the interest in R&D public or government institutions to public interest strategic fields or R&D programs. These changes most strongly are reflected in the prevalence of R&D funding in comparison with institutional funding,

mechanism also adopted by countries in transition to market economy, whose systems of science and technology are in full process of reform.

The experiences of developed countries are particularly relevant in terms of forming inter-institutional research networks, promoting research in collaboration between teams from public institutions and teams from private enterprises or institutions.

*Table 1. General objectives of the EU Member States in the field of science and technology strategies*

	<b>Objectives</b>
Objectives common to most Member States	<ul style="list-style-type: none"> <li>-Developing training and mobility for researchers;</li> <li>- Promoting innovation and technology transfer (exploitation of results, especially in small and medium companies)</li> <li>- Increasing collaboration and cooperation between industry and higher education and, in general, improving cooperation between private companies and public research sector;</li> <li>- Supporting and promoting industrial research both financially and in implementation;</li> <li>- Sustaining and developing high quality basic research;</li> <li>- Boosting economic competitiveness and stimulating economic growth;</li> <li>- Increasing R&amp;D contribution to regional development;</li> <li>- Intensifying international cooperation, especially within Europe.</li> </ul>
Objectives that tend to become common to Member States	<ul style="list-style-type: none"> <li>- Developing programs containing socio-economic objectives of major importance;</li> <li>- Promoting public acceptance of science and technology;</li> <li>- Assessing the ethical and social aspects of technological development;</li> <li>- Improving the mechanisms and methods for program evaluation;</li> <li>- Developing the capacities of strategic deliberation in selecting priorities in science and technology.</li> </ul>

(Source: Sandu S., 2002)

In **Belgium**, between 1987 and 1991, 14 of these networks worked under the “inter-university attraction poles” program in domains as: genetics, raw materials, robotics and optics, being financed for a period of 5 years. In **France**, starting with 1982 and until 1992 24 “groups of public interest” (Groupement d’interêt public) worked, and it created a collaboration between research actors involved in national interest projects. A series of “corporations” were created, corporations formed by public R-D institutions (at least one), local authorities and firms that elaborated together programs from primary science fields such as: agronomy, medicine, new materials, computer science. In **Holland**, public interest programs financed from 1984 until today, had as a research object: the stimulation of small and medium companies; technologies orientated towards business – PBTs; research programs orientated towards innovation IOPs. For the stimulation of private companies in order to collaborate for the realization and implementation of these programs, subventions were granted, representing 50% from the cost of the projects deployed in domains like: materials technology, biotechnologies, informative technologies, environment technology, etc. Regarding the programs orientated towards innovation, it was pursued the creation of research networks in those important fields for the growth of competitiveness of the Holland industry between industry and universities. The programs were financed for 8 years with an intermediary evaluation in 4 years.

In European countries that are recently on the market economy, R-D systems are in more or less advanced stages of profound reforms, aiming the modernization of the legislation, the institutional structures, financing and management mechanisms, in order to adapt more to those west-European.

In **Romania**, although this process started later than in other countries, the directions of the reform are convergent, aiming: the making permanent the evaluation processes of research programs, of institutions and researchers after the scientific performance’s criteria, the intensification of the relations between the research inside the Romanian Academy and the superior education, the growth of the scientific cooperation and collaboration level, both on an European and international level.

Like in other countries, industrial research encountered, initially, in Romania, serious difficulties due to the absence of financing sources. Today, financing this domain from budgetary sources is based on programs and homework, evaluated by specialty committees which work under a R-D authority of the Minister of Education and Research, especially the National Authority for Scientific Research.

In **Bulgaria**, the main institutions developing the R-D activity are, mainly, like in other eastern European countries, institutions of the Science Academy, superior education institutions and those for industrial research which have a certain tendency to decrease and to transform into service organizations for the R-D activity. Financing the industrial research is granted more and more from special funds replacing the state budget.

In **Hungary**, in 1997, R-D expenses were 0,74% from PIB, in comparison to 2,28% in 1988 and 1,61% in 1990. In different types of financing, meaning: the state budget, the Central Fund for Technological Research (KNUFA) and special state funds, the structure of public expenses had an evolution unfavorable after 1990, especially regarding the weight of the expenses for technological research. In public research unities, like those from the superior education, the Science Academy’s institutes or other governmental unities, they were spent, in 1997, 54,8% from the total R-D funds.

In **Poland**, like in Hungary, where research unities and personnel were reduced, industrial research and the innovation activity encountered the highest difficulties after 1990. The reform of the science and technology financing system, introduced in 1990, aimed the cut of the financing weight from governmental sources and the stimulation of private financing, but also the perfection of the evaluation systems. The volume of the governmental funds received by each institute for an activity of public interest, such as: health, environment, fundamental research, etc. depends on the performance level evaluated by Poland’s State Council for Scientific Research (KBN). The unities from group A have the right to grants that covers 30% of the basic activity’s needs, those from group B – 20%, those from group C – 10%, and those from group D – 0%. The expenses for research-development were in 1995, 0,7% from the PIB, in comparison with 0,9% in 1992.[3]

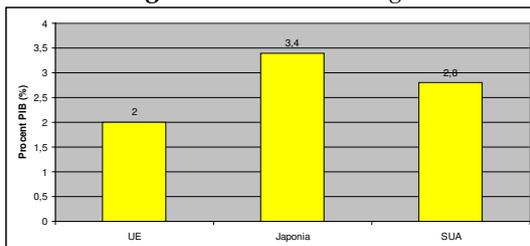
## 5. Europe 2020 and "Innovation Union"

As other states adhered to the European Union, the creation of common policies insuring the Union's development became more and more necessary. Thus, common policies were created in fields like agriculture, trade, fishing, taxation, justice, internal affairs, etc. Research policy in the European Union is part of a broader policy of the European construct, namely, "Science and Technology". Policies in the field of information society arise from this, concerning audiovisual, media, space, life sciences and biotechnology.

The reason for a policy in research and innovation is justified by satisfying two needs. Firstly, the need of coordination for the member states' activity in increasing efficiency and reducing costs, and secondly the need to strengthen the international competitiveness of European economy. Also, research and development develops economy and creates new jobs, and technological innovation can fight or diminish social problems like poverty, certain diseases or environmental degradation.

In 2009, the EU allocated an average 2% of GDP to R&D and innovation, while the US allocated 2.8% and Japan 3.4%. For 2010; the average for the EU countries was 2.7-2.8%. Also, we should not ignore the fact that in 2014, China's net RDI expenditure will surpass the EU.

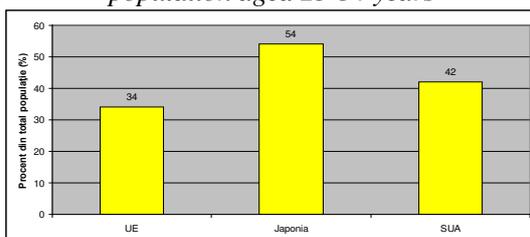
**Figure 1. 2009RDI budget**



TN: GDB Percentage (%)

(Source: <http://www.ec.europa.eu/innovation>)

**Figure 2. People with university degree in the population aged 25-34 years**



TN: Total population percentage (%)

(Source: <http://www.ec.europa.eu/innovation>)

However, the rate of people aged 25-34 who have a university degree, in the year 2009, shows they Europe does not lack potential. It has researchers, entrepreneurs and world-class companies as well as high quality in terms of values, traditions, creativity and diversity. European companies and civil society are actively engaged in emerging and developing economies all over the world. Many innovations that changed the world occurred in Europe.

The biggest challenge for the EU and Member States is probably a more strategic approach to innovation. An approach where innovation is the primary policy objective, that would consider a medium and long-term perspective, where the measures and funding are designed so that they contribute to innovation, where EU and national / regional policies closely aligned and mutually consolidated and last, but not least, where the highest political level sets a strategic program and regularly monitors its progress.

The initiative, "Innovation Union established such an ambitious, integrated and strategic approach, exploiting and enhancing our strengths by using new and productive ways, preserving therefore the economic foundation that supports our quality of life and social model in the conditions of population aging. "Business as usual" is equivalent to a gradual loss of the competitive advantages that we possess and accepting Europe's constant decline. [5]

More specifically, in order to achieve, "Innovation Union, among other things, the following are required:

a) In times of budgetary restrictions, the EU and Member States should continue to invest in education, research, development, innovation and ICT. Such investment should, if possible, not only be protected by budget cuts, but should they receive additional funding.

b) They should be accompanied by reforms that would increase the return on investment and approach the issue of fragmentation. The systems of research and innovation in the EU and Member states should be better coordinated and their performance must be improved.

c) Researchers and innovators must be able to work and cooperate across the EU as easily as at national level. The European Research Area must be completed within four years,

establishing therefore a framework for a genuine free movement of knowledge.

d) Access to EU programs should be simplified and their leverage effect on private sector investments should be increased, with the support of the European Investment Bank. The contribution of the development framework program to fast-growing SMEs should be intensified. The European Regional Development Fund should be fully exploited for the development of research and innovation capacity throughout Europe, based on intelligent specialized regional strategies.

## 6. Conclusions

The European Union has an extraordinary potential for innovation. Europe has a long tradition of determined inventions. It has a variety of creative talents and it can rely on its It has a variety of creative talents. We should not forget that Europe founded one of the largest single markets in the world, where innovative products and services can be widely marketed. The Union also has a tradition of a strong and responsible public sector, which must be exploited.

Almost all EU Member States have improved their performance in research. However, the increase of performances in innovation has slowed down, and the EU is not covering the persistent gap in relation to the world leaders in innovation, U.S., Japan and South Korea. For EU-27, the largest gap remains for innovation in the private sector. EU still has a clear lead from the emerging economies of China, Brazil, India, Russia and South Africa. However, China is improving its innovation performances and continuously reduces the gap.

In the EU and the developed European countries, innovation has been seen for several years as an engine of economic and social progress, and the EU budget for 2014-2020 provides for the allocation of large sums of money to technological research and inventions within the "Horizon 2020" program, which will have a budget of over 80 billion euro. [6]

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# Particularities Regarding the Apparition and Evolution of the Audit’s Activity

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## Abstract

*In the context of a competitor environment more and more dynamic, the entities are confronting with a general problem which might be defined as being that of finding solutions for improving the obtained performances. The managers of entities are constantly putting questions regarding the efficiency and effectiveness of the control about the manner of entity’s function, so these ones appeal many times to audit’s services offered by the professional accounting in order to obtain correct and concrete about the activity developed by the entity they are leading. Due to the transactions and operation’s complexity and largeness effectuated by the economical entities as well as the development of the economical business environment, they have definitely determined even the evolution of the audit’s activity.*

**Keywords:** evolution, audit, audit’s activity, auditor, regulations,

**JEL Classification:** M42

## 1. Introduction

The word *audit* has its origin in the Latin “*audire*” – which means “*to listen and to transmit farther*” [1], in English it has been taken as meaning the “*checking or accounting control*”[1]. Initially, the word *to audit* had the signification of checking the financial situations of a society but progressively, the word *to audit* took the signification of studying a society in order to appreciate its transformation process, the transactions and the financial situations (financial audit), in order to ameliorate the performances (operational audit) or to make a judge upon the inventory (inventory audit).

## 2. The aparition and the evolution of audit’s activity

From the effectuated researches it has been taken the conclusion that from the third century B.J. the roman governments named people (questeurs) to control the provinces accounting. The audit was commanded by kings, emperors, churches and had as objective the identification and punishment of thieves for traceable malversations and preventing these kind of facts with the purpose of protecting that patrimony’s entity. [1] At the beginning the named persons were the priests.

The historical events which happened in the XVIII th century and until the half of the XIX th century brought changes among the audit’s sequencers, hence the states’ formation brought to the jurisdictional court’s foundation and the commercial societies which were led by the shareholders, who took the place to old social classes, and the auditors were the named persons among the best professional accountings. All these things led to audit activity’s development through the amplification of objectives upon detecting the fraud, punishing those who made them as well as searching solutions to keep the patrimony’s entity.

The sense of *audit* was different at that time compared to the one we know today, so this one started to become known and used in the XVIII th century, transformed in time by the Anglo-Saxon practice, he means today, strictly a control of the account, realized by independent experts called auditors, who expresses a professional opinion, responsible and independent upon the way of elaborating and presenting the financial situations of an entity. At the end of XIX Century, starts to settle into shape the relationship between the audit’s entity and auditors, who are chosen among the accounting professionals and jury consult. At that time, the accounting

professionals had as an objective the attestation and certification reality's financial situations against avoiding the errors and frauds from the audit entities. .

In the first part of the XX th century, the audit activity is realized by the professionals specialized in audit with accountings who effectuated works commanded by states and shareholders upon the activity developed by their entities.

Using the term audit nowadays is relatively recent and it is situated in the period of the economic crises from 1929, from the United States of America, when the economic entities were affected by the economic recession and had to pay important amount of money to auditors who effectuated the certification of accounts rated to exchange. Big economic entities started to use the services offered by the Audit Offices, independent constitutions, which had the mission to check the accounts and accounting audit and certify the final financial situations. In order to accomplish the responsibility the audit offices effectuated a series of preparing specialized works as follows: the patrimony's inventory, account's inspection, checking the sold, different probing, etc, which led to a good understanding of audit entities, of their economic situation. After the finishing of the economic crises, the auditors played an important role in offering information to audit entities, using various techniques and knowledge as well as specified tools from the accounting – financial domain.

Alongside the years, the audit activity has diversified by modifying its objectives leading to the need of function's existence as well as the intern audit activity that has been organized in the entities' interior.

The role of the intern auditors started to grow, and this is why these felt the need of organizing as a professional constitution. Thus, in the year 1941, Orlando has been created, Florida and USA, the Institute of Intern Auditors I.I.A.I.[2] is a professional constitution recognize internationally to which it adhered other auditors from countries like Great Britain, Sweden, Norway, Denmark and other states. Nowadays, at this Institute were aggregated over 90 national institutes of intern auditors and members over 120 countries who obtained the quality of

C.I.A- intern audit certified after taking some exams of professional competence. During the years 1940-1970, when the international trade is developing, and it is dominated by exchange relationships between states of goods and services, the audit sequencers are amplifying the sphere of applying the audit activity upon banks, owners, and other financial institutes due to market capital. Audit activity is realized by profesionists in audit and accounting. and their objectives were leading to give an attesting shape of the sincerity and financial situations.

In the year 1941, J.B Thurson, the first president of the International Institute of Intern Auditors, declared with an amazing prediction that the most brilliant perspective of the intern audit would be “the assistant manager”. In 1991, Joseph J. Mossis- the president of the Intern Auditors from Great Britain, takes the same remark, but in more exact terms.” It is clear for those who work in the function of the Intern Audit that this has a vital role to be judged, helping the administration to take the lead of the intern control”[3]. After the year 1970, the word audit was used to designate checking missions of the accounts and then its meaning spread up to control and certification of financial situations, so, the audit of entities becomes a mature domain, which has as objective the attestation of intern control, the abidance by accounting conceptual field and audit norms, all that will open various ways of research in audit activity. After the year 1970, the professional accountants would be constituted in independent, professional organizations under the form of audit and expertise societies. Through the activity taken, the auditors analyzed the facts, documents, operations, and they formulated opinions which attested the real image of accountings, the quality of intern control, respecting the norms and protecting against national and international frauds.

In our country in the communist period, the accounting profession was not let to be developed and it has been limited only to simple mathematic

operations, but after the year 1994 the accounting activity was reinstated as it had to be.

In Romania, the activity of financial audit was regulated through the publication in the Official Monitor of Emergency Ordinance number 75/01.06.1999 which constitutes legal border for organizing the activity of financial audit and the independent prosecution of profession of financial audit.[4]

Still through Emergency Ordinance nr. 75/1999 was brought into being the Financial Auditor's Room from Romania, self-governing person, as a professional organization of public use without a working purpose.

The financial Auditor's Room from Romania has elaborated the Audit Standards and the Code regarding the professional ethical conduct in the financial audit domain, after the International Federation of Accountants (IFAC)[5].

From this perspective, the accountant financial audit is interposing between the producers and users, from accounting information, through professionals of high class (auditors) who assume their responsibility of certifying the financial situations through their reference to a standard or a legal quality norm.

Through the publishing of the Minister's Public Financial Ordinance nr. 403 from 22.04.1999, for approving the accounting regulations, with the IV<sup>th</sup> Directive and the VII<sup>th</sup> Directive of European Economical Communities ,[6] was introduced the indispensability of effectuating the accounting financial audit for all the commercial societies, self-governing administrations, public institutions, banks, investment funds, etc, those who accomplish certain criteria provided in this Ordinance. Thus, through effectuating the audit upon the financial situations, a lot of entities could prevent the insolvency, the liquidation, bankruptcy and the loss of financial resources through a correct informing, exact, real an honest of all the participants to a social economical life.

The audit activity was defined by auditors as being the professional examination of information with the purpose of expressing a

responsible and independent opinion with quality criteria.

According to national norm of audit, an audit mission of financial situations has as an objective the expressing by the auditor of an opinion according to the financial situations has been established, in all their aspects, according to an international accounting reference.”

Nowadays, the economical social phenomena are complex and they cannot be multilaterally analyzed in order to clear some aspects, only with the help of specialists of high professional and moral integrity.

This work refers to the referential from the audit domain, represented by International Audit Standards, Ethic Code of IFAC and the VIII<sup>th</sup> European Directive as well as the research and the studies taken in worldwide and in Romania, in connection with audit activity and the audit of financial situations.

On the European area, the accounting harmony is realized by:

- IV<sup>th</sup> Directive of Council 78/660/EEC regarding the yearly accounts of certain titles of commercial societies;

- VII<sup>th</sup> Directive of Council 83/349/EEC regarding the hardened accounts;

- VIII<sup>th</sup> Directive of Council 84/253/EEC

regarding the authorized persons responsible with effectuating the financial audit of accounting documents.

In Romania, it is organized a national system of public control of audit estate activity, having as base the OUG nr. 90/2008 regarding the estate audit activity of financial yearly situation and the hardened financial situations.[7]

The European Legislation through

- Directive 78/660/CEE from 25<sup>th</sup> of July 1978 regarding the yearly accounts of ceratin form of commercial societies;

- Directive 83/349/CEE from 13<sup>th</sup> of June 1983, regarding the hardened accounts;

- Directive 86/635/CEE from 8<sup>th</sup> of December 1986 regarding the yearly accounts and the hardened accounts of the banks and other financial institutes.

- Directive 91/674/CEE from 19<sup>th</sup> of December 1991 regarding the yearly financial situations and financial situations hardened by the insurance companies, imposes auditing the hardened accounts by

one or many authorized persons to effectuate this kind of auditing.

The need of a harmonized approach of the audit activity at the level of Community was the reason for which the Commission proposed its Communication from 1998 regarding the audit in the European Union, creating a committee regarding the audit that could elaborate future actions connected to the accounting profession and with the member states. As a materialization of the committee's activity, was emitted Directive 2006/43/CE from 17<sup>th</sup> of May 2006 regarding the legal audit of yearly accounts and of hardened accounts, which has modified Directives 78/660/CEE and 83/349/CEE and approved the Directive 84/253/CEE, having as an objective the harmony on a high level of the audit legal requirements

Directive 2006/43/CE has a double objective. On one hand, it proposes to contribute to the improvement of yearly audit accounts quality on the entire territory of European Union, in this way accumulating the thrust in this type of reporting and improving the situation of financial markets situation. On the other hand, it proposes to create conditions of competition for the accounting field on the intern market.

Over the time, the audit methodology has known a big evolution. Until the years '30, the activity uncoiled by the financial auditors consisted in checking the accounting records. After the years 50' in the audit's methodology was integrated the problem of the risk. Between the years 1950-1960, the financial auditors has passes to the checking of accounting records to analyzing the flux of information and the system's intern control.[8]

### 3. Conclusions

The audit activity is a pluridiscipline complex one and it continues to develop itself. In Romania, as well as in other states, the methodological undertaking is brought to be known by the professionals through norm and recommendations from professional organization but even through work methodologies specified to big audit companies.

The entire evolution of audit methodology led in time to an increase of the number and of the obtained proves quality, with the

effects upon the credibility of the opinion expressed by the auditor.

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## Accounting Information - A Fundamental Factor in Winning Battles

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### Abstract

*Decision has an important role in our lives. From the point of view, it is closely connected with the ultimate goal and efficiency of any activities in the economic entity. To take appropriate decision, every manager needs a set of conclusive information.*

*Given the importance of accounting information, the responsibility for preparing and presenting financial statements of the unit is legally regulated and returns management. The latter is also interested in the information contained in financial statements, even if it has access to additional financial and management information to help achieving the planning, decision making and control. To meet their own needs, any unit can determine its form and content of additional information contained in the notes.*

**Cuvinte cheie:** Decision, Accounting information, Financial statements, IASB Framework, Quality.

**Clasificare J.E.L.:** M49, D81.

### Introduction

Information is a vital necessity decision-making. Generally speaking, information is defined as new knowledge about the past, depending on which management decisions and determines the measures to be taken in future for the work the leads to be effective.

#### 1. Main factors in developing the decision-making

Making the decision requires the presence of four elements:

- **Management**, as governor, is responsible for deciding upon the information it holds. Given the

privileged position held within the organization, he will base his decision solely on external information contained in annual financial statements, but will benefit from inside information from specific processing of management accounting. In an organization, which recognize management under the name of an entity is formally established, with permanent or temporary operation (board of directors, steering committee, committee work).

- **Objectives** reflect usually results (performance) that are intended to be further obtained. The business objectives are developed complex units, differentiated by multiple criteria: partners' interests, time frame, hierarchical level, functional area and others. In this case, the decision that directly affects performance, they should consider directly the real possibilities to increase revenues, decrease costs without affecting quality of work and maximize the benefit.
- **Factors influence performance** considering the elements of internal and external organizational environment that significantly affect activities of the organization and their results.
- **Performance (results) shows the actual** extent to which desired goals are met. Regarding this aspect of the results of decisions, accounting information in space and time allows comparison of the results, so necessary management decision making. Depending on the results reported, managers can base their strategies work for future periods. For example, management accounting provides information on the cost price of each product, which is formed on the sale price. From here, one may find the profitability of a product or service in a

specific area of sales. Suppose that the unit delivers the same product in country X and country Y of accounting information, it appears that selling the product in country X is extremely profitable, while selling the product in country Y is poor. Management unit balances the data obtained and decide to stop selling the product in country Y. If he acted otherwise, would have had to give up sales in country X, because supplies in the two countries are related to each. Profits from country X are sufficient to cover the deficit in country Y. In total, the unit stands to profit.

## 2. Accounting data – the core in developing the decision-making

Accounting data is obtained by methods, procedures and instruments of economic data processing. She is the real, accurate, complete and operative information, such as process management support.

Accounting is the core management information system (MIS - Management Information System). This system is a set of interrelated information subsystems required normal operation of the economic entity. The objective of an accounting system is to provide financial information on the observation. This information relates to the financial position and performance of an entity and is intended for users in the decision-making.

Most of the decisions made by management are based on information obtained from accounting. Decisions in the unit are collective, being involved in making their general manager, finance director, heads of specialized offices, information obtained as a result of consensus and compromise between them.

Component decision cannot be reduced to a single enterprise management level. In this context there are at least three echelons:

- First, related to basic strategy sets strategic objectives in the medium term (1-2 years) and long-term (3-5 years);
- Second, related to operative strategy expresses the basic objectives of the strategy over the medium term (1-2 years) in short-term operational objectives (quarter, semester);

- Third, related to operational tactics used to reach the operational objectives in the medium term (quarter, half) and their declining short-term objectives (week, month).

Reduced to its simplest expression, the strategy can be understood as all the targets set and monitored to maintain and / or increase profits through competitive advantages and long term. In this perspective:

- Defined objectives are the result of decisions taken or planned by the management company, driven by investors in tangible and intangible capital required to achieve those objectives;
- Pursuit of strategic objectives have an impact on the organization and declining performance objectives and management by delegation of supervisory monitoring (enforcement of the means and resources) and control (degree of fulfillment of objectives achieved through the enforcement of the means and resources in various entities).

Competitive advantage will be obtained through an offensive strategy and / or defense based on production costs and / or differentiation of products and services or through integration of activities.

## 3. The qualitative characteristics of accounting information

For accounting information to be useful to take all decisions, regardless of driving and temporal perspective, it must acquire four quality characteristics. These qualitative characteristics of information contained in annual financial statements were presented for the first time in the Framework were taken IASB accounting regulations harmonized with European directives contained in Order no. 3055/2009.

Thus, *the intelligibility* means that financial statements should be readily understood by users. For this, they must have sufficient economic knowledge of accounting concepts and an interest in studying the information presented.

Accounting information is *relevant* if it influences the economic decisions of users, helping them to analyze past, present, or future, confirming or correcting their past

evaluations. Size the relevance of information is influenced by the nature and importance, the latter being assessed by omission or inaccuracy its consequences on the economic decisions of users taken on the financial statements. That information is considered *significant* whose omission or misrepresentation may significantly influence the decisions taken on of them, and materiality depends on the size of the item or error judged in the particular circumstances of omission or erroneous declaration. Therefore materiality limit is rather than a qualitative characteristic which information must have in order to be useful.

Information is *credible* (reliable) when it does not contain errors or elements leading to misinterpretation and therefore users can trust it. Most financial information is subject to some risk of giving a representation less credible, which is not due to bias, but rather the inherent difficulties or identify transactions and other events to be evaluated, or design and application evaluation and presentation techniques that can provide feedback relating to other transactions and events.

*Limits* of credible and relevant information regarding refers to opportunity cost and profit ratio of the balance of qualitative characteristics of financial information. Opportunity refers to timeliness in presenting financial information; information may lead to undue loss of its relevance.

Information provided annual financial statements must be *comparable*, meaning that users must be able to compare financial statements of an enterprise the *time* to identify trends in financial position and performance and in *space*, that is financial statements can be compared with those of other undertakings.

Professional accountants should provide useful information in making decisions, thus ensuring the usefulness of financial statements, together with the relevance of including the value of the image of the past, the foresight and timeliness, and reliability by faithful representation, verifiability and neutrality, provides all necessary conditions makers interpret accounting information in making decisions.

Information provided unless they lose their utility qualities presented. At the same time can not possess all these qualities, each

presenting a "mixture" of qualitative characteristics, as each having a different weight.

There is also scope *to increase the quality of accounting information* such as harmonization of accounting principles under the internationalization of business, defining an overall conceptual framework of accounting principles and promoting research to guide best options for their applications, empowering accounting to taxation rules, the definition and implementation of management accounting, development of business applications solutions to the difficulties of application of accounting principles, practices comparative study of corporations in international accounting principles, financial disclosure and accounting estimates; active participation accounting profession in developing accounting standards; restructuring accounting and financial information sources available; accelerate the development and publication of financial information, simplifying financial information for the public, establish a comparison of financial information obligations.

Accounting information contained in financial statements must present all of the above to reflect fairly the financial position and performance unit. From the offered position of accounting information, accounting information management unit used to substantiate the internal decisions, but also to communicate with different users.

Financial and accounting information users base their decisions on information disclosed by companies. IASB Framework summarizes these decisions, considering that users are interested to:

- Decide when to buy, keep or sell an investment in equity;
- Assess the management and leadership responsibility;
- Evaluate the company's capacity to pay staff and provide other benefits to its employees;
- Assess guarantee that the entity can provide for loans which have been granted?
- Determine the fiscal policies;
- Determine profit and dividends can be distributed;

- Develop and use statistical data on national income;
- Regulate the activities of entities.

Responsibility for preparing and presenting financial statements of the unit is legally regulated and returns management, stressing the importance of accounting information. The latter is also interested in the information contained in financial statements, even if it has access to additional financial and management information to help achieving the planning, decision making and control. To meet their own needs, any unit can determine its form and content of additional information contained in the notes.

### Conclusions

Most of the decisions made by management are based on information obtained from accounting. Decisions in the unit are collective, being involved in making their general manager, finance director, heads of specialized offices, information obtained as a result of consensus and compromise between them.

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# The Attractiveness of Harmonized Investment Funds Evidence on Romanian Investment Fund Market

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## Abstract

*This paper explores the latest trends in Romanian investment fund industry by examining the investors' prudentially behavior before and after the crisis.*

*We focus our study on a data set from the Romanian National Securities Commission (abr. CNVMR), with evidence on quarterly data on net sales value, number of units of funds and number of investors.*

*This study provides two contributions. First, it presents the newest UCITS regulations to maintain investors' trust in these investment vehicles. On the other hand, it provides a comparative analysis on open-end and close-end funds evidence. As a result, the paper concludes that open funds are more attractive for the domestic capital as compared to closed funds, but their evolution according to the preference for certain types is rather similar, in the sense that money market or diversified funds are preferred, as they offer a higher degree of certainty during crisis periods.*

**Keywords:** investment funds, harmonized funds, non-harmonized funds, EU Directive

**J.E.L. Classification:** G28, G29, K22

## 1. Introduction

Investment funds represent a viable alternative for investors' individual portfolios. The advantages of this choice would be the access to financial instruments-otherwise not available for small amounts of money, reasonable management costs and the absence of the obligation to be permanently connected to the evolution of one or several markets. Furthermore, the investment

liquidation as well as the disinvestment is easy, the deriving costs and conditions are known and the counterparty is sure. Although, unfortunately, the only unknown quantity is the evolution of the net asset value of fund units, this opportunity is chosen by an increasing number of investors. Due to their success and in order to meet investors' demand, investment funds became more complex and specialized.

But what are investment funds or mutual funds, as they are known by the public? They represent collective investment schemes that have as functioning principle the combining of money belonging to a large number of investors and investing it in order to achieve the best possible return. Investment funds are like living organisms, they attract money through a permanent offer of units and they continuously redeem these units.

It is said that the stock exchange represents the barometer of the economy and this is true for both its functions, of primary and secondary market, but we must mention that a thorough study on the evolution of open funds number, correlated to the value of the assets they attract and the evolution of investors' number may reveal interesting aspects.

This is the reason why we are aiming to make an analysis of the evolution of the Romanian mutual funds industry in the post-crisis period.

## 2. The crisis and the prudence regulatory

We notice that during the financial crisis the invested amounts in Romanian funds are increasing. We could therefore conclude that they are deriving either from the withdrawal from stock exchanges or from the closing of

bank deposits, thus renouncing to the safety that they are offering.

The merit could be shared between the regulatory authority - that introduced this market in the European circuit by transposing Community regulations, making them accessible and understandable to foreign capital - and the management companies that made huge efforts in order to delete their recent history from the public memory. Money market funds, equity funds, bond funds, diversified funds appeared. This market sector has an ascendant evolution. In the meantime, investors became more sophisticated and they understood, some of them after losing their own money, how these funds are functioning, the advantages they are offering, but also the risks they are entailing.

First of all, investors learned that an investment in UCITS depends on the evolution of the entire financial market and, consequently, this investment is not riskless. At the same time, they have to be aware that these risks cannot and will not be covered by any state authority. Investors understood that the choice of the funds they are going to invest in is made according to several criteria and in several stages. Hence, they must analyze the investment horizon, the level of

new UCITS Directive (i.e. Directive 2009/65/EC of the European Parliament) that will create the premises of a development according to the more coherent and open for business community expectations are encouraging.

### 3. UCITS compliance in Europe

UCITS in Europe has a longer and more important history. In 2006, UCITS net assets stood at EUR 5.9 trillion and it reaches 4.5 trillion EUR at the end of 2008 because of the global financial crisis which has made from 2008 one of the most difficult year in the perspective of investment funds too. UCITS outflows for the year were EUR 356 billion in 2008. Almost 40% of the total outflows from UCITS in 2008 were recorded in the single month of October. 2009 saw the UCITS fund industry recovering from the onslaught of the global credit crisis in 2008, with total net assets growing 17% to EUR5.3trillion. In 2010, UCITS continued to grow with total net assets growing 13% to EUR5.9trillion. UCITS enjoyed net inflows of EUR 166 billion in 2010.

If we examine the last five years (Table 1) we can see that the UCITS funds industry had a setback in 2008 as a result of the global

*Table 1. UCITS in Europe – statistical evidence on NAV and number of UCITS funds*

<i>Year</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
Net assets € bn	5,956	6,159	4,543	5,315	5,990
Year on Year % growth	-	3%	-26%	17%	13%
Total number of UCITS	33,347	36,156	37,330	36,011	36,490
Year on Year % growth	-	8%	3%	-4%	1%

*Source: EFAMA Fact Book 2010, PwC analysis*

risk, namely the level of risk aversion, the available amount of money, the fund portfolio structure, the applicable taxation, the expectations as regards the evolution of the units, in other words the return of the investment. At the same time, investment and disinvestment costs, the reputation of the management company or the reputation of its management team, the previous fund evolution are also assessed. It turns out that a preliminary research is necessary and crucial when making an investment decision.

The battle for regaining the trust has been won and the perspectives offered by the transposition in the national legislation of the

financial crisis, where the number assets decreased dramatically. The impact on the number of UCITS funds was not felt until the following year, where at the end of 2009, the total number of UCITS stood at 36,011 compared to 37,330 at the end of 2008. The financial crisis were quickly reversed and in 2009 UCITS assets rose by 17% and as of 2010, UCITS assets were making their way up to the previous high of 2007. Subsequently, as of 2010, UCITS fund numbers had increased again to 36,490.

In the five years from 2006 to 2010, we can see that the top ten countries each year for UCITS distribution have been mainly

European based, which is not surprising given that UCITS is a European products. The top three have been consistent for the last five years; Germany, Austria and Switzerland. France Spain and the Netherlands have moved between ranks 4 and 7.(see Table 2.)

were attracted by the newly created harmonized or non-harmonized, specialized or diversified funds, with the aim to meet the demand and to adjust themselves according to the profile of the domestic investor.

Taking the year 2009 as a reference point, as it represents the first year after the beginning of the crisis.

*Table.2.Top five European countries for UCITS*

	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
1	Germany	Germany	Germany	Germany	Germany
2	Austria	Austria	Austria	Austria	Austria
3	Switzerland	Switzerland	Switzerland	Switzerland	Switzerland
4	France	France	Netherlands	France	Netherlands
5	Netherlands	Spain	France	Netherlands	Spain

*source: EFAMA) Fact Book 2010, PwC analysis*

#### 4. Evidence on Romanian Market

Romania is not, we hope for the moment, on the map of the European UCITS industry, as could be seen in table 2.

Unlike our neighbor countries where the investment per capita in mutual funds is

Since the very first year of economic contraction, the structure is revealing prudence and, at the same time, a reduced growth potential, considering the rather large percent of bank deposits (Table 3.)

*Table 3. The portfolio structure of Romanian Mutual Funds*

<b>Assets</b>	<b>30.06.2009</b>	<b>31.12.2009</b>
Quoted shares	9.40	6.30
Unquoted shares	0.35	0.12
Traded shares in the EU	0.11	0.40
Quoted governmental bonds	1.99	12.62
Quoted municipal bonds	3.66	1.91
Unquoted municipal bonds	0.27	3.85
Bonds issued in the EU	18.22	17.36
New issued securities	0.02	0.03
Current accounts	6.86	2.70
Treasury bills	0.96	3.58
Bank Deposits	52.41	45.07
Harmonized funds/non-harmonized shares	3.15	3.31
Quoted harmonized funds/non-harmonized shares	2.40	2.36
Promissory notes	0.00	0.09
Derivatives	0.04	0.04

*source: [www.cnvmr.ro](http://www.cnvmr.ro), [www.aaf.ro](http://www.aaf.ro), [www.kmarket.ro](http://www.kmarket.ro)*

around EUR 900, the Romanian market, with EUR 10 investment per capita, represents a huge potential that both Romanian and foreign management companies are decided to develop. After 2008, a series of new management companies were set up, many of them belonging to banks. A period of consolidation followed, when new investors

#### 4.1. Open – end funds evidence

The evolution of the net asset value of funds (Table 4.) operating in Romania indicates that the money market funds and the bond funds attracted the largest number

of investors and managed to get a superior yield for their assets.

Crisis implies prudence and this is proven by the fact that money was directed towards

Table 4. The evolution of net asset values, fund units and number of investors

Specification	31.12.2009	31.12.2010	30.06.2011	31.12.2011	2011/2009
Net assets NAV(lei)	3352187302	5482202427	6714097316	6780079087	202,26%
Number of fund units	211344275	272707014	297804837	296086603	140,10%
- held by individuals	129863778	185257351	201958211	204497872	157,47%
- held by institutionals	81480497	87449663	95537616	91582731	112,40%
Number of investors	164460	221862	235456	233807	142,17%
- individuals	158804	214847	226909	225284	141,86%
- institutional	5607	6967	8543	8523	152,01%

source: [www.cnvmr.ro](http://www.cnvmr.ro), [www.aaf.ro](http://www.aaf.ro), [www.kmarket.ro](http://www.kmarket.ro)

The net assets of investment funds has increased steadily and the number of fund units held by investors, also, has been reduced in the last quarter of the year 2011. Generally, this kind of decrease at the end of the year is not relevant as long as the decrease is not registered also in the first quarter of the next year. The net asset dramatically increased to over 200%, representing a relevant factor for the period of profound economic contraction we are referring to and for the investment culture of Romanian public.

Also, the analysis of net asset evolution on the types of funds (Table 5.) is indicating that the money market funds and bond funds are the ones that

money market funds. Unlike equity funds, which, either they track or not an index, they have an evolution that is correlated with the stock market and, consequently, they are confronted with its volatility. It is hopeful that investments prove responsibility, knowledge and prudence.

#### 4.2. Close-end funds perspective

The number of closed funds increased in 2011 as compared to 2010. A number of 23 closed funds were operating in Romania at the end of 2011, as compared to 18 in the previous year.

However, this type of UCITS has not yet

Table 5. Quarter ev		Table 5. The evolution of Romanian close-end funds investors' in 2010-2011			
NAV	31.12	Number of investors in Romanian close-end funds	Dec. 2010	Dec. 2011	(%) Change rate 2011/2010
Equity funds	211.8	TOTAL	92.909	92.597	- 0,34
Diversified funds	190.7	- individual investors	92.589	92.276	- 0,33
		- institutional investors	320	321	+ 0,31
Bond Funds	1.860.309.023		2.406.713.178	2.630.421.696	40,11
Money market funds	3.155.885.866		3.846.692.915	3.984.331.908	19,88

source: [www.cnvmr.ro](http://www.cnvmr.ro), [www.aaf.ro](http://www.aaf.ro), [www.kmarket.ro](http://www.kmarket.ro)

attracted the investors' attention and succeeded to manage and to exploit the disposed assets.

Although the number of investors hasn't increased significantly, we must not forget that the crisis persists and generates financial prudence among investors.

gained a significant part of the market. This is the reason why, most of the times, they are ignored by the statistics and the studies on the general phenomenon of investment schemes.

At the end of 2011, the number of investors slightly decreased.

*Tabel. 6. The number of fund units – evidence on Romanian Close-end funds*

<b>Indicators</b>	<b>31 dec. 2010</b>	<b>31 dec.2011</b>	<b>(%) Changing rate 2011/2010</b>
Number of unit funds, held by	7.057.427	7.069.417	+ 0,17
Individual investors	6.022.248	6.205.166	+ 0,05
Institutional investors	855.149	864.251	+ 1,06

source: [www.cnvmr.ro](http://www.cnvmr.ro), [www.aaf.ro](http://www.aaf.ro), [www.kmarket.ro](http://www.kmarket.ro)

We can notice the interest of investors for funds with a prudent investment policy, money market funds. The number of fund units did not register significant changes (Table 6.).

## **6. Final remarks**

We can conclude that open funds are more attractive for the domestic capital as compared to closed funds, but their evolution according to the preference for certain types is rather similar, in the sense that money market or diversified funds are preferred, as they offer a higher degree of certainty during crisis periods.

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## Banks and Companies - Partners in a Challenging Economy

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### Abstract

*Nowadays, banks have become interested in saving companies from insolvency in order to protect themselves from not getting back the loans released and have involved themselves in restructuring operations.*

*This paper presents the temporary holding of shares by credit institutions in companies and entities from outside the financial sector, this operation being a new way of restructuring and a measure of last resort, involving the change of the company's capital structure, by converting debts into shares.*

*Representing a market maturation process, the subject is approached on different aspects: the need of such an institution, its legal regime, main characteristics and consequences .*

*The analysis is objective, presenting the rules and regulations issued, showing the limits and the possible interferences with other law acts.*

*This procedure is a practical example of overcoming risks, making the borrower and the lender partners on the same side of the game, sharing capital and motivation.*

**Keywords:** shares, debt, banks, companies, capital

**JEL Classification:** D21, E22, G32

### 1. Introduction

The actual economic recession in the context of the global financial and banking crisis, has created problems even to the Romanian credit institutions, our country being more and more integrated in the global financial system.

The negative aspects of all the economies and financial systems directly related to the Romanian economy had a great influence

over our national economy the same way as the positive aspects did before the crisis.

These consequences of globalization cannot be ignored by the banking system in Romania, as it has been deeply affected.

In this economic context, the operation of converting debts into shares for a company, as a way of activity restructuring, represents the signal of a maturation process in the relationship between bank and its clients.

There are several points which sustain the necessity of this restructuring process: the first point is the one that the market of insolvency has reached its maturity and in these conditions converting debts into shares is a new and efficient solution that permits a correct diagnosis of the company and gives the creditors the perspectives of future profitability. Another idea is that the debts canceling action, although a simple and convenient way for the debtor, has a great risk because canceling a debt means in fact generating another.

Today's increased competition, cyclical and volatile financial markets, and economic trends have created a climate in which no business can take stability for granted. The operation of converting debts into shares is a good solution, giving the credit institutions the possibility to directly influence the restructuring of the client. The solution of debt to equity swap is temporary and credit institutions can hold shares only for short term (2-3 years), giving the former shareholders the possibility to buy back their part of shares.

### 2. Ways of restructuring for a company

Debts restructuring represents the process that permits the debtors, both individuals and companies, having problems with their cash flows, to change their credit conditions, agreeing with their banks on several matters; interests, period, deadlines.

In the actual economic context, the relationship between creditors and debtors has evolved and has generated ways of agreement, which are beneficial for both parts of the economic equation. Starting from this relationship, there are several ways of restructuring:

- the debt to equity swap;
- the concordat;
- the mandate;
- the mediation.

The restructuring schemes can be analyzed both from the company's perspective and from the credit institution's perspective (and here we include banks, as banks are the main creditors for the companies).

Starting from the banking perspective, the most frequent restructuring schemes are:

- rescheduling by the change of the monthly deadline or of the monthly amount without exceeding the established final period;
- rescheduling by the change of the monthly amount and the monthly deadline together with the change of the final deadline or even the change of the term category of the credit;
- refinancing through a new credit facility for reimbursement of the previous which presents difficulties
- short term credit facilities for the companies to help them manage their temporary lack of cash;
- other solutions as assignment of receivables, subrogation, novation.

When it comes to the company's perspective, the financial difficulties can be overcome by using different methods, such as: changes in the management's structure, a credit restructuring process, following a restructuring program which has to be based on reasonable forecasts and has to demonstrate that the business can generate cash flow and can function on a profitable basis.

Coming back to the ways of restructuring in relationship with banks we are going to shortly describe the alternative ways to insolvency and among these, we are going to refer to mandate, concordat and mediation and we will analyze the features of the debt to equity swap.

**The debt to equity swap** represents a bilateral way of action, a symbol of

cooperation between debtors and creditors and it will be widely described in chapters 3 and 4 of the present paper.

**The concordat** and **mandate** have been established as alternative methods of intervention to sustain the negotiations between the companies in difficulty and their creditors.

**The mandate** is a confidential procedure which starts at debtor's request, through which a legally called representative negotiates with the creditors for establishing a mutual agreement between two or more creditors and the debtor in order to overcome the difficulty of the company [9]. The final purpose of this procedure is to reach a solution in 90 days time, for saving the company and cover its debts.

**The concordat** [5] is another procedure based on a agreement between the debtor and the creditors holding 2/3 of debts and by which, the debtor propose a recovery plan. Accepting the plan, the creditors sustain the debtor in his trial of getting over the difficulties. What is very important is the fact that during the concordat procedure, the insolvency cannot be opened against the debtor. The concordat [1] represents an alternative way to bankruptcy and helps the company to maintain its function. It is a necessary tool for protecting the debtors which are confronted with financial difficulties, starting from the opinion that recovery is always preferred to insolvency. This tool is considered to be more flexible and more efficient, due to the fact that all the terms are shorter and all the procedures are simpler.

Another method [5], to overcome the difficulties without insolvency is **the mediation**. The mediation is a negotiation form, assisted by a professional called mediator, who has all the necessary pieces of knowledge to facilitate the discussions between creditors and debtors and to identify the best solution between them. It has specific advantages such as confidentiality, which is essential in the banking system.

By mediation the parties can solve their problems through an agreement that reflects their wish resulted from negotiation, that is why the costs are lower than in a legal procedure.

All these ways of company's debts restructuring have a common element [8]: the

fact that they are all trying to generate supporting mechanisms in the relationship between banks and companies. When it comes to the credit agreements between banks and companies these mechanisms can give more power to companies in order to negotiate with banks from similar positions.

### 3. Debts to equity swap – main characteristics

The process of holding shares can be considered among the temporary operations during an assistance operation or financial restructuring.

The analysis of the share holding process means the analysis of the mechanism which operates in this situation, especially because debt to equity swap means changing the company's capital structure. The mechanism presumes several steps [5]: the first is **the social capital increase through issuance of shares** and the second is **the transformation of debts into shares**.

Acquiring and temporary holding of shares and their disposal shall be made in accordance with the provisions of the companies' legislation.

The shares must be obtained through the effect of the converting debt into shares, the main purpose of this operation being the restructuring process of the company.

Concerning the preference right of the former shareholders there is the possibility of giving up the right of preference or cancellation of this right by the decision of the general meeting of shareholders.

The effects of converting debts into shares are:

- the temporary holding of shares are not considered qualified parts of capital
- the credit institution gains control over the company
- the initial guarantees are canceled.

There are several conditions that must be fulfilled by a credit institution in order to be considered eligible or able to participate in the capital structure of a company :

- formalizing a strategy and a general policy on this type of operations, at individual or consolidated level;
- to have and implement a concrete, viable and well-founded financial reconstruction or rescue plan for the undertaking concerned, plan that should

be approved by the credit institution's management body (management function or supervisory function according to their competences). This plan should provide at least the maximum level of future guarantees and financing the credit institution commits to put up to that undertaking. However, this level can not exceed 25% of the exposure the credit institution recorded against that entity at the end of the month preceding the month in which the conversion was made; the plan should provide at least the following: a) in case of the restructuring of an entity outside the financial sector requires obtaining additional financing and guarantees, it shall mention the maximum estimated value, which shall not exceed 25% of the exposure value before the completion of the conversion; b) the motivation for selecting this solution, based on the cost-benefit analysis, of all the methods of insuring the credit institution's interests in respect of the receivables against the entity outside the financial sector; c) a documented estimation of the method, achievement level and timing for the recovery of the advanced funds;

- to have policies/procedures for assuming, identifying, measuring, controlling and reporting all risks entailed by such a transaction, including the concentration risk. Within these policies, the credit institution has to establish a maximum level (related to its individual original own funds) for the total amount of temporary holdings of shares during financial reconstruction or rescue operations. This level can not exceed 10% of credit institution individual original own funds, and is set to include the temporary holdings shown in credit institution's financial statements and also those of the entities within the group toward which such holdings/claims were transferred and which initially were displayed in the credit institution's financial statements;
- formalizing (at individual or consolidated level), a shares valuation methodology to the lowest assigned value to them in accordance with applicable accounting framework.

As regards the temporary nature of the

holding, credit institutions are allowed to own the shares acquired during a financial reconstruction or rescue operation for a period that can not exceed 36 months from the date of acquisition. In order to comply with this time limit, the credit institution must take the appropriate steps for the disposal of such shares or for its withdrawal from that undertaking, with the transfer of such shares to an entity outside the prudential consolidated supervision area of the credit institution.

#### **4. Rules and regulations concerning the temporary holding of shares**

Credit restructuring and companies rescue operations are instruments adapted to the current economic context. That is why the legal framework for such actions should be developed and adapted to the new requirements of the financial market.

The supervision authority in Romania, The National Bank of Romania, has answered to this demanding situation and has found legal solutions to maintain the financial stability.

First of all there was a draft of a regulation which obtained the agreement from the Central European Bank on the 5th of november 2010.

The final form of regulation concerning this matter was enacted by The National Bank of Romania (“**NBR**”) on the 18<sup>th</sup> of November 2011 and it is the Regulation no. 26 regarding the temporary holdings of shares of an entity outside the financial sector during an assistance or financial restructuring operation („**Regulation**”). The Regulation was published in the Romanian Official Gazette, Part I, no. 855/05.12.2011, and entered into force on the date of its publication.

The regulation sets out requirements for credit institutions’ prudent decision-making processes when they seek to temporarily acquire shares in (and possibly control of) a non-financial undertaking during a financial reconstruction or a rescue operation, by way of a debt-to-equity swap.[4]

The regulation provides further details on the exemption clause under Article 145 of the Government’s Emergency Ordinance No 99/2006 (GEO 99/2006), which transposes Article 121 of Directive 2006/48/EC. This clause provides that shares held temporarily

during a financial reconstruction or rescue operation shall not be counted as qualifying holdings. Therefore, the limitation applicable to qualifying holdings of credit institutions in non-financial undertakings, as laid down in Articles 143 and 144 of GEO 99/2006, which transposes Article 120 of Directive 2006/48/EC, does not apply.

The Regulation establishes the requirements that have to be fulfilled in order to apply the provisions of Article 145 of the Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy („**Ordinance**”), regarding temporary holding of shares acquired by the credit institutions or by the entities in their area of consolidation, by totally or partially converting the debts they have against entities outside the financial sector, during an operation of assistance or financial restructuring.

The temporary holdings of shares that comply with the requirements provided under the Regulation are not considered qualified participations in the meaning of Article 143 paragraph 1 of the Ordinance, and the restrictions under Article 144 under the Ordinance are not applicable to holding such shares.

Article 5 of the regulation sets out the specific requirements to be met by a credit institution before acquiring shares in order for it to benefit from the exemption. In particular, the credit institution needs to provide a strategy and an overall policy. It must formulate and implement a concrete, viable and well-founded financial reconstruction or rescue plan for the undertaking concerned. It must also properly justify its view that the acquisition of shares is a measure of last resort and it must have suitable risk management policies/procedures in place.

According to the provisions of the regulation, the credit institutions are required to notify to the Supervision Department of NBR their intention to acquire shares and to submit documentation; within 60 days as of receipt of the complete documentation, NBR communicates to the credit institution the result of the analysis. If in the opinion of the Supervision Department, the Regulation requirements are not fulfilled, the shares can be acquired, but the provisions of Article 143 and 144 of the Ordinance shall apply to

holding such shares.

Furthermore, the credit institution needs to notify National Bank of Romania’s Supervision Department of its intention to acquire the shares and to submit documentation demonstrating that it meets the requirements stipulated in Article 5 of the draft regulation. The Supervision Department shall then deliver an opinion as to whether these requirements have been met.

In their intention of acquiring some temporary holdings of shares during a financial reconstruction or rescue operation, all credit institutions must submit the following documents to the Supervision Department within the National Bank of Romania [7]:

- written notice of its intention of temporary holding of shares during a financial reconstruction or rescue operation of an undertaking operating outside the financial sector as well as the manner of acquisition and foreseeable holding period;
- the overall strategy and policy regarding this kind of operations;
- the financial reconstruction or rescue plan for the undertaking concerned and its most recent financial statements;
- the policies/procedures for assuming, identifying, measuring, controlling and reporting the risks entailed by such a transaction;
- the written justification which shows that there is no other manner more efficient for the credit institution to recover the claims against that undertaking;

The total net value of holdings is deducted from its tier 1 capital, calculated by the credit institution at individual or consolidated level.

The shares can be held for a maximum period of 36 months, which can be extended by NBR for valid reasons, without exceeding a total of 48 months as of the acquisition date. At the expiry of this period, the shares will be considered qualified participations and the credit institution has the obligation to totally or partially dispose of these shares. The disposal of shares shall not be made to an entity in the area of consolidation of the credit institution. In order to comply with the time limit referred to, the credit institution must take the appropriate steps for the alienation of such shares or for its withdrawal from the entity in question, with

the transfer of such shares in the holding of an entity outside the scope of consolidated supervision of that credit institution.

In respect of the ongoing assistance or financial restructuring operations, the credit institutions must follow the procedure established under the Regulation, within 3 months after its entry into force.

## 5. Conclusions

The debt to equity swap represents a way of debt recovery, instead of collateral execution which needs a long term and depends a lot on the market functionality.

This operation of taking off shares has a beneficial effect mainly for the banks. Using this way of action they do not overload their balance with low performance credits and they have to establish a lower amount of provisions and their image reflected in their risk profile is better.

Economic analysts appreciate this new way of relationship between banks and companies as a different way of foreign investments . Considering the fact that most of the banks are not romanian banks, but foreigners, it is a way through which foreign banks have access to the romanian economy.

This process of converting debts into shares makes a better image for the company in front of the other creditors because, by this procedure, the company’s debts are reduced and the possibility of recovery is increased. For the former shareholders the situation is different, because they must share even the potential benefits with the newcomers, but anyway is a better situation towards insolvency.

Although, at the beginning, this new type of partnership between banks and companies has attracted for and against points of view.

In the previous paragraph we mentioned some of the “for” opinions. When it comes to the “against” opinions, they mainly refer to the fact that through this method, banks can solve some emergency problems: the passives becomes shares which means actives and generates a reduction in the degree of capitalization if banks use this facility they partially become investment funds. The competencies requested in these two situations are not the same and there is the risk that banks do not have the adequate personnel both quantitative and qualitative.

There also might appear the risk of a conflict between the bank's quality of creditor and the one of shareholder.

Other against opinions finds many difficulties in establishing the price of shares for converting debts and the operation in itself is considered to be quite difficult

When it comes to the political influence over these operations, this risk can appear only if in this kind of business are involved public banks. In the private sector where most of the banks operate there is no fear for such an involvement and the conditions in which there is done such an operation can be very demanding, but in fact this is a stimulative point.

Although there are for and against opinions on this matter, this new type of rescue operation is an answer to the demanding reality. The involvement of banks in the companies' life, as shareholders, will definitely increase the chances of successfully passing over this difficult period.

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# Building an Optimal Portfolio Using Fundamental Analysis of Stocks

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## Abstract

*Various methods of analyzing the value of the stocks are called as a general characterization, titles evaluation. Fundamental analysis attempts to predict the direction of evolution of prices of the medium and long term stocks from past and present achievements of the company and the estimates of its future. This article discusses some of the most popular methods of stock assessment using fundamental analysis and propose a build of portfolio for stocks listed at Italian Stock Market using indicators of fundamental analysis.*

**Key words:** risk; selection of assets; fundamental analyzes; optimization;

**J.E.L. Classification:** C02, C61, G11

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## 1. Introduction

All investors, whether institutional or private individuals, are establishing criteria by which to invest money.

In the process of making any investment decision, the primary issue is the aknowledge of accurate and up to date information. Fundamental analysis takes into account the

"health" of the company's financial, the macroeconomic and political conditions of the environment in which the company operates, the global development factor of the industry that is part of the projections about the future company performance.

Fundamental analysis is the method of forecasting future price movements of a financial instrument based on economical, political, environmental and other factors, and the relevant statistical data which significantly affect the supply and demand for whatever support of the financial instrument. Fundamental analysis identifies and measures factors that determine the intrinsic value of a financial instrument, such as general economic and political climate, including any factors affecting supply and demand for the product or service reference. If there is a reduction in supply, but demand remains the same, then there will be an increase in market prices. An increase in supply, and the demand is the same, produces the opposite effect.

For example, an analyst of a listed company studies: the supply and the demand for products or services for that company, the quality of the management and its policies, its historical and forecasted performances, its future plans, the prospects and plans of its competitors, industry statistics, general economic conditions, government policies.

In the case of goods, an analyst studies statistics on prices, supply, demand and inventory levels, prospects for use, production or planned crops, weather and climatic conditions, availability of substitutes, economic conditions, political developments. From these data, the analyst

could build a model to determine the current and future value of the instrument. The basic idea is that for the inconsistent increase of supply corresponds the decline of prices, while for the discrepancies in the demand increases corresponds the tendency in prices to rise. Once the intrinsic value is estimated, the analyst compares it with current prices and decides if prices should increase or decrease. The basic premise is that if the price is currently lower than the intrinsic value, it should increase. If price is currently more than intrinsic value, then it should decrease.

One of the fundamental analysis difficulties in ensuring such accuracy is measured by the correlation between variables. Inevitably, the analyst must make estimates based on experience. Moreover, markets tend to anticipate events and punish them through price. Ultimately, the markets often take time to recognize that prices are not in line with the value, which acts both as an advantage and as a disadvantage (depending on the correlation time).

## 2. Multipliers method

### 2.1 Book price/value (P/BV) and book value per stock (BV)

Generally there is a relatively weak correlation between the net asset value of a company and its market capitalization. Net asset value usually refers to the book amount for the assets of a company, as shown in annual accounts, and is "cash value" of the company or close to that value. The net asset value may be used as an indicator of the wealth of a company when it is subject to a takeover bid. A high value of net assets is perceived by investors as support for the market price of the stock. The better the performances of a company, the larger the gap is between net assets and market capitalization, which is seen as a measure of that company's ability to "increase profits." Over a period, the value of a successful company becomes greater than its net asset value. Coefficient price/ book value is comparing market valuation of a company with its market value:

$$\text{Price/ Book value} = \frac{\text{Market Capitalization}}{\text{Shareholders Capital}}$$

Price/ book value is important for evaluating a company about to receive a takeover bid. If a stock is close to net asset value, the cash balance is too high, thus reducing the likelihood of a takeover, especially when a market declines (bear)

*Book value per stock (BV)* is the ratio of stockholders capital and number of stocks issued (  $\frac{\text{Shareholders Capital}}{\text{Number of stocks}}$  )

$$\text{So, Price/Book value} = \frac{\text{Market price of the stocks}}{BV}$$

**P/BV**

### 2.2 Price/profit (P/E or PER) and earnings per stock (EPS)

*Earnings per stock (EPS)*, EPS will normally be higher than the dividend per stock, because some earnings are retained by the title company reserves and are not distributed as dividends.

Another way to address the ratio P / E refers to the number of years for the company's market value to be matched by its earnings. Ratio P / E is given by the quoted price for common stocks divided by the most recent EPS value

$$\text{So, Price / earnings} = \frac{\text{Market price of the stocks}}{EPS}$$

**P / E (PER)**

### 2.3 Price/Sales (P / S) and turnover per stock (S)

*Turnover per stock (S)* is calculated by dividing company's revenue by the total number of stocks

**Price / Sales = P / S** is calculated by dividing the current price action market value of turnover of the company registered in the past four consecutive quarters divided by the number of outstanding stocks.

## 3. Case study: Italian Stock Market

### 3.1. Stage of selection of assets

In the context of present financial markets it is a huge amount of available financial data. Therefore, it is very difficult to make use of such amount of information and find basic patterns, relationships or trends in data. We apply data analysis techniques in order to

discover relevant information to financial data, which will be useful during the selection of assets and decision making. Consider that we have collected information on a number  $S$  of assets, each with  $P$  features, which represent various financial ratios, still called variables. Denote by  $y_i^j$  the  $j$ -th variable for stock  $i$ . Multivariate data set will be represented by a matrix  $Y = (y_i^j)_{i=1, \overline{S}}^{j=1, \overline{P}}$  and can be viewed as a set of  $S$

points in a  $P$ -dimensional space. Principal components analysis (PCA) is a useful technique for analyzing data in order to find patterns in a large-scale data space. PCA involves a mathematical procedure that transforms  $P$  variables, usually correlated in a number of  $p \leq P$  uncorrelated variables called principal components. After applying the PCA, each asset  $i$  will be characterized by  $p$  variables, represented by a set of parameters  $y_i^1, y_i^2, \dots, y_i^p$ . Therefore, it is possible to form the arrays  $Y_i = (y_i^1, y_i^2, \dots, y_i^p)$ ,  $i = \overline{1, S}$ , which correspond to a set of  $S$  assets. Suppose now that we have obtained a data set  $Y_i = (y_i^1, y_i^2, \dots, y_i^p)$ ,  $i = \overline{1, S}$ . Then we will use clustering techniques in order to find similarities and differences between the stocks under consideration. The idea of clustering is an assignment of the vectors  $Y_1, Y_2, \dots, Y_S$  in  $T$  classes  $C_1, C_2, \dots, C_T$ . Once completed the selection of activities, we construct the initial portfolio by selecting low-risk assets in each class.

We will present some of the most important financial indicators that we will use in the study:

- The  $P / E$  is calculated by dividing the current market price to the value of net profit per share for the past four consecutive quarters, net income per share is calculated by dividing the total net profit earned by the company during the reporting period (it is relevant to relate to the last 12 months) and the number of shares issued and outstanding.

- The  $P / BV$  is calculated by dividing the current trading price to book value per share determined according to the latest financial reporting; accounting value of a share is calculated by dividing the total equity value

of the company to the total of its shares issued and outstanding; equity value is determined by deducting total liabilities from total assets owned company and its "shareholder wealth", which is what remains to be recovered if the assets and liabilities would be paid.

- *Dividend index* measures the performance of dividends and is calculated as the ratio between the amount of the dividend and book value or market value of the stock. This assesses the efficiency of investment in an asset.

- *Volatility* is a measure for price variation of a financial instrument over time. It is used to quantify the risk of the financial instrument over the specified time period.

- *Evolution of price* observes the price level at a given time, taking into account the maximum price and minimum price achieved in the last 6 months.

We used information on a total of those 40 shares representing shares of FTSE MIB Index traded on the Borsa Italiana. The aim of our study is to find similarities and differences between the current analysis and build a diversified portfolio. We took into account for each stock the 5 features described above.

We used data analysis techniques in order to process the vast amount of information. Table 1 lists, for each of the 40 stocks analyzed, the values of the five features; we used the data available on the Borsa Italiana on 27 March 2012.

Table 1: The value of the 6 features

No	Company	P/E	P/BV	DIVY %	Volatility %	P/Max	P/Min
1	AJA	11.4	0.8	8	26	0.66	1
2	Arsalo Siv	13.9	2.8	2.5	21	0.91	1.07
3	Adama	8.8	5.8	6.9	25	0.81	1.34
4	Amagril	13.8	2.7	3.7	21	0.92	1.32
5	Amann	11.6	1.87	3.1	31	0.97	1.56
6	Banca Popolare	27.7	0.37	0.00	60	0.95	1.85
7	Bca Mpa	16.5	0.18	0.00	77	0.83	1.8
8	BcaPopEmal						
9	Bcomgru	11.1	0.4	1.3	38	0.39	1.28
10	BcaPop Milano	38.4	0.3	0.00	64	0.87	1.92
11	Banzi Unicrea	39.7	0.6	0.00	33	1	1.61
12	Caripari	18	2.98	0.07	19	0.92	1.04
13	Dai Sorani	11.8	4.5	2.03	32	0.78	1.25
14	Erel	6.1	0.72	8.7	26	0.8	1
15	Enel Green Power	6.1	0.72	8.7	26	0.84	1.04
16	Eni	8.2	6.2	6.4	24	0.98	1.38
17	Enxor	3.9	1.3	1.7	21	0.94	1.37
18	Enx	23.1	0.6	0.00	36	0.89	1.38
19	Fiat Industrial	29.1	0.6	0.00	36	0.97	1.67
20	Fimeccaraca	10.9	0.7	0.00	48	0.63	1.33
21	Generali	1	1.4	1.4	27	0.92	1.1
22	Imperial	12.8	1.26	1.29	25	0.98	1.68
23	Intesa Sanpaolo	9.7	0.34	3.3	40	0.9	1.24
24	Lottomatica	10.1	7.1	5.27	23	0.98	1.38
25	Luzatnica	21.8	3.0	7.3	20	0.99	1.45
26	Mediobanca	9.2	1.6	5.9	34	0.98	1.16
27	Mediolanum	9.7	0.94	2.6	38	0.99	1.21
28	Mediolanum	12.9	2.9	4.4	31	0.99	1.52
29	Montedison	16.1	0.7	3.1	32	0.98	1.39
30	Novelis	8.9	1.1	4.3	32	0.98	1.14
31	Proximus	10.6	1.8	7.7	30	0.97	1.48
32	Sapere	16.4	3.2	2	39	0.97	1.55
33	Salvatore Ferragamo	25.2	8.23	1.6	35	0.99	1.63
34	Selenia	16	2.3	6.2	16	0.99	1.16
35	St microelectronics	9.96	0.85	0.00	36	0.96	1.46
36	Telecom Italia	6.30	0.6	3.1	26	0.97	1.17
37	Ternis	13.6	1.9	2	27	0.65	1.65
38	Terna	16.9	1.8	7	17	1	1.24
39	TosS	18.8	4	3	25	0.99	1.37
40	Unibanco	21.4	0.43	0.00	44	0.84	1.34
41	Unicredit	17.7	0.31	0.00	79	0.57	1.11

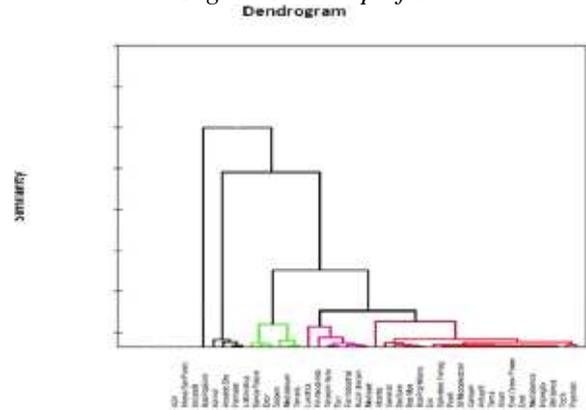
Source: [www.borsaitaliana.it](http://www.borsaitaliana.it)

We apply data analysis techniques to discover the similarities and differences between the stocks of the Bucharest Stock Exchange, using the package StatistiXL 1.8.

Figure 1 contains the tree resulted from PCA (dendrogram).

Dendrogram usually begins with all assets as separate groups and shows a combination of mergers to a single root. Stocks belonging to the same cluster are similar in terms of features taken into account. In order to build a diversified portfolio, we first choose the number of clusters, which will be taken into account. We will then choose a stock from each group and we will get the initial portfolio.

Figure 1: Group of stocks



Source: programe STATISTI XL 1.8

### 3.2. Phase risk estimation.

We evaluate the performance of an asset using expected future income, an indicator widely used in financial analysis. Denote by  $S_j(t)$  the closing price for an asset  $j$  at time  $t$ . Expected future income attached to the time horizon  $[t, t + 1]$  is given by:

$$R_j(t) = \ln S_j(t + 1) - \ln S_j(t), \quad j \in \overline{1, S}.$$

Similarly, we define the loss random variable, the variable  $L_j$ , for asset  $j$  for  $[t, t + 1]$  as

$$L_j(t) = -R_j(t) = \ln S_j(t) - \ln S_j(t + 1), \quad j \in \overline{1, S}.$$

Using Rockafellar et al., 2000, we define the risk measure VaR corresponding loss random variable  $L_j$ . Probability of  $L_j$  not to exceed a threshold  $z \in \mathbf{R}$  is  $G_{L_j}(z) = P(L_j \leq z)$ .

Value at risk of loss random variable  $L_j$  associated with the value of asset  $j$  income and corresponding probability level  $\alpha \in (0, 1)$  is:  $VaR_\alpha(L_j) = \min\{z \in \mathbf{R} | G_{L_j}(z) \geq 1 - \alpha\}$

or  $P(X > VaR) = \alpha$ . If  $G_{L_j}$  is strictly increasing and continuous,  $VaR_\alpha(L_j)$  is the unique solution of equation  $G_{L_j}(z) = 1 - \alpha$  then  $VaR_\alpha(L_j) = G_{L_j}^{-1}(1 - \alpha)$ .

One of the most frequently used methods for estimating the risk is the *historical simulation method*. This risk assessment method is useful if empirical evidence indicates that the random variables in question may not be well approximated by normal distribution, or if we are not able to make assumptions on the

distribution. Historical simulation method calculates the value of a hypothetical changes in the current portfolio, according to historical changes in risk factors. The great advantage of this method is that it makes no assumption of probability distribution, using the empirical distribution obtained from analysis of past data. Disadvantage of this method is that it predicts the future development based on historical data, which could lead to inaccurate estimates if the trend of the past no longer corresponds. If  $L_j$  is the loss random variable and  $\hat{G}_n$  is empirical distribution function of  $L_j$  and  $\alpha \in (0,1)$  a fixed level of probability, then  $\hat{G}_n(z) = \frac{1}{n} \sum_{i=1}^n I_{\{L_j \leq z\}}$ .

We can prove that:

$$VaR(L_j) = \min \left\{ z \in \mathbf{R} \mid \frac{1}{n} \sum_{i=1}^n I_{\{L_j \leq z\}} \geq 1 - \alpha \right\}.$$

Once completed the phase of grouping the assets in T classes by the existing similarities, we focus on the selection of the assets of each class to have a minimal risk. Consider the loss random variable corresponding to each asset in each obtained class  $C_i, i = \overline{1, T}$  :  $\min_k VaR L(A_k^i)$

We used the closing price values daily for each share, corresponding to a time horizon of 50 days to measure VaR for each stock. We used the data available on the Borsa Italiana from 15 March, 2012 - 30 April, 2012. The following tables contain values of VaR for each stock and three levels of probability values

Class 1	0.90	0.95	0.99
Adiasia	0.0139	0.0171	0.0519
Artgarifi	0.0290	0.0271	0.0555
BcaPop			
Milano	0.0195	0.0231	0.0561
Bca Mps	0.0134	0.0204	0.0259
Borzi Univers	0.0551	0.0742	0.0669
Compari	0.0333	0.0388	0.0558
DafScin	0.0221	0.0202	0.0330
Enel	0.0247	0.0447	0.0492
Enel Green			
Enel	0.0248	0.0471	0.0750
Eni	0.0201	0.0248	0.0325
Generali	0.0418	0.0555	0.0624
Immagolo	0.0568	0.0607	0.1476
Mediobanca	0.0261	0.0259	0.1449
Medioban	0.0246	0.0317	0.0379
Pirelli	0.0317	0.0385	0.0582
Proton	0.0282	0.0313	0.0420
Snam	0.0228	0.0222	0.0701
S.Frangonzo	0.0348	0.0382	0.0584
St			
microelettronica	0.0415	0.0705	0.1025
Terna	0.0534	0.0687	0.0748
TollS	0.0287	0.0455	0.0995
Ubi Banca	0.0465	0.0550	0.1003

Class 4	0.90	0.95	0.99
Asiar	0.0225	0.0270	0.0329
BcaPop Enel			
Borzonza	0.0276	0.0317	0.0405
Enel			
EnelGreen	0.0255	0.0205	0.0343
Unicredit	0.0242	0.0260	0.0295

Class 2	0.90	0.95	0.99
Enel	0.0222	0.0421	0.0486
Enel			
Industrial	0.0531	0.0742	0.0969
Finmeccanica	0.0512	0.0747	0.1289
Leonian	0.0265	0.0405	0.0669
Mediobanca	0.0270	0.0390	0.0676
Telecom	0.0235	0.0372	0.0434
Terris	0.0328	0.0400	0.0468

Class 3	0.90	0.95	0.99
Avallio St.	0.0721	0.0891	0.1325
Banca			
Popolare	0.0460	0.0562	0.0815
Enel	0.0217	0.0280	0.0388
Lottomatica	0.0248	0.0448	0.0566
Paradise	0.0572	0.0650	0.1074
Saipa	0.0239	0.0250	0.0368

Class 5	0.90	0.95	0.99
A2A	0.0167	0.0221	0.0227

### 3.3 Optimization portfolio phase in the framework Mean - VaR

We obtained an initial portfolio comprising a wide range of stocks with minimal risk. We will try to determine what percentage is the optimal composition of capital that needs to be invested in each of the assets under consideration, so that at the end of the investment we will have a maximum return on investment.

Thus, T is a set of stocks, with stock  $j$  that leads to expected income  $R_j, j = \overline{1, T}$ ; Expected income of portfolio is:  $R_x = \sum_{j=1}^T x_j R_j$ . The model to be solved is:

$$\max \sum_{j=1}^T x_j R_j, \text{ with } VaR_\alpha(L_x) \leq v_0, \text{ where}$$

$v_0$  is the parameter of the model.

As a consequence of applying the technique of selection, we selected a portfolio of 5 stocks, each of them representing the minimum risk stock class corresponding VaR measured probability level 0.99: Bca, Mps, Telecom, Saipem, Unicredit, A2A.

In these conditions, the optimization problem to be solved is:

$$\begin{aligned} \max f &= 0.1122x_1 + 0.0286x_2 + 0.04x_3 + 0.1724x_4 + 0.205x_5 \\ &\left\{ \begin{aligned} 0.031x_1 + 0.052x_2 + 0.044x_3 + 0.0354x_4 + 0.0392x_5 &\leq v_0 \\ \sum_{i=1}^5 x_i &= 1 \\ x_i &\geq 0, i = \overline{1,5} \end{aligned} \right. \end{aligned}$$

There are several methods for solving this problem (math programming or software *Scientific Work Place*). A solution to this problem remains a challenge for future.

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## Investment Projects Analyse Methodology

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### Abstract

*The IFIs analyze methodology of investment projects based on dynamic methods of assessment and financial analysis in which the predominant component is to update the flow of revenues and expenses. IFIs have adopted the method of analysis based on internal rate of return (financial and economic), considered the most appropriate because it allows comparison with the appropriate cost of capital, the reference standard for financial analysis in market economies. The expression of projects efficiency by the two forms the financial and economic aims on the one hand, satisfying investors' decisions and on the other hand the governments to allocate resources at national and international financial institutions to apply uniform criteria regardless of economic policies countries in which the project.*

**Keywords:** Financial Institution (IFIs); internal rate of return; investment projects; economic analysis; financial analysis.

**J.E.L Classification:** G21

### 1. Introducere

Access to financing from the IFIs on beneficiary demand is based on a complex and rigorous analysis of these institutions. For this the beneficiary must draw up a file to allow the creditor conducting the review and funding decision.

### 2. Preparation and analysis of the investment projects by IFIs methodology

Drafting the investment projects mainly takes up a series of steps, of which the most important are:

### 2.1. Identification of investment projects

In this stage is determined if the the future objective fits within the general development strategy of the country. It aims to feasible production technologies to be applied and markets. Generally, to identify investment projects using two methods: relay project, when there is an initial draft, and the new project is an improvement of the old, and methods of strategic development projects, projects involving the development of policy on circumscribed development of industry or activity, of which the future economic objective to be achieved

### 2.2. Feasibility Study Project

This is the tool by which an identified project is feasible from the technical, economic and financial. The feasibility study includes: project history; market outlets; objective and program production capacity; material facilities, including necessary supplies; study site with consideration of the various variations; engineering studies; strategies adopted; placement areas; target organization; economic and financial evaluation. The economical and financial evaluation includes: budgeting; project financing; production cost; financial evaluation: payback period, break-even point, rate of return on investment, internal rate of return (IRR); economical evaluation: cost / profit, savings estimates, annual cash flow (cash flow).

### 3. Specific issues of the assessment methodology of investment projects

These issues are examined by experts who advise favorable bank loans for investment projects.

### 3.1. The economic issue

The IFIs aim to effectively manage internal resources by comparing the expected economic effects of investment and production efforts.

Market type (newly created, well established and traditional) is essential to determine the risk of project cash flow forecast. Depending on the project can be described and any funding that could benefit customers in the project. This concern the following: determining the relevant markets; market share and sales volume; competition; pricing strategy his is necessary and retrospective analysis of the evolution of prices of products and the main factors that determine the price (cost of market entry, consumer awareness, product substitution); distribution and sales

### 3.2. Environmental issues

The IFIs are tasked to promote projects that are based on a sound and sustainable development in environmental terms. It's necessary that the applications contain sufficient information on the incidence of project on environment. It will consider: the location of investment, current or previous land use, description of construction or changes of land, measures intended to protect or improve the environment, defining responsibilities for pollution, the policy pursued by the enterprise environment, authorizations obtained from public authorities, restrictions or facilities that are undertaking the necessary imports, restrictions or existing facilities in the export, public services price structure, currency restrictions

### 3.3. Technical issue

IFIs shall review the production to ensure that the technology will provide a competitive advantage with the potential benefits of taxation and low cost labor. Five categories of information are required: location, plant and equipment, manufacture, raw materials costs, labor.

### 3.4. Institutional, organizational and leadership issues

Promoters are generally responsible for project development to execution to final and usually are major shareholders in the project, contributing in cash or in kind to it. Bank requires a firm commitment from promoters and detailed information on global assistance, on their plans for participation in the capital and on their involvement in management, production and marketing to the project. It aims at:

- Experience of promoters in the field. A promoter who has some experience in area is considered to be more aware of the risks which it could take. It will take strategic decisions based on commercial and financial experience
- Financial situation. Require information on the financial statements of projects previous knowledge enabling bank activity results. This can be seen to what extent the promoter carried out their duties and the extent of this activity is a guarantee to finance the new project. The documents provided should cover the last three years. If the shareholder is an individual will be given information on its heritage elements, they hold shares in other companies.
- Other shareholders. When the project participants and other stakeholders, the promoter will provide information on their role in the project, their power and decision control. It also specifies the contribution they can make to guarantee or project funding.

### 3.5. Financial aspect

Consist of considerations on financial and investment policy practiced in that country. IFIs will only be one source of financing of the project. It may be the only fund only if an extension is made of existing capacities, provided that this does not represent more than 35% of its final value. Given that the promoter has difficulty in attracting other funding sources, the bank can help by giving assistance in this regard. In such co-financing bank is interested in sharing risks with other donors that have a richer experience in the field concerned and wants to play a catalytic role by encouraging other organizations to fund projects.

Information on sources of funding must include the following elements:

a) Details of equity: who participates capital and for how long; what is the distribution of contribution in kind and in cash; how shares are shared;

b) Details of loans: who provide credit; currency of the granted loans; credit conditions;

c) Details of agreements signed: guarantee agreements; subsidize agreements; tax agreements

d) Details of guarantees: guarantees given to creditors and describe the nature and type (pledge, mortgage, privilege, etc..).

The information given in this section should enable the IFIs to assess the possibilities of the project to release sufficient cash flow to repay debt and pay dividends. Forecasts are for a number of years equal to the period of involvement of the bank. To this end are under consideration:

- operating assumptions regarding: sales volume and product price; cost allocation, taking into account labor force (number of employees and average salary), raw materials, transportation, public services, sales and administration; equipment and maintenance expenses of their working capital
- financial forecasts: on the income statement, balance sheet and operating cash flow, calendar of maturities and repayments of loans and interest, the depreciation of assets, the working capital, the taxes that the company must pay the bank during the intervention of bank in the project.

For the profit and loss forecasts, revenues are estimated based on expected sales volume and unit price forecast. Cost of sales is estimated based on volume forecasts, costs of raw materials and labor and indirect costs. Depreciation expense arises from amortization plan. Interest costs are calculated based on the terms and conditions of financial agreements including repayment plan, grace period, interest, commissions, etc.

Cash flow statement (cash flow) consists of three elements: operating cash flows from financing activities and investing activities. To estimate operating cash flows, projected net income, depreciation, taxes will be taken from the profit and loss forecast. To estimate forecast flows from financing activities, the agreements provide the data necessary funding as repayment plan, interest, fees and

investment activity forecasts are estimated based on the investment plan or the company's capital expenditures.

Balance forecast sheet is based on the income statement forecast and cash flow statement. Customer receivables are estimated based on the number of days of collection or collection average period. Stocks designed are based on projected inventory velocity. Fixed assets are extracted from the expenditure of capital, depreciation and amortization resulting from the plan. Long-term debts are obtained from anticipated borrowing plan Equity is calculated from the investment plan and earnings is shown in the profit and loss forecast.

Forecast financial statements are used to calculate financial ratios. Five categories of financial ratios: liquidity, leverage, activity, profitability and market.

A distinguishing feature of the methodology is the proper economic analysis of financial analysis.

Economic analysis is used primarily to assess the economic efficiency of investment projects with international funding aimed at economic issues - social, levels of infrastructure to provide a stable and sustainable growth. The results of economic analysis is the starting point in developing projects and that the allocation of funds for development of international programs for macroeconomic growth.

Financial analysis aims evaluation of the economic efficiency of projects under the loan application, funding from banks and financial companies for expansion and business development. This is to reveal the economic efficiency in the public and private economic agents taking into account the sources and destinations efforts and effects involved. The result of this type of analysis is much greater for investors who are faced with deciding how best allocation and distribution of own funds and financial institutions who want to place the funds available to enable effective business recovery fund and obtain an additional profit. Prices used in financial analysis are market prices for both products in the country and those imported including related taxes.

The main aspect that distinguishes the two types of analysis is the structure of income statement. Purpose of economic analysis is to

highlight the project return to the national economy regardless of the nature of resources committed and the effects obtained by the beneficiaries. In this regard the establishment of income statement is not taken into account subsidies, taxes of any nature.

Determination of the structure of income and expenditure in the financial analysis will include all fees, taxes and subsidies related to the economic relationship with the state and financial institutions. In terms of revenues, financial analysis, will be included in addition to operation income, credits upon receipt is income to expense when the entity returned. The depreciation of fixed assets are not included in operating costs in the feasibility study because it would be double counting, the value of fixed assets is taken into account through investment.

Calculation of economic efficiency are based on technical upgrade, which provide comparability the efforts with investment and production and the effects achieved, revenue, profits, etc.. This comparability is achieved at the beginning of the investment objective.

Another feature of the methodology is that the effects and efforts are taken into account throughout the implementation and operation of investment objective. Duration of achievement can vary from 1 to 2 months for minor objectives, to 2 to 3 years for the industrial scale. Operating periods are between 5 and 7 years or less machines for special construction and 10 30 years from construction to certain destinations.

These time periods used in efficiency calculations give rise to difficulties in accurate assessment of income and expenditure because a series of calculations should be considered that take into account forecast demand, market trends, cost of raw materials and materials, labor and the situation on international markets.

Element to be taken into account in the preparation of revenue and expenditure forecasts for investment projects developed in developing countries is inflation, which will correct the values recorded in the base year.

Updated calculations use a index called the update rate. Recommendations for drafting investment bank in stable economies, suggest using a level of 15%

update rate, for economies in transition where the value should be corrected by the inflation rate, the level of interest for borrowings and the rate economic efficiency at the branch environment and economy.

Any investment project regardless of its size and length of time is affected by a number of factors influence favorable or unfavorable. Anticipating the influence of factors on the project can be achieved by performing sensitivity studies in which calculations are recovering successively modifying one item at a time and then a combination of successive element. These studies are a means to assess changes that may arise in carrying out investment and production processes, since all predictions are subject to great degree of uncertainty. Through them, sensitivity, project profitability is tested in a series of changes that may occur in the conduct of investment and production processes,

All efficiency calculations are considering estimates regarding the investment, costs, revenues and profits. Not all items can be determined accurately. If these elements have an important share in the project and their variation induces significant deviations in calculations require better understanding of existing relationships to see whether calculations of the project are reliable. Thus, projects are tested for sensitivity to deviations of 10%, generally to items such as costs increase, loss of revenue, reducing exports. A project may be solid if the tests succeed to maintain the internal rate of return or if it is not reduced by more than 10%, not fall below 7-8%.

#### **4. Conclusions**

Methodology for analyzing investment projects based on analysis of expected cash - flow. IFIs used analysis method based on internal rate of return (financial and economic), considered the most appropriate because it allows comparison with the appropriate cost of capital, the reference standard for financial analysis in market economies. The article presents in detail the stages of the development of investment projects and specific assessment methodology, focusing on the calculation of internal rate (financial and economic) profitability. Using the most rigorous available funds based on investment

decisions that are based on technical calculations - economic feasibility study contained in each investment objective.

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## Features of Commercial Operating Risk Analysis

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### Abstract

The activity of any trade businesses is subjected to risk of exploitation or economic since it can not predict with certainty the various components of its outcome (cost, quantity, price) and of the operating cycle (purchases, sales). Sales condition the activity across the enterprise, their variation being considered the main risk factor for the performance of commercial enterprise. Breakeven analysis in commercial activity is based on the indicators: turnover critical (critical sales volume) and sales of goods critical which prove their usefulness in providing and implementing a risk management that enables decision optimization, risk diminution and uncertainty.

**Keywords:** performance, risk analysis, commercial enterprise.

**J.E.L. Classification:** D61, M41, M49.

### 1. Introduction

Commercially operational risk assessment refers to analysis and identification of relevant risks in goals achievement, to know how they should be managed.

Economic risk can appreciate the possibility of registration (obtaining) an insufficient result or even losses, expressing the result economic volatility in operating conditions [1].

The main indicator that measures the operation risk of breakeven is called the critical point, the equilibrium or neutral „point mort” or „breakeven point”.

Risk management consists in running a series of processes of identification, estimation of consequences, evaluation, management and monitoring the business’ risks. This is realized in a sequence of steps, such as: *risk identification; analysis and risk*

*assessment; determination of priority interventions to limit risk; risk treatment* [2].

### 2. The breakeven point in trade

In commercial enterprises, which are based exclusively on **trade activity**, breakeven point is determined by taking into account the *fixed costs* ( $C_f$ ) and the development of specific factors, namely:

- Loose goods turnover ( $R$ );
- Average rate of profit margin ( $\bar{A}$ );
- Average rate of service variable costs ( $\bar{N}_v$ ) (related to sales of goods).

Factorial, sales of goods related benefit ( $B$ ) is determined by the relationship [3]:

$$B = Vz - Ch_{circ} = \frac{R \cdot \bar{A}}{100} - \left( Cf + \frac{R \cdot \bar{N}_v}{100} \right)$$

where:

$Vz$  = sales of goods;

$$Vz = \frac{R \cdot \bar{A}}{100};$$

$Ch_{circ}$  = circulation costs concerning goods made from fixed costs ( $C_f$ ) and variable movement costs.

**Breakeven trade** marks that dimension of activity where **revenues from the sale of goods** ( $Vz$ ) covers **movement costs related to goods** ( $Ch_{circ}$ ), the company not getting any profit or loss, *the benefit being zero* ( $B = 0$ ).

Equality  $Vz = Ch_{circ}$  corresponding to equilibrium point leads to the next equation:

$$\begin{aligned} \frac{R \cdot \bar{A}}{100} &= Cf + \frac{R \cdot \bar{N}_v}{100} \Rightarrow \\ \frac{R \cdot \bar{A}}{100} - \frac{R \cdot \bar{N}_v}{100} - Cf &= 0 \Rightarrow \\ \frac{R \cdot (\bar{A} - \bar{N}_v)}{100} - Cf &= 0 \end{aligned}$$

Indicators used in the trade breakeven analysis are presented in Table 1.

Table 1. Indicators used in the trade breakeven analysis

Indicator's name	Calculation relation
<b>1. Critical turnover (sales volume) (R<sub>crit</sub>)</b> = is related to breakeven sales volume (critical point)	$R_{crit} = \frac{Cf}{\bar{A} - \bar{N}_v} \cdot 100$ (lei)
<b>2. Critical goods sales (V<sub>z<sub>crit</sub></sub>)</b> : is related break-even sales volume (critical point)	$V_{z_{crit}} = R_{crit} \cdot \bar{A};$ $V_{z_{crit}} = \frac{Cf}{1 - \frac{\bar{N}_v}{\bar{A}}} \text{ (lei)}$

Source: Petrescu, S., *Financial accounting analysis and diagnosis - Theoretical Application Guide*, 3<sup>rd</sup> edition, revised and enlarged, CECCAR Publisher, Bucharest, 2010, p. 163

Based on critical values (critical turnover, sales criticism) is estimated safety indicators presented in Table 2.

Table 2 Safety indicators

Indicator's name	Calculation relation
<b>1. Safety margin (Ms)</b> = expresses the <i>existing gap between the actual values realized in the analyzed period</i> (sales of realized goods) and <i>critical values</i> (critical goods sales)	$Ms = Vz - Vz_{critic}$
<b>2. Safety interval (Is)</b> = expresses the company's ability to change its sales of goods and adapt to market requirements	$Is = \frac{Vz - Vz_{critic}}{Vz_{critic}} \cdot 100$
<b>3. Gains in efficiency (Se) or index return</b>	$Se = \frac{Vz - Vz_{critic}}{Vz} \cdot 100$

Source: Petrescu, S., *Financial accounting analysis and diagnosis - Theoretical Application Guide*, 3<sup>rd</sup> edition, revised and enlarged, CECCAR Publisher, Bucharest, 2010, p. 163

### 3. Breakeven point analysis in trade

Analysis of threshold return from trade for two studied companies is realized based on data from Table 3.

Table 3 Indicators breakeven trade

Indicators	N-4	N-3	N-2	N-1	N
<b>1. Sales of goods (Vz)</b>					
ALFA	8047087	5617771	3682313	3669445	2177826
BETA	3830748	4385872	3511355	3962964	4316240
<b>2. Fixed costs * (Cf)</b>					
ALFA	1418919	944887	772279	723082	539772
BETA	1158066	995233	881250	935311	913203
<b>3. Average rate of profit margin - % (<math>\bar{A}</math>)</b>					
ALFA	-	18.71	20.56	18.95	17.89
BETA	28.05	31.96	35.40	36.99	36.63
<b>4. Average rate of service variable costs - % (<math>\bar{N}_v</math>)</b>					
ALFA	15.96	15.21	16.34	15.36	14.69
BETA	20.18	21.74	22.87	23.31	23.21
<b>5. <math>\bar{A} - \bar{N}_v</math> (%)</b>					
ALFA	3.98	3.50	4.22	3.59	3.20
BETA	7.87	10.22	12.53	13.68	13.42
<b>6. Critical turnover -lei (R<sub>crit</sub>)</b>					
ALFA	35652906	27002932	18279921	20122758	16884367
BETA	14706299	9742610	7034574	6836383	6804061
<b>7. Critical goods sales - lei (V<sub>z<sub>crit</sub></sub>)</b>					
ALFA	7109122	5052032	3759218	3813938	3020086
BETA	4125797	3113277	2490058	2528872	2492426
<b>8. Safety margin - lei (Ms)</b>					
ALFA	937965	565739	-76905	-144493	-842260
BETA	-295049	1272595	1021297	1434092	1823814
<b>9. Safety interval % (Is)</b>					
ALFA	13.19	11.20	-2.05	-3.79	-27.89
BETA	-7.15	40.88	41.02	56.71	73.17
<b>10. Gains in efficiency (Se) or index return - %</b>					
ALFA	11.66	10.07	-2.09	-3.94	-38.67
BETA	-7.70	29.02	29.09	36.19	42.25

\* Fixed costs (Cf) related to sales of goods - according to the management accounting data

Graphical representation of the evolution of sales of goods in relation to actual critical sales of goods is suggestively presented in Figure 1 for S.C. ALFA S.A. and in Figure 2, for S.C. BETA S.A.

S.C. ALFA S.A. proves low economic performance in trading activity compared to S.C. BETA S.A. as interval values of safety, efficiency growth are much lower in the first two years, and during the three last years values are negative actual sales of goods being situated below break-even (sales of goods critical) making company to be „unstable” and to be at risk of exploitation.

Figure 1 The evolution of critical goods sale for S.C. ALFA S.A.

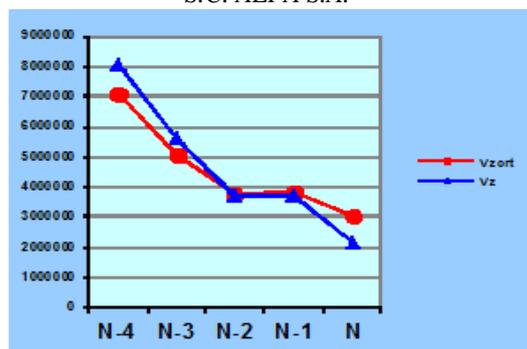
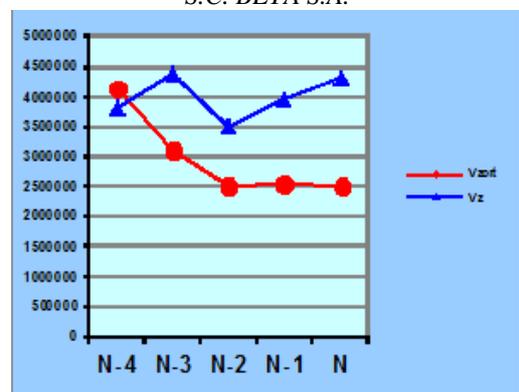


Figure 2 The evolution of critical goods sale for S.C. BETA S.A.



S.C. BETA S.A. shows high performance in trade activity in the last four years, being in a „comfortable” situation as sales of goods are well above the critical goods sales, ahead of safety interval of 20%, so the company is not subject to risk in trading activity.

Existing gap between sales of goods and critical values is higher for S.C. BETA S.A. during the last four years, proving flexibility and adaptability higher than the short and medium term developments in the economic sector recorded operating, while in case of S.C. ALFA S.A. spread is negative in the last three years the company being at risk in trading activity.

#### 4. Conclusions

On future S.C. ALFA S.A. needs to review its strategy, to reformulate their sales and marketing objectives focusing mainly on increasing turnover, object achievable by: reducing the sales price (sales price reduction effect may lead to increased turnover), improvement of product’s quality, increased

business area, product diversification and restructuring (elimination of noncompetitive products, launching new products, green ones), improving the promotion and distribution of products (website updating, expanding online sales) etc.

Operational risk will be even greater as the operating weight of fixed costs, variable operating costs compared with the expenditure of movement will be higher. Fixed costs reduce business flexibility, namely its ability to adapt to changes in turnover. Degree of flexibility is dependent on the technical potential of the enterprise, human potential and its organizational structure, variability in outcome will be better mastered by the entity, the more it manifests a degree of flexibility.

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# Theoretical and Methodological Foundations of the Financial System of the Enterprise

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## Abstract

*In conceptual terms, definition of financial system has a complex content and meaning, both in the finance literature and in everyday human activities, that phrase is used with quite different meanings. In this situation, can be observed quite different approaches on how to define and interpret the foreign and domestic professional literature, particularly its emphasis on content items to be considered relevant by the authors.*

**Key words:** financial system, financial and monetary flows, financial markets, real flows.

**J.E.L. clasification:** G19

## 1. Introduction

So, for shaping the concept of financial system is important to the general notion reporting system, which has several meanings, but means, in essence, a set of interdependent elements (principles, rules, criteria, etc..), Which is an organized, that puts order in a field of theoretical thinking, governing the classification of material in a field of natural sciences or cause to operate as a practical purpose.

### 1.1. Enterprise approach to financial system

The philosopher Aristotle, gives a first definition of the system, saying that "the whole is greater than the sum of parts".

In another approach, the system is seen as "a meeting of principles linked together in a manner to establish a doctrine", or "a combination of parts that are coordinated to contribute to a result or to form an assembly." In a simplified way, is to admit that a multiplicity of elements common essence and

manifest link between the interaction and interdependence, integration and operation enabling a consistent set is, generally, a system.

To be components of a system, all the items and categories regarded as objects of research must meet a number of cumulative conditions.

First, in the context considered, the components must have common reference elements, organic connection and interdependence.

Second, the system is a generator output - s, based on input-s, materialized through a series of input and output streams (streams real financial - monetary, informational, etc.).

Third, the system consists of many interconnected subsystems, which have connections between that can occur in a particular context, opportunities for substitution.

In the light of the delimitation process and economic relations that takes into account the concept of finance, in line with the scope of the finances, the financial system can be assigned and accepting more restrictive or more extensive, in relation to other concepts, such as for example that the financial sector. At the same time, however, aspects of the concept of financial system is interrelated with other areas of event concepts, such as those of system and banking sector, monetary system and taxation system.

Usually, the term of the financial system is dealt with quite differently understood in relation to the concept of "financial sector". In the literature it is considered that the term "financial sector" has a narrower sense, the financial sector is often defined as "a component, part of an economy that provides financial services to other entities of the economy".

Viewed in another aspect, continuing analysis of the particular to the general one can see that, in a broader approach to running processes, phenomena and economic relations

of the scope of the financial sector, financial processes and phenomena manifest specific financial system .

It seeks, therefore, a more general reference to economic relations and processes taking place in connection with "the interaction between supply and demand for financial services, and, looking deeper financial services, as set of "interrelations that occurs between demand and supply capital for establishing various economic entities".

In this sense, that the concept delineation and analysis of its financial system, is important to study the demand for financial services, which comes not only from financial agents (banks, non-bank financial institutions, etc.), but also from non-financial agents, like for example households, firms and state.

The notion of financial system has also a broader sense and because of the kind expressed above, includes including running financial flows are interrelated with the development of real flows, but has also considered the development of other types flows, such as the information.

The concept of monetary system is part of the same area of analysis is most often defined as "a complex of institutions and arrangements that allow regulation of monetary circulation in a country through a set of legal rules emanating from the public authority and that all payment instruments and techniques." Monetary system refers mainly to the currency as legal tender and must specify its parity. Depending on the content of the monetary standard adopted were established, over time, several types of monetary systems namely monetary systems as standard with metal monetary standard monetary systems based on combined and monetary systems based on standard power purchase. Expression of all processes and phenomena referred to the financial system today is done through standard purchasing power, the currency issued, so the central bank of a state or union of States.

In the context of research concept definition and financial system, given the processes and phenomena to which it relates, is important to clarify that a significant part of these processes take place in the context of public authorities' involvement in economic and social government.

Of the many definitions of the notion of a common system emerges designating a set of components to achieve a group objective.

A system can have a relative character, in that it can be decomposed into subsystems and in turn can be regarded as a subsystem of a more complex system. In this respect, the economic system can be considered as belonging to macro system - social system. In turn, the financial system is a subsystem belonging to the economic system.

System concept can be applied to many areas of economic and social characteristics of each field that induces the system complexity.

The concept of system in a more close socio-economic, is designated a part of objective reality that can be identified processes, phenomena, concepts, objects or groups connected by a multitude of mutual relations, which have links with external environment and working to achieve established objectives.

Features economies today shows that the system is a mix of types of systems previously known and considered the theoretically "pure economic systems." However, giving it the character of economic system in the above sense, the economy appears as a integrated whole (in terms of fundamental) elements of economic links exist between interdependence and compatibility, which interact and influence each other.

In this respect, the financial system results in a subsystem consisting of components of economic substance expressed in cash, part of the (sub) economic systems that interact with its various structures.

Thus, the concept of financial system has, in turn, more accepted arising usually in differently oriented approaches to certain elements of it. Thus, we consider that any economic system that uses money and place processes and financial relationships include financial component, so the financial system.

In other words, a type of financial system emerges and works in any economy in which the expression of economic processes in cash (irrespective of their expression of specific instances of money - goods or money - a sign, or degree of development), being able to say that the financial system known today is "an integrated component of the economic system of advanced and industrialized society", that information and knowledge.

In the literature, how to define and address the financial system is to describe and explore ways in which various components (financial) system are interconnected and interact, both within the system (endogenous) and at the influences mutual various phenomena and processes external (exogenous).

Also appears important to distinguish clearly between those categories there are interconnections that determine, in fact, the possibility of grouping and regrouping them into the financial system.

In this approach, the financial system is structured as follows:

- as a system of economic relationships, in cash, which circulates financial resources;
- as a system of institutions with responsibilities in the organization of financial relations, development and execution of financial decisions;
- as a fund of funds, that is, distributed and used in various economic and financial structures;
- as a financial planning system, through which the leadership and, to some extent, regulate financial activity.

Briefly, the financial system and in the opinion of other authors regarded as a system of economic relations, financial funds, financial plans and institutions.

Therefore, the event brings together a wealth of financial systems specific elements, connected by a common essence and financial phenomena which have interdependent relationships. At the same time, the financial system is viewed as a whole, representing all economic relations in cash, resulting in the distribution of national income, manifested in the complex process of formation, distribution and use of funds and financial.

Financial system as a set of financial relationships is presented, in terms of its economic content, "as a set of financial relationships that manifest in the complex process of formation, distribution and use of funds to financial".

The system is defined in terms of two components namely character subsystem:

- public financial subsystem;
- private financial subsystem.

On the one hand, the emergence of financial relations system components leading to the development of financial relations established among the participants, the financial system is represented mainly by "the ways in which they

exchanged for cash resources," while "elements that facilitate this exchange (markets, institutions) play a secondary role".

On the other hand, the content of the financial system may be considered as a fundamental element of financial institutions, and operates in a specific economic and social field, signifying a different assessment from that set out above. Core financial system, in this respect is the existence and functioning of financial markets and a socio-economic area, by performing specific functions.

The approach focuses on participation (institutions) for solving problems of financial economics. Initially, they are grouped in institutions that are part of representative democracy, the authority is administrative or specialized organs of executive power or financial departments in companies and institutions, as appropriate.

From another perspective, the demarcation of the financial system based on their financial institutions operate in a certain economic and social context, is studied based on the existence of specific tasks financial institutions and markets in the economy. Conforms to it, "financial institutions and financial markets are combined in a network forming the financial system".

If the early stages of a financial, real processes are considered the economic development, however, in the current, and financial transactions occur as part of it, and this is also achieved without inter-transactions in natural form and material (goods and / or services). What we have here an approach might subscribe treat the financial system as financial relationships.

In this first variant of the financial system shows two components:

- market (financial);
- financial institutions (financial intermediaries).

In the design of other authors, indicating a second variant of the institutional approach, are considered three components of the financial system:

- financial instruments, defined as claims arising from the change in resources among participants;
- financial markets-areas or mechanisms through which financial instruments are traded;
- financial institutions that issue and negotiate financial securities, facilitating the

transfer of resources between market participants.

Financial institutions in the context above, are those entities that issue and use financial instruments, making important financial system definition.

The role of the financial system is necessary to provide mechanisms through which financial funds can be transferred between companies with surplus and those who want to borrow (firms with deficit).

As parts of the financial system, we believe that its elements are important in function and the role they perform in the economy. Thus, an essential function of the system resulting from the use of complex financial instruments lies in their ability to facilitate transfer of resources (transfer value) in the economic system. Financial market functions is essential to establish, through negotiation, the value of financial instruments and trading them. Financial institutions in the context of belonging to the financial system, and stands as financial intermediaries, whose function is to supply bodies lack the resources obtained from entities account surplus. The role of entities referred to above, taken within the system may be considered to be distribution and redistribution of resources (financial) due to event specific distribution function finances and financial system amid transactions that involve the use of money and hence transfer gain value.

The financial system performs in our opinion, and finance specific functions such as distribution function, control and regulation - stability.

Expression of the financial system functions would fall more in the context of defining the functions which it can fulfill in the economy and not the delimitation of the concept of system. Presentation of financial system functions is, however, necessary to express its purpose, namely the ability to lead the implementation of processes that may not manifest in the absence of the class considered optimal.

Content and significance of the financial system may be described in terms of financing arrangements and the economy, and from this angle, the literature distinguishes financial system based on capital market operations based on operation at banks. Content and its characteristics are expressed in this case with

reference to the manner of carrying out the operations through banks or the capital market.

The literature defines and interprets the concept of financial system analysis based on the following issues:

- institutional analysis;
- analysis in terms of "financial intermediary";
- functional analysis;
- systemic analysis.

Institutional analysis focuses on the creation and functioning financial institutions - such as existing bank central bank, commercial banks, insurance companies, stock exchanges, investment and pension funds, etc.. This involves structuring and analytical description of the financial institutions that form, effective financial system.

Mainly, the analysis in terms of financial intermediation is the role of the financial system intermediation, transformation (maturity) and transfer of capital to cover different needs of participants in economic and financial activity. Financial intermediation occurs when indirect finance as a solution to solve some inconveniences that may occur as a result of direct financing. This problem results from different preferences and needs against the need for placement and investment of money capital. Thus, companies with surplus capital funding wish to place smaller, short-term at low risk and the possibility to withdraw at any time, while those deficient (investors - the typical case of companies) want placing as high scale of capital investment, long term, to a high degree of risk.

A second problem is related to direct funding of moral hazard ("ex ante" and "ex post") that accurate information is the inability of those who saved resources and effective monitoring of the use of capital transferred to investors. The result is that lenders will waive the transfer of capital available to investors or would require too high a cost of capital, which the latter are not willing to pay.

Functional analysis can be considered as a complement to institutional analysis in that the latter does not deal with structural changes and the causes which produced them, but focuses mainly on identifying the specific functions of financial institutions "seeks to identify the most appropriate structure for the manifestation of these functions at some point in time and space ". The focus is therefore on the functions performed by various

components of the financial system and ways of achieving them. The functional analysis, these functions are considered "anchors" and "known" system and institutional structure of each system and structural changes would require some restructuring. In this case "institutional structure" includes financial institutions, financial markets, production, service, organization operations, regulation, including the book. Financial functions may occur in private, public (government) and households. Assessment may be, on the one hand, descriptive, for the purposes of structure analysis of existing financial systems, and on the other hand, dogmatic, that is to expose how the system should be structured.

Financial system is done through money transfer financial resources in time and space (between regions or sectors), which is the fundamental function of the financial system.

The financial system provides the mechanism necessary concentration of resources and also provides ways to control uncertainty and risk. In this sense, provides information about prices, useful decentralized decision processes and help in the control of information asymmetry.

Functional analysis is useful in presenting and analyzing the global financial system of a country. However, the approach is more stable to changes in time and space, compared with analysis of institutional structure.

Considering the recent guidelines on the impact of the financial system on sustainable development, whereby a high functionality of financial institutions leads to economic and social development in the functional analysis that institutional restructuring is needed, to meet the requirements for inclusion and technologies information in carrying out specific functions based on the use of data that can be delivered simultaneously by many financial institutions in order to achieve the system, primarily to achieve economic growth.

Systemic analysis is done through the interrelationships between system components is manifested finance and the impact of interdependencies on the system as a whole.

Thus, it is intended to structure the financial system integrated subsystems, analyzing the possibility of complementarity various subsystems within the whole. In this respect, complementarity may consider how the various components of the system enterprises induce or impact on others, such as the positive

effects resulting from the manifestation of the role of banks in one segment or another, or the global financial system, influence on finance companies, the financial policies of the enterprise application, effects of government policies on economic growth by applying fiscal policies - budget and monetary effects resulting from the event role of financial markets in relation to financial intermediaries at the cost of capital.

Depending on how the management and control of the economy and hence the financial flows, there are two economic systems which correspond to two possible types of financial systems, namely:

- market economy system, on the one hand;
- statist economic system, the command, led by plan provisions required to execute, on the other.

In another approach to the content of the financial system, consider a simple model economy consists of two sectors:

- business sector, producing goods and services,
- household sector, which provides resources on the first possession.

Sharing resources within the system is in its infancy, through barter. With the emergence of intermediaries universally accepted by the participants - money, the shortcomings of the first type of exchange disappear. In an economy that does not take into account the financial markets assume that cash flows are carried out in correspondence with real flows, the latter manifesting either as input streams - resources (capital, land, labor, etc.) or as streams output - transfer of goods and services.

Involve cash flows, on the one hand income (rents, interest, profits), and on the other hand, payments for real output streams.

In this type of economy where trade is done through money there, but the possibility of the large-scale savings and investment.

Financial system, that any economic system can be regarded as an information system, defined as a set of processes and means of collecting, processing and transmission of information necessary for the management of enterprises, institutions, ministries, etc.. In the present context, where money (currency unit), the instrument tends to transform the economic information - financial, it (information) is a component of value creation, along with matter and energy is reflected in the value of goods

and services. Information in general, and financial-monetary, in particular, is seen as a factor of production alongside labor, land and capital. Financial information is considered a means of economic and social knowledge, an important support for economic-financial decisions.

The accuracy of the information circulating through the financial system is in close interdependence with the quality of decisions at different levels of economic and social organization, of which the most relevant to meet the financial policy of the enterprise, the micro level, and policy financial, fiscal and monetary macroeconomic.

### **1.2. Addressed the financial system against financial environment of the enterprise**

Taking into account the economic environment and the impact of financial decisions at the micro level "is a set of processes of creation, preservation and circulation of currency and other financial assets.

However, currency and other assets, are only one manifestation of which involve complex financial system, in fact, five distinct categories of components".

These parts are in the literature:

- » payment instruments,
- » specialized financial institutions,
- » financial asset markets,
- » legal provisions,
- » control variables (interest rate, exchange rate, stock).

### **2. Conclusion**

That the concept of financial system has multiple signifiers, and a possible definition that emerges in relation to the meanings addressed is "essentially set of components that show financial links between organic, which would impart a unitary system. Normally, incumbent financial system functions similar to those of finance, and in context, we can admit that it is meant to

mediate the transactions of payments in an economy, and its main role is to provide mechanisms to finance company .

In terms of structure elements, with the support of the literature different approaches, consider the following relevant financial system accepts:

a) system of financial relations - economic relations set in cash, often called financial, or financially - money that is circulating cash resources;

b) system of financial institutions - all the institutions participating in the organization of financial relations, the creation and distribution of funds and the organization, conduct and control of economic activities;

c) as a system of financial funds - general fund cash resources of an enterprise that is used in relation to certain destinations;

d) as a system of financing the economy - the financing of the economy, being found most often in the form of capital market financing, that the debt from banks;

e) as a financial and monetary flows, all flows that take place in the economy, micro and macro level, which is analyzed, usually in relation to conduct real flows, as part of the financial circuits.

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# New Approaches to Monetary Policy in the Context of Actual Financial Crisis

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## Abstract

*As a result of economic turmoil started in 2007, some questions have been risen whether monetary policy suffers radical changes or just rethinking the details of the basic monetary policy stance. Therefore, in this article, inter alia, we have analyzed the monetary policy relationship with the financial stability. In the context of actual crises, monetary policy should consider whether to rely on credit bubbles and to clean up after their explosion or to interfere and fight against financial fragility during both the financial boom and bust (Lean vs. Clean debate)*

**Keywords :** monetary policy, financial crisis and instability, bubbles

**JEL Classification:** B26; E40

## 1. Introduction

After the high-tech bubble in 2001-2002, there has been a growing debate on how to integrate financial instability in monetary policy. The central bankers conventional wisdom of “cleaning up after the bubble bursts” defended an ex post integration, central banks intervening only during the burst. On the contrary, some academics preferred the ‘leaning the wind strategy’ approach promoting a policy intervention against financial fragility during both the financial boom and bust. This ‘cleaning up after the bubble bursts’ versus ‘leaning against the wind’ debate is re-examined in light of the current financial crisis that begun in August 2007.

The paper, using comparison methodology, introduces the “lean” versus “clean” debate and its implication on monetary policy (interest rate).

## 2. The debate “lean versus clean” in the context of actual financial crisis

Since the New Economy boom-bust in 2001-2002, the common wisdom among central bankers is the ‘clean after the bubble burst’ strategy: *‘the monetary authorities should deal with the financial instability that may result from a crash in asset prices if and when the latter occurs, but they should not adjust monetary policy pre-emptively in the boom phase’* (Bordo & Jeanne, 2002:4). This means that central bankers do not have to take directly into account financial instability such as asset boom-bust or credit boom, instead they should laissez-faire the bubble (Greenspan, 2002). The “clean after the bubbles burst” strategy calls for addressing indirectly financial instability, via the primary goal of inflation. Financial imbalances matter only if they impact on future inflation or output. This “clean after the bubble bursts” strategy has been developed in the academic field by Bernanke and Gertler (1999 ; 2001) and comforted by practitioners (Greenspan, 2002).

This common wisdom is criticised by promoters of the ‘*leaning against the wind*’ (LW) strategy defended by Cecchetti *et al.* (2000; 2002) but also at the Bank of International Settlements. They claim that the high-tech bubble and boom-bust should have been regulated via a more activist interest rate policy. A pre-emptive action “to prick” the bubble could have reduced the bust and so would have improved social welfare.

The financial crisis has challenged the standard “clean after the bubble bursts” strategy, calling for a re-examination of the “lean versus clean” dispute. Despite it concerned New Economy asset prices in 2001-2002, this controversy suits to the current crisis with the problem of toxic assets or houses prices. In the aftermath of the current financial crisis, does “clean after the

bubble bursts” consensus among central bankers still hold?

To answer this question we present the pros and cons for “Cleaning up after the bubble bursts ” strategy and the” Leaning against the wind” strategy.

### **3. The”clean after the bubbles burst strategy”’: pros and cons**

First cross argument is that bubbles are hard to detect: the central bank can not really determinate if a financial imbalance, like a bubble, is under way. Since by definition the bubble means a situation out of the fundamental value and results instead of animal spirit, there is no reason for irrational markets acting with ‘irrational exuberance’ to react to the rational action from the central bank.

Besides, because financial markets are not necessary inefficient, but can follow the Keynes’s animal spirit psychology, it is difficult to predict their reaction to an active monetary policy. The LW can do more harm than good, adding extra market volatility instead of reducing it (Papademos, 2004). Moreover, because of their herding behaviour, it is difficult to influence market participants, making the LW poorly efficient. Furthermore, due to financial markets complexity and their potential inefficiency, their reactions to large interest rate increase.

A second objection against leaning against bubbles is that raising interest rates may be very ineffective in restraining the bubble, because market participants expect such high rates of return from buying bubble-driven assets. The main feature of bubbles is departures from the behavior that is normally incorporated within models, and so the tools of monetary policy are unlikely to work normally in abnormal conditions.

A third objection is that there are many asset prices, and at any one time a bubble may be present in only a fraction of assets. Monetary policy actions are a very blunt instrument in such a case, as such actions would be likely to affect asset prices in general, rather than solely those in a bubble.

The fourth rejection of the LW strategy suggests that raising interest rates would cause a bubble to burst more severely, thus doing even more damage to the economy. This view was supported by historical

examples, such as the monetary tightening that occurred in 1928 and 1929 in the United States and 1989 in Japan, suggesting that raising interest rates may cause a bubble to burst more severely, thereby increasing the damage to the economy. Another way of saying this is that bubbles are departures from normal behavior, and it is unrealistic to expect that the usual tools of monetary policy will be effective in abnormal conditions.

Moreover, because of the transmission lags of the interest rate instrument, there is potentially a timing problem: the LW can affect too late the economy, being out of phase with the current situation: when rates increases affect the economy to fight the boom, the economy can already have turn to a burst. This implies that the LW is pro-cyclical for timing reasons.

On top of that, markets distorted reaction or overreaction to the stabilising policy cannot be ruled out, hence ”lean against the wind” efficiency is not warranted and it can even do more harm than good. Financial instability, like bubbles, can be only the symptom of an underlying more structural imbalances, suggesting that instability should be address through other more appropriate policy than interest rate policies like prudential regulation or supervision.

Another empirical argument is that the Greenspan doctrine, which was strongly supported by Federal Reserve officials, held great sway in the central banking world before the crisis. However, there were dissenting voices. For example, Mervyn King, the Governor of the Bank of England, did not advocate leaning against the wind but did suggest that, to prevent a buildup of financial imbalances, a central bank might extend the horizon over which inflation is brought back to target.

The main pros argument is that, by stabilising the financial cycles, this strategy is supposed to improve macroeconomic stability. The idea that asset imbalances are not identifiable is not specific to financial instability: it is also difficult to estimate potential output (output gap), the NAIRU or the natural or neutral real interest rate. Yet central banks produce forecasts from these variables and publish these variables misalignment state. So it does not seem totally impossible for asset prices. Moreover, ”the clean after the bubbles burst” claims to

be able to forecast the financial instability impact on inflation and output. So there are some reasons to expect them to assess financial instability itself.

#### **4. The “clean after the bubbles burst strategy”: pros and cons**

The ‘mop up’ after the bubble burst consists in using monetary policy to offset its negative impact on the economy. Methodologically speaking, it consists in acting *ex post*, not *ex ante*. The mop up is not supposed to create a bubble, since monetary policy easing is followed by a form of bubble in only one third of case, and because asset prices boom can happen when monetary conditions are not easy. This strategy is based on the efficient market hypothesis and the dichotomy between the real and financial economies. Hence, there is little or no chance that the bubble feeds into the real economy, meaning the boom and the bust are inoffensive. It is also based on historical studies claiming that bubbles do not influence the real economy since market crashes generally do not degenerate into financial instability (Mishkin, 2008).

The main cross argument contests identification problem. First, as an institution, the central bank is supposed to have more information than the markets and is supposed to be independent from the markets some should have information on them. The fact that the fundamental value cannot be judged precisely, so that the proper action is difficult to assess, does not mean that no action is possible. It simply implies that the precise action to implement is difficult to estimate, but the action direction seems to be identifiable (Issing, 2003:8). During the financial crisis, the exact magnitude of policy action was clearly difficult to determinate, but the direction was clear: stop the housing bubble (boom) and stop the credit crunch (burst). Hence it was not impossible to identify the housing bubble (Trichet 2009). Moreover the “clean after the bubble bursts” strategy rests upon the fundamental value theory that has been challenged by the current financial crisis.

The “clean after the bubble bursts” asymmetric nature is an incentive to moral hazard since it stresses that the central bank will help banks and financial actors, what

ever the price (Issing, 2009:14). Asymmetric policy also means inactive interest rate policy during the boom period, implying potentially too low interest rates, encouraging excessive risk taking so preparing the burst and threatening risk taking.

The mop up strategy is also perilous since it is not necessary fast working enough. Indeed the current financial crisis has suggested that it could be overwhelmed by the speed and magnitude of the financial crash, in particular because of the zero lower bound on nominal interest rate that constrains the extent of the mop up. The burst is actually non linear and can be brutal and deep, threatening the whole economy, making the mop up inefficient. Moreover, the mop up can lay the ground for the next bubble by setting interest rate too low (Issing, 2009:15). Besides, this address of the bubble bursting can relocate the bubble elsewhere, in another part of the financial system or the real economy, meaning that one imbalance is leading to another: ‘*So I do not think that mopping up is a doctrine than can be relied upon*’ (Tucker, 2008:7).

Furthermore, the inefficient interest rate policy stressed by the “clean after the bubble bursts” strategy during the boom works in both direction: if market participants do not react to rate increases during the boom because of optimism, there are reasons to think they won’t react to rate decreases during the mop up, because of pessimism. Market participants’ panic requires large rate decreases for the mop up, meaning that the 0% lower bound is quickly achieved. Yet, the idea that monetary is ‘too blunt a tool’ to deal with financial instability is now contested in light of the current crisis experience.

#### **5. Conclusions**

The global financial crisis of 2007-2009 was not only a tsunami that flattened the economy, but it has flattened the science of monetary policy, requiring a total rethink. Before the recent financial crisis, the common view, both in academia and in central banks was that achieving price and output stability would promote financial stability. This was supported by research which indicated that monetary policy which optimally stabilizes inflation and output is likely to stabilize asset prices, making asset-

price bubbles less likely. Indeed, central bank's success in stabilizing inflation and the decreased volatility of business cycle fluctuations, which became known as the Great Moderation, made policymakers complacent about the risks from financial disruptions. The benign economic environment leading up to 2007, however, surely did not protect the economy from financial instability. Indeed, it may have promoted it. The low volatility of both inflation and output fluctuations may have determined market participants into thinking there was less risk in the economic system than was really the case. Credit risk premiums fell to very low levels and underwriting standards for loans dropped considerably. Some recent theoretical research even suggests that benign economic environments may promote excessive risk taking and may actually make the financial system more fragile. In our opinion, although price and output stability are surely beneficial, the recent crisis indicates that a policy focus solely on these objectives may not be enough to produce good economic outcomes.

A lesson from this analysis is that policy makers and, especially, monetary policy makers will need tools to assess whether the credit bubble is developing. Research is being underway to find measures to signal that credit bubbles are likely to form. But even so there is a strong case for monetary policy to support the credit bubble rather than to order after the explosion bubbles. Using monetary policy to pursue objectives of financial stability is not an easy task, and research how to monitor credit conditions in order to take monetary policy decision to restrict the use of excessive ownership risk are based on correct information and have a high priority for future research.

The financial crisis of 2007-2009 although demonstrates demonstrates the role of nonlinearities in the macro economy when there is a financial disruption.

Many quantitative studies have also assumed that the shocks hitting the economy have a time-invariant Gaussian distribution, that is, a classical bell curve with symmetric and well-behaved tails. When there are significant financial disruptions, as we have seen in the recent crisis, the shocks hitting the economy may exhibit excess kurtosis,

that is, tail risk, because the probability of relatively large negative disturbances is higher than would be implied by a Gaussian distribution.

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## Finishing the Financial Audit Mission

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### Abstract

*The purpose of the financial audit is to ensure the credibility of the financial statements presented to the shareholders, investors, send to the financial institutions and to the public but also to contribute to the good operating of the company.*

*Users needs for financial audit, review the historical financial statements, review of intermediar financial statements, procedures, have increased lately due to requests of regulators or as a result of shareholders interests to protect their business.*

*Only a quality financial audit, which assumes conformity with International Standards on Auditing, Ethic Code and valid national regulations, will achive the objectives and fulfill its purpose.*

**Key words:** financial audit, audit report, auditor conclusions, recommendations, review financial statements

**J.E.L Classification.:** M4, M42

### 1. Introduction

In the narrow circumstances of the financial economical crisis, the companies need more than ever the services provided by the financial auditors.

The auditors can perform a lot of operations like verify financial transactions, results of the inventories, reevaluations, accounts and documents control, main financial-economical indicators analysis, interpretation of financial position, performance, forecast financial information, review financial statements. Their recommendations and conclusions may have significant impact in improving financial results.

Of all services provided by financial auditors, the audit remains the most complex,

with the most samples required, with most tests and applied procedures.

Regardless of the activity he performs, the auditor should ensure that he obtains sufficient appropriate audit evidence in order to support the conclusions presented in the report.

Economic entities may apply for financial mission or may be required to be audites under current regulations.

### 2.Performing a financial audit mission

In order to execute an audit mission, the auditors must complete several steps, from which visible for the audited company are: preparation and submission of the mission letter, planning the mission and send the audit planning, accounts and documents verifications, being part of the inventory teams, submission of the recomandations letters and the audit raport.

The auditors must built two files for each financial audit: current file and permanent file. The permanent file will be prepared at the begining of the mission and it will be updated along the way for a recurrent audit.

The current file must contain at least the tests provided in the „Quality Audit Guide”, which replaced the „Minimum audit requirements”. Beside this mandatory minimum tests, the auditors can attach other procedures, workcharts, checks.

Unlike the current file, the permanent file is not provided with minimum procedures, but only with recommendations about the information that must be collected: activity field, management of the society, organization, assets, etc.

Both files must be provided in any audit company Quality manual so there is a certain standard, a certain document organization, unique and appropriate procedures that are applied as well as documentation of every important aspects, decisions, additional applied procedures.

Inside the audit company, internal control must follow the quality of the performed audit missions, meaning that the policies and procedures from the quality manual exists and are applied by the audit teams. In order to respect this, inside the company must be respected for every mission International Standards on Auditing, Ethic Code regulations including ethics requirements (independency, confidentiality, professional behavior, objectivity and integrity), review of the audit file before and after the audit report is released, follow-up of the audit missions, solve the differences between team members.

A part with major importance in finalizing the financial audit mission is review the audit process, which involves:

- Evaluation of the teams professional opinions and conclusions made during the mission and how these are presented in the audit report
- Valutate the documents from the audit files in order to identify any aspects regarding non-conformity
- Valutate audit risk and semnification point to establish possible errors and their influences on financial situations, in order to define professional thinking, apply more procedures and resuce risks to an acceptable level

From the review notes must result a series of aspects like:

- All the procedures shown in the „Quality Audit Guide” are present
- Mission letter is in conformity with ISA 210
- Documents to certificate the independency (Independency statement and survey form)
- Audit plan exists
- Balance confirmations
- Audit risk assessment
- Respect the minimum number of hours according the HC CAFR no. 44/2005
- Conclusions presented by the auditor
- Verify that the continuity principle is respected
- Verify leasings and loans
- Document the previous auditor was consulted
- Signification point value is documented

- Check the mathematical calculations
- Document that the auditor was present at the inventory
- Verify the amortizations method and amortizations calculations are correct
- Verify bills cancellations / storno
- Define the provisions for risks and expenses
- Document communications with the government
- Develop the recommendation letters for the management
- Document client meetings
- Respect the workcharts patterns
- Verify tax calculations
- Affiliated parts situation
- Communicate with the internal auditor
- Verify how the internal control works
- Define the opinion based on the developed conclusions
- Sign and date all the documents

For those parts where, according to professional thinking, the financial auditor considers there are not enough probations, or fraud suspicions exists, he will extend the tests applying extra procedures.

The existence of the audit probations in the mission files is necessary both for support the opinion and for guarantee a quality financial audit. Maximum 60 days later after the audit mission was completed, the auditor must complete the audit files.

### **3.Preparing the recommendation letter and writing the audit report**

The audit documents is auditors property and he alone can decide to show the client some workcharts or statements. The auditated company will receive recommendation letters from the auditor as well as the audit report.

A recommendation letter can contain elements like:

- If the company respects the laws, the accounting reglementations according Law No. 82/1991 republished with modifications and OMFP 3055/2009 which defines the approval of the Accounting Reglementations with the european guidelines, with its modifications or IRFSs (International Standards of Financial Statement)

- Internal audit is in conformity with the HC CAFR no. 88/2007 for Internal Audit Guidelines which states that the companies with yearly financial situations are audited according to the law or its shareholders option and must organize internal audit in a distinct department, inside the company, or if is company choice, an external audit based on a contract

- The evolution of the general inventory, presence of the documents (inventory decision, inventory charts, inventory minute), entries of the results in the accounting

- Appropriate/Non-appropriate organization of financial accounting, defined internal procedures supplying the needed information to ensure a good and quality management based on appropriate decisions

- Existence/non-existence of the internal control and how it works (efficient/non-efficient)

- Existence/non-existence of the accounting policies

- Financial books show/doesn't show in a good manner the entries based on necessary documents

- Financial reports were/weren't built by correctly transferring the account balance from 31.12

- Account Books and Inventory Book are/aren't up to date

- The company use/doesn't use a proper informatical system in accounting

- Exist/doesn't exist formalized procedures for compiling account books

- Professional training program for the personal inside financial department

No audit report will be dated or signed if declaration letter is not present and it shall not be issued if differences still exists between the auditor and the person that review the report.

Preparing of the audit report must be according ISA 700, ISA 705, ISA 706, depending on the case when we discuss about an unmodified audit report, report with a matter paragraph, observations paragraph or according ISRE 2400 when the auditor makes a review of the historical financial situations, ISRE 2410 when he makes a review of the intermediary financial situation, ISAE 3400 when he makes an assurance

mission like checking the prospective financial information ISRS 4400 when he performs an agreed procedure (financial audit on a EU financed project). It is not accepted a different format than the one imposed by the standard with minimum mandatory paragraphs.

#### 4. Conclusions

The role of the financial auditors became more and more known inside the companies. The shareholders require an audit when suspicions exists, when they are taking over the company, when they purchase something or when they want to know the real status of the company. In the same time the auditors are called to explain in the General Shareholders Meeting their conclusions, the financial status of the company, his opinion on the company and they are asked about the recommendations and about the solutions they proposed.

In these times, the auditors only have one solution: to perform a quality financial audit both for customer retention as well for avoiding the problems that may occur after the audit and for which problems the auditor must answer according the documentation he made, tests applied, procedures and opinion he formulated.

I consider that in Romania the purpose of the audit is more and more useful and growing as well as the market due to the understanding of the importance of the audit in a company, the need to have a very well trained person but more important an independent person.

Going out of the economical crisis will add value to the financial audit which in the crisis period was improved and will increase the number of the audit departments inside the companies.

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## The Place of Sustainable Development in the Financial Reporting of Large Romanian Companies

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### Abstract

*How can we reconcile economic and social progress without endangering the natural balance of the planet? How can we spread the wealth between developed and less developed ones? How to ensure a decent living for millions of people in danger, where the planet already seems stifled by excessive exploitation of natural resources? To answer these questions was born the concept of sustainable development ([www.mmediu.ro](http://www.mmediu.ro)). More efficient use of resources in order to reduce the economic costs and environmental impact provides benefits to society, environment and economy. In what follows, based on this concept appealing both basic research and applied research, which consisted in testing several hypotheses based on a questionnaire. We intend to establish to what extent it is assimilated by the Romanian economic entities to determine the importance given and to highlight practical ways in which companies meet the objective of sustainable development.*

**Keywords:** sustainable development, social responsibility, environment, environmental reports, financial reports, accounting environment.

**Clasificare J.E.L.:**G20, Q01, Q56

### 1. Introduction

The concept of **sustainable development** means that all forms and methods of socio-economic development whose foundation are providing socio-economic balance between

systems and potential natural (<http://ro.wikipedia.org/wiki/>).

The best-known definition of sustainable development is the date of the world for the Environment and Development (WCEF) in the report "*our shared future*", known under the name of "*The Bruntland report*". "Sustainable development is development which seeks needs, without compromising possibilities future generations to meet their own needs."

The key challenge of sustainable development is the opposition between the needs of the population growth and limits imposed by planet resources and environmental degradation process. During the summit in Rio in 1992, at which attended 120 heads of state, have been brought back to the center of attention, problems on the Environment and Development. On this occasion, sustainable development was defined as: "*a new path of development to support human progress for the whole world and for a long future*". The stated aim of the conference century was setting a new strategy of economic development, industrial and social world, covered under the name of sustainable development "*sustainable development*" (<http://www.un.org/geninfo/bp/enviro.html>).

In this process, there have been taken into account international conventions in which were established obligations precise from states and deadlines of strict implementation on climate change, conservation of biodiversity, protecting forestry and wetlands, limiting use of certain chemicals, access to information on the state environmental protection, and others, which

covers a juridical space international for implementation of sustainable development.

The concept of **sustainable development** is that human civilization has the premise that it is a subsystem of ecosphere, dependent on flows of material and energy within it, the stability and its capacity of self-adjustment. Public policies that are drawn up on this basis, such as this National strategy for Sustainable Development of Romania, aimed at restoring and maintaining a balance rationally, long-term between economic development and integrity of natural environment in forms understood and accepted by society (the National Strategy for sustainable development of Romania, doors 2013-2020-2030, [www.euractiv.ro/uniunea-European/articles/](http://www.euractiv.ro/uniunea-European/articles/)).

## 2. Sustainable development-past, present and future

The sustainable development has become a political objective of the European Union from the year 1997, through its inclusion in the Treaty of Maastricht. In 2001, the European Council in Gothenburg adopted the strategy of sustainable development of the European Union, to which it has been added a dimension abroad at Barcelona in 2002.

In 2005, the European Commission has started a process of Revision of Strategy and published in February, a critical evaluation of progress after 2001, which points a series of guidelines for action to be followed and to continue. The document revealed some trends nonsustainable, with adverse effects on environment, which could affect future development of the European Union, i.e. climate change, threats to public health, poverty and social exclusion, depletion of natural resources and biodiversity erosion. As a result of identifying these issues, in June 2005, heads of state and governments of countries of the European Union adopted a declaration on the guidelines of sustainable development, which incorporates Lisbon agenda, reviewed the economic growth and created new jobs as an essential component of the sustainable development's objective. After wide consultation, the European Commission presented on 13th of December 2005, a proposal for a review of strategy at Gothenburg in 2001.

As a result of the process, the EU Council adopted on 9<sup>th</sup> of June 2006, the renewed Strategy for the sustainable development, for an extended Europe. The document is designed in a strategic vision and consistency unit, with the **overall objective** of continuing improvement in the quality of life for present and future generations by creating sustainable communities, able to handle and use resources efficiently and to use the potential for environmental innovation and social economy in order to ensure prosperity, environmental protection and social cohesion.

## 3. The national strategy for sustainable development of Romania

The UE strategy for Sustainable Development, which represents the fundament of Romania's National Strategy in this field, completes Lisbon Strategy and wants to be a catalyst for those who develop public policy and the public opinion, in order to change behavior in European and Romanian society also, and to actively involve the decisional factors, private and public in society and citizens in the development, implementation and monitoring of the objectives of sustainable development.

The responsibility to implement the Strategy pertains to European Union and its Member States, involving all the institutional components at Community level and national levels. It is underlined the importance of close collaboration with civil society, the social partners, local communities and citizens to achieve the objectives of sustainable development (National Strategy for Sustainable Development of Romania, Horizons 2013-2020-2030, [www.euractiv.ro/uniunea-European/articles/](http://www.euractiv.ro/uniunea-European/articles/)).

**Four key objectives** that are underlying this strategy are:

-Environmental protection, through measures to enable dissociation of economic growth and its negative environmental impacts,

-Fairness and social cohesion, through respecting fundamental rights, cultural diversity, equality of chances and the fight against discrimination of any kind,

-Economic prosperity by promoting knowledge and innovation and

competitiveness to ensure certain standards of living high and some abundant and well-paid jobs,

-Accomplishing the international responsibilities of the EU by promoting democratic institutions to serve peace, security and freedom, the principles and practices of sustainable development throughout the world.

#### **4. Environment reporting in the economic entities in Romania**

For Romania, as a Member State of the European Union, the sustainable development is not one of the options, but only rational perspective of having as result implementation of new development paradigms through the confluence of economic, social and environment factors.

In the current context of globalization, sustainable development and competitiveness, companies are getting more valued considering not only the economic achievements, quality management and political communication, but also considering the contribution made by the social life of community they belong.

A complete reporting must comprise the spectrum of values on which an organization must adopt –from economically, environmentally and social point of view. In practical terms, accounts must expand its traditional reporting framework so as to take into account not only financial results, but also the company's environment. In financial reports should be found information on elements of reporting environmental, social and economic; a coherent vision on sustainable development; the main challenges of sustainable development from the point of view of the company; the clear strategy for sustainable development of the company; information and data environmental, social and economic presented in a coherent manner (Şendroi C., Roman C., 2006).

At the end of 80's, there were only a few companies in the world which issued reports about environment. At the beginning of the XXth century, were about 2000 such companies, their number growing in time. This is in large part due to the appearance of some models of environment reports.

Taking into account that the problems of environment have significant impact on certain areas of interest, such as:

##### **Accounting for management, through:**

-evaluating investments, judging by costs and benefits of environment,

-incorporating the new costs, the increase in capital and other information in budgets and business plans,

-conduct cost analysis/benefit on environmental improvements.

##### **Financial accounting, through:**

-the effects of costs arising from cleaning space, waste treatment and removal, on profit and loss,

-measure the impact on the balance sheet, in particular of debt, valuation reserves and assets' evaluation;

-effect of environmental aspects and potential debt over the business relations with the financial creditors and shareholders majority;

-performance evaluation of the environment in the annual reports.

##### **Projects accounting:**

-the audit of environmental factors in the case of acquisitions, mergers and other matters of planning,

-evaluating investments.

##### **Internal audit, meaning environmental audit:**

Informatics accounting systems, through its effects and their changes required to financial and managerial informatics systems.

##### **Environmental accounting**

In order to describe this field, we start by identifying the main approached aspects, meaning:

-recognition and search for ways to remove any negative effects of conventional accounting practices over the environment,

-separately identification of income and expenses related to environment matters in the accounting systems;

-developing new accounting informatics systems financial and non-financial and also of control systems with the aim of encouraging managerial decisions related to environment;

-the development of new forms of reporting and appreciation of how to measure the performance both for internal and external purposes;

-identification, examination and search for situations in which the criteria for environmental and financial ones are in conflict,

-experimenting ways in which sustainability can be assessed and incorporated into the organizational order.

The environment agenda is in continue change, the enterprise being forced to monitor carefully the situation.

The ways of codification of enterprises' attitude towards the environment are often the result of a politic and environment document, which can be adopted at internal level or through a general standard approved. Through the followed problems, there can be named: biosphere protection, natural resources sustainability, waste removal and reduction, rational utilization of energy, risk reduction, promoting secure products and services, damage compensation, information offer, managers' and directors' involvement regarding the environment matters, evaluation, annually audit, etc. There is often the fear that the commitments required to the companies could be too large and with severe effects over the indebtment.

#### **Environmental audit**

The audit covers a large scale of domains and it involves the performance of the realized tests. The goal of this activity has to be determined, depending on the type of company.

#### **Financial reporting**

There are disclosure requirements imposed by international standards in environmental issues. Thus, any presentation tends to be voluntary, if environmental issues are not covered by accounting principles required by international standards. In most cases, the information is descriptive and unskilled, with no sufficient motivation to produce environmental information. In most cases occur for reasons such as the secrecy of the company. The main factor seems to be apathy that demonstrates the company, especially shareholders and investors. If information is not required, nor is it offered.

Environmental issues can be reported to the company accounts for contingent liabilities, extraordinary costs, comments on the financial and operating situation, the estimates of investment income and expenses.

One more step in this endeavor to achieve the goal of complete reporting was done by placing the operating costs of new categories of "environmental costs" (OMPF 3055/2009 for the approval of the accounts in accordance with European directives). It offers the opportunity for entities to keep track of environmental costs separately for a better tracking and control them, but for better information.

#### **The limits of the company's management**

A company provides goods and services to customers and has employees. It is an integral part of society and is subject to the pressures. Many companies have similar objectives regarding:

- looking for a good public image;
- environmental protection against pollution and waste of non-renewable resources;
- provision of welfare facilities or local community through sponsorships, donations to charity;
- adoption of a good wage policy.

There are different views on the extent to which external pressure changes and generates business objectives limits the exercise of management discretion.

Shareholders concerning business objectives by the fact that there are several interest groups: commercial lenders, managers, employees and customers. A business depends on relations between these groups, otherwise its operation would be questioned. Each group has its own objectives, which requires the emergence of a compromise. Management must balance the objective of obtaining profit pressures from these groups in establishing strategic business plans.

There are views that consider that managers run the company, but does not hold, and the targets are actually of interest. Therefore, not all targets are selected and controlled by management.

#### **5. Investigation on the place of sustainable development and environmental reporting within the company**

The aim of our approach was so determine to what extent they took big Romanian companies and understand the concept of "sustainable development" and to identify

sustainable development given the site's activity and reports made by it.

We followed the analysis made in response to the following questions to find:

1. The company has published information on sustainable development?
2. Information on sustainable development are presented separately?
3. It used the concept of corporate social responsibility?
4. What concrete measures for environmental protection were adopted?

We started with the view that "an entity that neglects the natural environment is penalized by investors" (Jianu I., 2006). Therefore, the financial reasons are the basis for strategies regarding the environment protection by the entities of any size and any sector. It speaks more about the need for "green accounting", which aims at presenting information about the natural environment in the financial statements, and presenting a specific report on the natural environment protection policy.

We chose as subjects for analysis to companies listed on the Bucharest Stock Exchange listing tier. Of the 21 such companies have eliminated the credit companies and financial brokerage companies, the number 9 on the grounds that environmental impact is negligible. The choice criterion for selecting companies were due to research conducted by us our opinion that sustainable development involves financial costs too large to be accepted by all classes of society. The complexity of activities, interest costs and to attract new investors and to preserve those old narrow the scope of companies "willing" to contribute to sustainable development.

Depending on the scope of the companies analyzed can be grouped depending on the field of activities: Pharmaceutical Industry (2 companies), Aluminum Production (1 companie), Production of fertilizers (1 companie), Electricity generating industry(1 companie), Exploitation of natural gas (1 companie), Chemical and petrochemical industry(2 companies), Handling of petroleum, petroleum products, petrochemicals, liquid chemicals and other finished products ( 1 companie), Port Operator (1 companie), Development (Promotion) Real estate ( 1 companie) and Manufacturer of subansable

components and aircraft industry ( 1 companie).

The analysis has reached the following conclusions:

The vast majority of companies analyzed (10) publish information related to sustainable development. In the following we will refer only to them.

Equally, in 50% of cases are part of the information published annual report, while 50% of companies granted a separate section on the website.

In general, the information published in connection with sustainable development refers to the environmental component. Three of the analyzed companies apply a policy of corporate social responsibility as an integral part of sustainable development, having allocated a separate chapter on its own website. In their case, corporate social responsibility for involving society in areas such as arts and culture, education, health, humanitarian, social development actions and community. The active contribution of the policy recognizes the company's growth long term. In the case of two companies, they have integrated quality management systems and environmental management, occupational safety and health.

An interlocking concrete measures taken by companies for environmental analysis led us to the next result:

- environmental programs and the quality of air and soil (specialized laboratories to control water pollution levels, air and soil);
- studies of environmental management and waste management;
- projects and investments undertaken for improving water treatment resulting from technological processes, storage, recycling, incineration, controlled disposal of hazardous wastes;
- water treatment plants since the beginning through advanced;
- the existence of selective waste collection points, including paper and cardboard;
- monitor the impact on the environment through wastewater analysis and semi-monthly for air emissions, including noise periuizinal;
- monitoring of soil, groundwater and wastewater.
- monitoring the level of risk of oil products and facilities to the environment by emissions of fumes or accidental loss;

- inspection of technical condition of transport capacity and safety of wastewater facilities;

- developing new materials and technologies for sustainable development in energy and maintenance;

- maintenance / repairs to the internal network and drill drainage and water distribution network, filter elements etc.

- projects, piping studies, their crossing of the underground above ground; initiatives in exploration and production operations (new energy monitoring system, replacing boilers with significant impact on energy efficiency and emissions of greenhouse gases, development of cogeneration facilities and energy use of gas can not be marketed);

- refining operations initiatives;

- prevention of leaks and waste management (well modernization program);

- energy efficiency;

- staffing for maintenance and operation of specific stations;

- education of the production team to develop enthusiasm and knowledge about the environment;

- publishing regular information distributed to all employees;

- financial support for partnerships with NGOs, schools or public institutions for environmental protection projects and development of green spaces;

Supporting projects initiated by local ecology.

## 6. Conclusions

From the research conducted, we conclude that the first steps towards awareness of sustainable development are taken by most large companies.

A consistent principle of applying a management company responsible in fulfilling obligations, acknowledges the importance that, sometimes, financial support for a worthy cause or an important goal, is vital and that the social responsibility programs and projects initiated and is actively involved in community life, thus demonstrating their status as "good citizen". We cannot speak about the existence of a proper green accounting or a clear delineation of the costs of applying sustainable development policy.

Part of the strategy of sustainable development, **corporate social responsibility** policy is to continuously increase the degree of accountability to the company's employees, shareholders, partners, community and environmental impact and efficiency programs as "*Triple P - Profit, People, Planet*" initiated for this purpose.

A true environmental culture comes from within the company. But, as everybody really learning and passion in action, a successful policy requires **staff involvement in all environmental programs and improving environmental performance indicators**.

On the whole national economy, the concept of sustainable development will remain, at least for the next few years, only one concept. The practice of selecting waste, reduce energy consumption, water, informing citizens about the measures to be taken to preserve the environment are just some ideas that should always be taken into account in implementing projects that provide for achieving the principle of regional convergence. Sustainable development is the notion that must always be considered the creation of any project, despite the additional costs involved.

Acknowledging the need for environmental awareness in all actions done by private actors or public is the first step in achieving sustainability in all areas. The solution is **to think and act fully aware of our responsibilities on long term in economic, social and environmental domains**.

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## Tax and Accounting Issues in Supply Chain

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### Abstract

*The investigation field of the paper covers two distinct areas, namely, the area of accounting research and the taxation field, focusing mainly on issues at the intersection of two research areas, customized to the supply chain. The study reveals some specific tax and accounting aspects for logistics companies. It highlights also the impact caused by the various tax measures on the cost of distribution logistics, assessment of the fiscal effect of various rules, proper tax management being able to optimize the tax position and allowing economic entities to find potential opportunities to reduce corporate tax exposure in the supply chain.*

**Key words:** accounting, taxation, logistics, supply chain.

**J.E.L. classification:** H21, H25, L81, M41

### 1. Introduction

The aim of this study is to analyze the relation between accounting and taxation for the activities in supply chain. The paper reveals also the impact caused by the various tax measures on the cost of distribution logistics. Besides the operational costs that needs to be optimized by the actions of supply chain management, it can be identified a series of other costs generated by different taxes and fees.

The large number of situations in which the business decisions are influenced by fiscal regulations requires a demarcation of fiscal management as a separate component in the activity of companies in logistics channel. The paper give indications about how economic entities from logistics field can use some tax provisions in their favor, thus trying to achieve a reduction in spending on certain categories of taxes. The level of

connection between accounting and taxation is considered one of the key factors in the study of differences in the international accounting. In countries where taxation has an impact on the accounting, through financial statements, companies try to benefit from tax advantages, often to the detriment of the economic reality.

Fiscal effectiveness of the business can be achieved both directly and indirectly. Directly, it can be achieved by it can be done through legal regulations that includes support measures or tax incentive. Indirectly, this is possible while the system of taxes and contributions provides a range of options for the taxpayer. From the point of view of the companies, the practice has proved the best fiscal solution is that it takes into account the objectives and strategies of business.

This study was conducted using qualitative methods, achieving a qualitative analysis of the relationship between accounting and taxation, based on information collected from various categories of logistics companies. The research was an exploratory nature, using interviews as a form of investigation. The scientific approach combined the descriptive perspective - with the empirical concept, using a wide range of research methods: external observation, document analysis, comparative method.

### 2. Literature review

Although in recent years, supply chain management has attracted the interest of a large number of specialists, the number of studies related to the accounting in supply chain is not very high [4], [14], [6]. There have not been, also, many concerns to address the specific fiscal features in supply chain. The fewer are the studies concerning the relationship between accounting and taxation in the supply chain.

In a study conducted in 2006, Bremmers

[1] introduces three principles for accounting in supply chains: the reciprocity in information access, retrieval and asset investment, and matching Risks and returns, with the aim to provide guidance in managerial and stakeholder decision making, monitoring and control.

Using a combination of analytical and computational techniques Shunk and Gavirneni [13] show that randomness in a supply chain magnifies the impact of transfer prices. Only few studies deal with the impact of fiscal policies on total logistics costs in the distribution of goods [10], [11].

Several studies deals with the relationship between accounting and taxation, analyzing the accounting and tax systems and their influence on different types of companies [2], [3], [5], [7], [8], [9], [12].

### **3. Impact of taxation in supply chain**

The expansion of globalization over the last years has given rise to changes in supply chain structure. A number of companies have expanded their market areas which it operates, increasing international transactions both in supply and distribution. Supply chains are setting up locations in all parts of the world. This has as result different local taxes in each of the countries where there are set up premises. International shipments, crossing multiple borders lead to some additional costs like customs and other taxes that are not used for domestic supply chains.

The export of products, the low-cost country sourcing and the trend of outsourcing certain activities, raise both operational as well as financial problems. As a result, besides the operational issues raised by logistical channel should be considered also the connections between supply chain management, accounting, international taxation and corporate finance.

Logistics network design involves selecting the most appropriate locations for distribution centers. In a vertically integrated structure of the logistics channel or for multinational firms, fiscal optimization may be given by the design of logistic channel regarding the choice of suppliers, manufacturing locations, warehouses, logistics platforms as well as transport routes, transit through certain countries, in a

combination that provides the lowest tax costs.

Decisions on design of supply chain and planning activities in logistics channel need to be based not only on operational considerations, but also on fiscal aspects, in order to protect the profit against excessive taxation in certain regions. Tax issues affect decisions about facility location. It is therefore necessary to find the countries, locations with low levels of taxation and minimize revenue and operations in countries with high levels of taxation. For example, in some countries of the EU profit tax is lower or there are practiced strong incentives for certain categories of companies.

Tax effectiveness of supply chain is about seeking solutions leading to record the lowest tax cost, including by using all facilities provided by the tax laws. Optimization of supply chain could be realized through differences in tax rates between country of parent company and the countries of subsidiaries, improving the after-tax profit (net profit).

The design of supply chain could be influenced by tax rebates or subsidized financing opportunities offered by some countries to attract investments, foreign capital. Companies can benefit also from postponement and avoidance of payment of indirect taxes by using foreign trade areas. Opportunities offered by free trade agreements or trade facilitating procedures are also means for supply chain optimization.

To avoid double taxation, fiscal laws of different countries allow companies to claim credit for foreign taxes paid or incurred by a subsidiary or a branch operating in other countries.

The customs and the VAT frameworks are very important. For goods imported the base for customs duties is the customs value of imported goods. At the customs value, to the extent that they were made but were not included in the price of goods, there can be included: international transportation costs to border, loading, unloading and handling expenses, transport related, and insurance cost for external route. In the European Union by removing customs barriers between member states, the distribution patterns could be changed, given that no longer required distribution centers in each country.

VAT is an indirect tax based on deductibility criteria, a tax that charges the final consumer and it affects only in certain situations the profitability. Obtaining tax benefits appears in the area of deductibility, and in terms of payment.

Besides customs duties and VAT, however, participants in the channel of distribution of goods are required and to pay other tax liabilities such as tax on profit, property taxes, contributions of wages, environmental taxes, etc..

In terms of labor costs it can be point out also some differences between European countries, in Eastern European countries labor costs being significantly lower than in Western countries.

In the field of excise duties, at the EU level it can be revealed also the existence of different treatments.

Regarding the acquisition of the land for development of logistics platforms, its cost includes a number of specific costs associated with the procurement process, such as taxes and fees.

Warehousing involves tangible costs associated storage facilities and a number of expenses for inventories management. Buildings incorporate in their cost, besides the purchasing price, the costs of repairs and costs of putting them into operation. For tax purposes, storage areas are subject to specific tax, depending on area and value of buildings.

In the case of a vertically integrated logistics company it will not have to pay VAT on each transaction. For tax purposes it will not have to support the cascading effect throughout the supply chain, the final price the consumer can be, therefore, lower.

In what it concerns the tax on profit, generally, operating expenses are deductible expenses in its determination. In the activity of companies in supply chain it can be identified some types of expenses that have limited deductibility or are not deductible for tax on profit. Limited deductibility of these costs reduces profitability of the activities in logistics channel.

#### **4. Interactions of accounting and taxation in supply chain**

Tax implications of equity accounting, are generated by initial capital contributions

and by their subsequent increases. Relative to firm constitution and increase the share capital by issuing actions, the tax consequences of this operation is materialized in the form of taxes to be paid.

Another group of components of equity, reserves established by different methods, know different tax implications depending on their type, that their method of constitution.

As regards the legal reserves, reserves formed by capitalizing profits, tax implications occur both from the constitution and their use.

The tax rules and the commercial, prohibit the increase of social capital from legal reserves. According Romanian laws in the case of their use to cover losses or their distribution in any form, subsequent reconstruction is not deductible in calculation taxable profits.

Relative to the effects of reserves on the outcome, they can be found in the analysis of legal reserves or reserves representing fiscal incentives. In the case of use of the corresponding values to increase in capital or to cover losses, they will be taxed, adding to the value of the tax on profit due the interest and late payment penalties.

The other categories of reserves, set up on net profit, have no influence on the determination of taxable income. Their use for capital increase will not generate dividends, unless it is done through the distribution of new units, changing thus the percentage of ownership of securities to participants.

In what it concerns the tax consequences of the revaluation of assets it can be identified in terms of tax two situations: revaluation of fixed assets for that is allowed tax depreciation and revaluation for tangible assets that are not subject for amortization.

In the first case, accounting revaluations are taken into account in determination of tax depreciation of revalued assets, but the value of the reduction or subsequent cancellation of reserves that were previously deducted due to the change of their use or their distribution to participants, will be imposed on that moment.

For the second category of assets, given that revaluation reserves are not deducted through amortization, these have no influence on taxable profit.

In addition, in case of sale, in the fiscal deducted value of the asset is included also

the revaluation value, but in the case of the change of reserve use this will be taxed on its turn.

An important source of financing economic entities is the long-term loans. The elements that influence funding decisions lies also tax issues, due to the influence they can have on resource costs and their incidence on taxable profit.

In most of the logistics companies surveyed are preferred rental or leasing contracts as the procurement over its own resources to the detriment of purchases of own resources or bank loans. Selection of method of financing is influenced by several variables, among which it can be revealed as critical the resource costs. Loan capital costs are determined not only by the interest rates for different forms of loans, but also by the tax rate, which can reduce these costs in proportion to the deductibility of these expenses. Taxation, through its direct and indirect influence on these costs, thus becomes one of the factors of influence that has a significant position in the financing, given the impact they have on funding decisions on taxable income.

In the case of the leasing contracts the impact of the cost is determined by the applicable amortization rules, tax rules that may limit the deductibility of interest or other expenses, and tax systems of lease, according to territoriality of transaction.

Leases are subject to the tax laws on tax on profit, VAT and customs duties. In the case finance lease the lessee is treated in terms of taxation as the owner, recording depreciation and interest expense, deductible for tax on profit. For operating leases the financier has the status of owner, user recording rent expense.

As regards the evaluation of the input of assets, tax implications are related to the options to include or not certain expenses, such as, for example, professional fees. Including them in the input value, can create negative effects on the entity's management, especially for non-depreciable assets for which recovery of these costs will not be achieved during use. Moreover, the increase of the assets value through their incorporation will lead to an increase in the tax charged on the asset, as is the case of land

Romanian regulations recognize as part of the asset the investments made in tangible

assets that have the effect of improvement of their original techniques and leading to future economic benefits, in addition to those originally estimated, as subsequent expenditures. This is the case of modernization expenses recognized as investment. All other expenses subsequent incurred to keep performance are recognized as expenses in the period, falling in this category the repair or maintenance expenses of tangible assets.

Selection of a method of amortization supposes an accounting option, a matter of judgment in setting accounting politics, according to business objectives and the approach of tax administration. The selected amortization method should reflect as fairly as the probable future rate of use of the asset by the economic entity, to match the consumption of economic benefits and not the general practices for certain categories of assets.

Tax benefits that are generated by the depreciation policy adopted by the enterprise, can improve the predictable return on investment in fixed assets. Option for a depreciation system, in the same financing conditions has a different effect on profitability of different investments.

Most of the surveyed companies use the straight-line method of amortization, but depreciation rates differ significantly from one sector to another. Use of degressive and accelerated methods presents the delay advantage of the tax burden. In times of inflation, this advantage is doubled by the payment in a depreciated currency.

The most significant and obvious fiscal implications can be identified at the assessment of stock outputs. In an inflationary economy, while the prices are growing, LIFO is considered the optimal method of evaluation in terms of results: it evaluates the maximum consumption value, the accounting result is presented at minimum values and the final stock value is minimal. From the taxation point of view, as the expenditures related to inventories are higher, the profit and the tax on profit are lower.

High levels of stocks determine, on the one hand, high costs of holding inventories, such as storage costs, property insurance, related taxes and, on the other hand,

immobilization of capital which may involve financial costs, but also a cost of opportunity.

## 5. Conclusions

The study reveals some specific tax and accounting aspects for logistics companies, which, besides the operational logistics requirements, need to be compliant to various tax and accounting legislations along the international supply chain. Organization, structure and specific supply chain management activities have evolved in recent years. In the meantime, as general rule, accounting systems have not evolved very much. It cannot be said that always accounting reflects very accurately the processes and transactions that take place in the logistics channel, both in centralized networks, as well as decentralized logistics networks.

On the other side, assessment of the fiscal impact of various rules and the adequate taxation management could determine significant improvement both of cash flow and profit and can help to optimize the tax position, allowing economic entities to find potential opportunities to reduce corporate tax exposure in the supply chain.

Even if some countries provide some tax incentives and exemptions from duties and taxes, it should not be neglected in the analysis the operational logistics costs. In some cases the benefit of configuration of logistics network by locating production in countries with low production costs or tax advantages may be offset by higher logistics costs.

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## The Evolution of Non-Performing Credits in Romania

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### Abstract

*This paper is an overview of the specialty literature as regards the non-performing credits, both globally and at the level of our country, expressing my own point of view concerning the evolution of this phenomenon. My paper shows that first of all it is necessary to make an analysis of provisions constituted in order to determine the bank's capacity to face the cases of non-payment followed by taking into consideration the impact on the profit and loss account in order to establish exactly the manner in which the credit institution will be affected by the deterioration of the assets' quality.*

**Keywords:** non-performing loans, assets' quality, Romania

**J.E.L. Classification:** M41, G21

### 1. Introduction

The indices, such as the delayed payments of instalments and interests, the deterioration of the relationships with their business partners or with the personnel, the legal actions against the client show that the respective credit can become in a short period of time a non-performing credit.

In general, the credits are considered non-performing when the principal or the afferent interest is matured and it has not been paid for 90 days or more, and better said the non-performing character of a credit is manifested when there are no more chances of integral reimbursement and payment of the afferent interests and commissions.

### 2. The notion of non-performing credit and the causes that lead to its occurrence in the international and national practice

A credit is considered non-performing and the debtor in payment incapacity when the payment of the principal and of the interest is

in default for more than 90 days [1].

Another approach of the notion of non-performing credit makes the distinction between the credits given to the population (consumer), the commercial credits and leasing and any credit for which there are clear non-performance indices. A credit being considered non-performing differs from the three situations and namely: in the case of the consumer credit it is considered non-performing if it registers defaults at the principal and interest for at least 60 days, in the case of the commercial credit and leasing it is considered non-performing if it registers defaults at the principal and interest of at least 90 days, and any credit for which there are clear indices of non-performance [2].

In 15 states of Europe (taken as research model) there is no unitary approach of the notion of non-performing credit, it differs from one country to the other and takes into account the following criteria in order to define the concept: the number of default days in the case of credits and interests (in countries such as Romania, Bulgaria, Cyprus, Greece Macedonia, Serbia, Hungary, Poland, Czech Republic, Ukraine, Latvia, Austria is considered non-performing if it exceeds 90 days, in countries such as Estonia, Lithuania it is considered non-performing if it exceeds 60 days, and in Russia it is considered non-performing if it exceeds 30 days), the financial performance (in all the countries), the contagion at the debtor level (in countries such as Romania, Bulgaria, Cyprus, Serbia, Hungary, Czech Republic, Ukraine, Latvia, Russia, Estonia, a credit becomes non-performing through contagion at the debtor level, in countries such as Greece, Poland, Lithuania, Austria, a credit does not become non-performing through contagion at the debtor level, and in Macedonia it depends from case to case, it depends/does not depend of the contagion at the debtor level) [3].

For a better comparability of data, the FMI Guide (Financial Soundness Indicator:

Compilation Guide) recommends that the loans and other assets are classified as non-performing when the payment instalments representing principal and interest register defaults of 90 days or more. Moreover, the non-performing credits will include those credits with a debt service smaller than 90 days which in the national legislation are recognized as being non-performing when there are clear indices of non-reimbursement (ex. Bankruptcy situation).

After the analysis made, the 90 days criterion represents the most encountered practice in different countries for determining the non-performing credits.

The mistakes in the professional reasoning of bank employees are often considered major causes of the occurrence of non-performing credits. The real problems are those afferent to the banking system and which are rooted in the banks' crediting politics, some of the signs of distortion of the credit cult quoted by the American Central Bank being: the internal operations, the award of too many credits to the managers and large shareholders or parties affiliated to them; compromising the healthy crediting principles, awarding credits with high risks, with the full awareness of breaching the healthy crediting principles; the desire of obtaining incomes as high as possible; incomplete credit information; complaisance, the lack of surveillance of old, familiar clients; the lack of monitoring; technical incompleteness; the weak selection of risks[4].

Other researches in the field have demonstrated the fact that the deterioration of the quality of credit portfolio is always manifested gradually, being accompanied by warning signals that allow the banks to act in order to prevent the aggravation of the situation or at least to minimize the loss that could be registered by the bank. Before not being able to reimburse a credit, the debtor goes through a cash crisis. The specialty literature mentions three distinctive stages regarding the cash: difficulty maintaining the liquidity, stage when the stocks start accumulating and the speed of cashing the boo debts slows down, the loaned person's reaction being the slowing down of the providers' payment, thus reducing the expenses; the second stage, when the cash administration becomes a priority, imposing

ceilings and expense limiting; the employees are left to look for other jobs, investments are no longer made, they attempt to capitalize the non-essential assets, dividends are no longer paid with the purpose of capitalizing them in order to cover their own capital diminished by the exploitation losses. The loaned person's relations with the bank start deteriorating, in the clauses of the existent credit contract; the threat of bankruptcy danger, stage when the loaned person uses all his cash resources from the accounts, no longer pays any debts or obligations. The last choice is to declare bankruptcy or find a partner to fuse with, that will absorb him [5].

Among the criteria used by the defining of non-performing credits by Romania we can mention the Prudential Methodology [6] and the Accounting Methodology [7].

The Prudential Methodology [6] defines the non-performing credits according to: the debt service, the initiation of judicial procedures, financial performance, rating downgrade through contagion, the past due credit and the past due interests.

The accounting methodologies [7] defines the non-performing credits according to : the debt service, the initiation of judicial procedures, the past due rates of the principal exceeding one day.

### **3. The evolution of non-performing credits in Romania and their causes of occurrence**

In Romania we noticed that in 1998 we reached a maximum level of non-performing credits, of about 54.77% of the total of credit exposal, fact due to the credit portfolios of the Agricultural Bank and Bancorex. In the immediately following period, the year 2000-2002 we noticed a decrease of the percentage of non-performing credits, fact due to the apparent improvement of the quality of credit portfolio as a result of the elimination of financial performance from the above-mentioned classification criterion and the percentage of low-quality credits has tripled. A slight decrease during the period 2004-2006v can be motivated by the real consolidation of the Romanian financial system and the increase of its stability as a result of the privatization of a great number of credit institutions and the buyout of their majority by foreign banks, differently said from the total of 33 credit institutions, only

two banks with state majority capital remained, and among those with private capital, 24 held a foreign majority capital.

Starting with 2006, the quality of credit portfolio started deteriorating, its negative evolution being emphasized in the following two years.

In the banking system of Romania, the non-performing credits reached the maximum level towards the end of 2011.

The recession of Romania negatively affected the quality of assets from the banking system. The non-performing credits increased to 13% from the total of credits, at the end of April 2011, from 11.9% at the end of 2010 and 7.9% at the end of 2009.

The crediting was strongly affected by the low industrial activity and the consume attenuation at the end of 2008, and the crediting has had a negative evolution in 2009 as well and in 2010, the exception being the mortgage loans through the “First House” program.

The National Bank of Romania adopted measures to stimulate the crediting activity. Thus, the interest rate was maintained at a low record level (5.25%) since April 2012.

In these conditions, the central bank started in the autumn of 2011 a cycle of reducing the monetary politics interest rate and of appropriate adequacy of liquidity conditions, the movements being quickly received by the monetary market through the decrease of inter-banking interest rates below the level of monetary politics interest level. The improvement of monetary market conditions induced a continuously descendant tendency of the turn-over of government securities on the primary market, their secondary market also becoming more active, with favourable impact on the redistribution of liquidity in the banking system.

Romania’s economy shows signs of recovery after a long recession, which should support an improvement of performances in the banking system, but, unlike other regions from the Central and Eastern Europe, Romania remained in recession in 2010 because the Government’s austerity program, which involved the reduction with 25% of the salaries in the public sector, was implemented over the effects of the world financial crisis.

The non-performing credits can be treated,

according to the bank’s crediting politics, in two manners and namely:

- by maintaining the active receivables until the debtor recover or until the bank is forced to admit the loss, registering as such. This approach is typical to the banking systems based on the British tradition, and the level of loan write-downs in this case could seem unusually high.
- by considering the non-reimbursed receivable as loss and its recovery from reserves, followed by the attempt to recover what is possible from the debtor. This model is typical for the USA and it is more conservatory through the fact that the assets-loss are considered to be “non-bankable” (Bratanovic, B and Greuning, H, 2004) and not necessarily non-recoverable. Through the immediate removal of the books of the non-performing credits the level of reserves will seem smaller in relation with the existent credit portfolio.

The recovery of non-performing economic agents supposes that the credit institution takes one of the following measures, necessary and opportune for recovering their payment capacity:

- rescheduling the credits, respectively postponing the reimbursement term of at least two intermediary credit instalments, without exceeding the maximum award term, or the modification, only once, both of the reimbursement terms and of the quantum of instalments, however by complying with the maximum crediting term initially approved. This may have beneficial effects on the cash flow by postponing without supplementary costs (the interest remaining the same) of a planned debt, thus offering the chance of recovering the debtor’s payment capacity
- restructuring the credits, respectively extending or postponing all the instalments’ due dates, and the modification of their quantum within the total balance remained to be reimbursed, by exceeding the initially approved term, but by complying with the maximum crediting term provided by the legislation for the respective type of credit. This is an intermediary measure, preceding the declaration of the payment default, and

starting the procedure of enforcement, offering the chance of recovering the debtor's payment capacity. Unlike the rescheduling, an interest increase occurs, however smaller than in the case of outstanding credits.

- Giving new loans, respectively supplementing the already-awarded credits, in order to avoid the debtor's entering into payment default. This measure supposes a supplementary analysis, extremely careful of the borrower and imposing some special conditions, such as: using the new credit strictly for the purpose agreed with the bank, performing all the receipts and payments through accounts open at the respective credit institution, ensuring and keeping the guarantees constituted in favour of the bank etc.
- Increasing the working capital, by increasing the long-term liabilities or reducing the fixed assets. Taking into account the client's financial situation, the long-term increase of liabilities is practically impossible, since the debtor does not dispose of the necessary sources for increasing the capital or issuing new bonds, and the capitalization of fixed assets is not desirable since it would affect the business solidity. However, in the case that the client made investments without having financing sources appropriate as term, a series of fixed assets being practically financed from short-term credits, there is the possibility of transforming these loans into medium and long term credits, which are reimbursed while amortizing the fixed assets they finance [8].
- Reducing the necessary of working capital, by increasing the rotation speed of circulating assets that will have as result either the reduction of stocks, or obtaining a higher turnover with the same stock, which means higher receipts, therefore supplementary cash flow.

As a result, in the evaluation of the level of provisions established by a bank, the analysts must clearly understand that if the bank performs the operation of registering the losses as expenses directly or purely and simply constitute provisions for them. The modality used often depends on the fiscal

regulations applicable to the provisions.

In the analysis of problematic credits, a special importance is held by guarantees, respectively their type and extent, which are used in case of the debtor's insolvency for covering the losses by capitalizing them, according to the current regulations [9] both in the bank credit contracts, and the real and personal guarantees constituted with the purpose of guaranteeing the bank credit, representing enforceable titles.

#### 4. Conclusions

The analysis of the portfolio of non-performing credits is very vast because it offers important clues on the quality of the total portfolio and, lastly, on the crediting decisions of a bank.

In this regard, it is not sufficient just to establish the time of overdue credits, but they must be divided according to the types of clients and segments of activity, in order to be able to determine the general tendencies and establish if all the clients are or not affected to an equal extent.

In addition, each case must be assessed to determine if the situation is reversible, what can be made to improve the reimbursement capacity and whether recovery plans were used in this regard or not.

In the analysis process, it is very important to establish the causes of the deterioration of the credit portfolio quality in order to be able to identify the possible measures to be undertaken by the bank to counter-attack a certain trend.

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# The Impact of Romanian Tax Measures on Black Sea Coastline Tourism

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## Abstract

*Even if Romania has a huge tourism potential, is moving slowly in this industry. This study aims to investigate the impacts of tax measures on the Romanian Black Sea Coastline tourism and we have chosen a very specific area, i.e. the southern part and namely a specific seaside resort Neptun – Olimp and also one of the hotels of it: Hotel Cocor. For our investigation we use a linear regression model. To highlight the impact of tax measures adopted by the national authorities on local tourism, the model take into consideration three scenarios: the rate of VAT applied at this moment (respectively, 24%), the rate of 0% VAT and the rate of 9% VAT that were could be applied to tourism services.*

**Keywords:** tax measures, VAT rate, occupancy degree, tourism.

**J.E.L. Classification:** H30 Fiscal policies and Behavior of Economic Agents, General

## 1. Introduction

Throughout the process of understanding tourism development, the main attention has been usually focused on the more advanced and stable societies of Central Europe - all of which are very closely related to major Western European states, such as: Hungary, Czech Republic, Poland and Slovenia. Outside of the former Soviet Union is post-socialist Europe's least developed South Eastern Europe (SEE) with countries like Romania, Bulgaria, Albania and Croatia that have a considerable tourism potential, but are still being relatively neglected in the literature. With a lack of media recognition and inconsistency in macroeconomics policy,

the region's image continues to be characterized by instability that usually has an impact on politics, economy, culture and tourism.

Therefore, this study focuses on understanding how tourism in the Romanian Black Sea Coastline is affected by national tax measures and severe worldwide economic downturn. The article has three parts: first part is a brief overview of Romanian tourism, the second part examines the impact of fiscal measures taken by authorities on the number of tourists using a linear correlation, and the last part presents the conclusions of issues considered.

## 2. A Short Review of Romanian Tourism

The broad concept of tourism includes a variety of jobs and industries (accommodation, food and beverage, etc). Hunter and Green (1995) describe tourism as a 'nebulous phenomenon, characterized by an amalgam of fragmented trades, organisations and activities'. This makes it difficult to assess who the ultimate beneficiaries of tourism are because if the social costs are internal to the region, the private and social benefits can be external (Pessoa and Silva, 2007).

Even though Romania has a huge tourism potential, in Hall's "edited review of Romania's post Ceausescu future, tourism is quoted only in one paragraph in comparison with the popularity for coastal holidays in Dalmatian coast and the notably high proportion of national income derived by Yugoslavia from the Croatian litoral before 1990. Hall noticed the SEE's relative wealth of cultural and natural resource potential for the development of interior niche tourism products, the (re)appearance of mass outbound tourism from Central Europe and

the rapid growth of high spending outbound tourism from Russia, and also the region’s need to consolidate employment and development strategies in order to be able to counterbalance the demise of heavy industry and a restructuring of agriculture” (Hall, 1998).

The economy of Romania is going through a difficult transition stage, starting with the 90’s, that included the decline in production throughout all sectors and sub-sectors including services, national currency depreciation, balance of payments, deficit of the public budget. Between the years 2000 and 2008, economic growth has been stimulated and specific measures have been taken, but the worldwide economic downturn has strongly affected this economic growth. In this context a special place in a future recovery position is held by the tourism industry, welcoming additional income for smaller countries, such as Romania and also generating jobs and promoting the countries’ image around the world.

In Romania, the concept of coastal tourism is becoming popular and therefore an important touristic attraction. This development has been presented in several articles (Cooper, 1990; Smith, 1992). In the management of the Romanian coastline resorts, sustainability is one of the most important principles that should be taken into consideration. Moreover, the government decided to get involved, having the intention to provide funds in order for this area to develop faster in the next 5-10 years. A negative aspect of the tourism activity on the coastline is seasonality, because hotels are operating 5 months a year, through the summer. Recent tourist arrivals statistics has showed a significant rise in tourists (domestic and international) from 25.000 to 200.000 that prefer to spend the summer on the Romanian coastline, which is not the best result, comparing to previous years when there was no economic crisis. The resort hotel is the most common form of resort development. The company holding a business meeting in a self-contained resort setting keeps the outside distractions of a city to a minimum while utilizing the recuperative effects of recreation to improve business productivity (R.C. Mill, 2001). Managers have difficulty in learning human relations skills rather than developing technical skills.

Therefore, planning, organizing, staffing, controlling make up the process of management. A revised plan is usually put in place and the process can begin.

### 3. How National Tax Measures affect the Romanian Black Sea Coastline Tourism

To highlight the impact of tax measures adopted by the national authorities on local tourism, the model take into consideration three scenarios: the rate of VAT applied at this moment (respectively, 24%), the rate of 0% VAT and the rate of 9% VAT that were could be applied to tourism services.

Using a linear regression model, further, we analyzed the impact of three rates of VAT on occupancy degree in a hotel located in the southern Romanian coast, respectively Cocor hotel, for a period of eight years (2004-2011).

Using regression techniques and Granger causality in the following is presented the impacts of national tax measures on local tourism, using the software package Eviews and the following variables:

- VAT rates, under three scenarios (presented above), rates receipts from tourism caught in the Cocor hotel during 2004-2011, as independent variables;
- occupancy degree, representing accommodation days / year, as the dependent variable;

The table below illustrates the descriptive statistics of variables

Table no.1. Descriptive statistivtic of the variables

	OCCUPA NCY_DEG REE	INCOME_0 VAT	INCOM E_9VAT	INCOM E_24VA T
Mean	51.7025	6.312	6.880	7.827
Median	53.565	5.781	6.302	7.169
Maximum	60.15	8.685	9.467	10.77
Minimum	32.77	3.823	4.167	4.741
Std. Dev.	9.365	1.962	2.139	2.433
Skewness	-1.007	0.147	0.147	0.147
Kurtosis	3.024	1.349	1.349	1.349
Jarque- Bera	1.353	0.936	0.936	0.937
Probability	0.508	0.626	0.626	0.625
Sum	413.62	50.498	55.043	62.617
Sum Sq. Dev.	614.041	26.958	32.030	41.453
Observatio ns	8	8	8	8

Source: Own calculations in Eviews software and the data from the Cocor hotel documents

In this analysis, the independent variable is the VAT rate under three scenarios and dependent variable is the occupancy degree of the Cocor hotel in the period analyzed.

For estimating the correlation between the occupancy degree and the other three indicators mentioned above, we will use the regression technique, applying the method of least squares for determining the parameters of the following regression equation for each variable.

$$Y = \alpha + \beta X$$

Y – is the dependent variable

X – is the independent variable

$\alpha, \beta$  – are the parameters of the regression equation.

*The correlation between occupancy degree and 0% VAT rate*

By using the method of least squares, the regression equation between the two variables over 2004-2011 period is:

*Table 2 The correlation between the occupancy degree and 0% VAT rate*

Dependent Variable: OCCUPANCY_DEGREE				
Method: Least Squares				
Sample: 2004 2011				
Included observations: 8				
OCCUPANCY_DEGREE=C(1)+C(2)*INCOME_0 VAT				
	Coefficient	Std. Error	t-Statistic	Prob.
C(1)	66.561	12.538	5.308	0.0018
C(2)	-2.353	1.962	-1.199	0.275
R-squared	0.243	Mean dependent var		51.702
Adjusted R-squared	0.117	S.D. dependent var		9.365
S.E. of regression	8.8	Akaike info criterion		7.399
Sum squared resid	464.65	Schwarz criterion		7.4195
Log likelihood	-27.598	Durbin-Watson stat		2.448

Source: Own calculations in Eviews software

On the basis of the table above, the regression equation of the variables is:

$$Occupancy\_degree = 66.56 - 2.35 * Income\_0\%VAT$$

According to this econometric relationship, the correlation of the occupancy degree of the Cocor hotel and the 0%VAT rate is unproportional, that is a rise of 1% of VAT rate implies a modification in the other way of 2.35% occupancy degree.

The coefficient of determination for regression (R-squared) signifies the fact that 24.3% of the variation in the occupancy degree is explainable by the modification of the 0% VAT rate.

*The correlation between occupancy degree and 9% VAT rate*

Estimating the parameters of the regression equation between the occupancy degree and the 9% VAT rate over 2004-2011 period, the following results are obtained:

*Table 3 The correlation between the occupancy degree and 9% VAT rate*

Dependent Variable: OCCUPANCY_DEGREE				
Method: Least Squares				
Sample: 2004 2011				
Included observations: 8				
OCCUPANCY_DEGREE=C(1)+C(2)*INCOME_9 VAT				
	Coefficient	Std. Error	t-Statistic	Prob.
C(1)	66.561	12.538	5.308	0.001
C(2)	-2.159	1.8	-1.199	0.275
R-squared	0.243	Mean dependent var		51.7
Adjusted R-squared	0.117	S.D. dependent var		9.36
S.E. of regression	8.8	Akaike info criterion		7.399
Sum squared resid	464.65	Schwarz criterion		7.419
Log likelihood	-27.598	Durbin-Watson stat		2.448

Source: Own calculations in Eviews software

According to the data in the table above, the regression equation between the analyzed variables is under this form:

$$Occupancy\_degree = 66.56 - 2.159 * Income\_9\%VAT$$

According to this econometric relationship, the correlation of the occupancy degree of the Cocor hotel and the 9%VAT

rate is unproportional , that is a rise of 1% of VAT rate implies a modification in the other way of 2.16% occupancy degree.

The coefficient of determination for regression (R-squared) signifies the fact that 24.3% of the variation in the occupancy degree is explainable by the modification of the 9% VAT rate.

*The correlation between occupancy degree and 24% VAT rate*

By using the method of least squares , the regression equation between the two variables over 2004-2011 period is:

*Table 4 The correlation between the occupancy degree and 24% VAT rate*

Dependent Variable: OCCUPANCY_DEGREE				
Method: Least Squares				
Sample: 2004 2011				
Included observations: 8				
OCCUPANCY_DEGREE=C(1)+C(2)*INCOME_24VAT				
	Coefficient	Std. Error	t-Statistic	Prob.
C(1)	66.564	12.536	5.30	0.001
C(2)	-1.89	1.582	-1.19	0.275
R-squared	0.243	Mean dependent var		51.70
Adjusted R-squared	0.117	S.D. dependent var		9.365
S.E. of regression	8.79	Akaike info criterion		7.39
Sum squared resid	464.58	Schwarz criterion		7.419
Log likelihood	-27.59	Durbin-Watson stat		2.44

Source: Own calculations in Eviews software

According to the data in the table above, the regression equation between the analyzed variables is under this form:

$$Occupancy\_degree = 66.56 - 1.89 * Income\_24\%VAT$$

According to this econometric relationship, the correlation of the occupancy degree of the Cocor hotel and the 24%VAT rate is unproportional , that is a rise of 1% of VAT rate implies a modification in the other way of 1.89% occupancy degree.

The coefficient of determination for regression (R-squared) signifies the fact that 24.3% of the variation in the occupancy degree is explainable by the modification of the 24% VAT rate.

I will further my analysis to the Granger causality for each pair formed in the four variables.

The type tests *Causality-Granger* (CG) indicate what variables are useful for forecasting other variables. More precisely, we may say that X causes -Granger Y if the forecasting of Y is made considering information about X history which is better than one that ignores the X history. We may check if X (the independent variable , which is the fiscal pressure )causes-Granger Y (the dependent variable given by the unemployment, inflation, economic growth, and public dept) testing if the parameters are significantly different from zero.I need to underline that despite the name,CG cannot be interpreted as the real causality (structural), as Cooley și LeRoy (Cooley, T.F., and LeRoy S.F, 1985, A theoretical macroeconomics, *Journal of Monetary Economics*) demonstrated. CG is consistent with (without being either necessary or sufficient for) the authentic causality, in that the effect has to follow the cause in time. More importantly, CG is extremely useful when answering question such as :”What variables can signal anticipatorily a rise in the X variable?”

*Table 5 Granger Causality Tests*

Pairwise Granger Causality Tests			
Sample: 2004 2011			
Lags: 2			
Null Hypothesis:	Obs	F-Statistic	Probability
INCOME_0VAT does not Granger Cause OCCUPANCY_DEGREE	6	18.956	0.160
OCCUPANCY_DEGREE does not Granger Cause INCOME_0VAT		1.716	0.474
INCOME_9VAT does not Granger Cause OCCUPANCY_DEGREE	6	18.814	0.1608
OCCUPANCY_DEGREE does not Granger Cause INCOME_9VAT		1.722	0.474

INCOME_24VAT does not Granger Cause OCCUPANCY_DEGREE	6	18.858	0.160
OCCUPANCY_DEGREE does not Granger Cause INCOME_24VAT		1.721	0.474
INCOME_9VAT does not Granger Cause INCOME_0VAT	6	0.250	0.816
INCOME_0VAT does not Granger Cause INCOME_9VAT		0.250	0.816
INCOME_24VAT does not Granger Cause INCOME_0VAT	6	0.248	0.817
INCOME_0VAT does not Granger Cause INCOME_24VAT		0.248	0.817
INCOME_24VAT does not Granger Cause INCOME_9VAT	6	0.0093	0.990
INCOME_9VAT does not Granger Cause INCOME_24VAT		0.009	0.990

Source: Own calculations in Eviews software

According to the test p-value null hypothesis claiming that X does not Granger cause Granger Y is rejected for values lower than 0,05 of the associated probabilities. Thus, the null hypothesis alleged default of the associated probabilities is rejected. So, it is possible that the 9% VAT rate causes Granger the 24% VAT rate. Therefore, it is denied the nule hypothesis presumed implied, so it is probable that the 24% VAT rate to cause Granger the 9% VAT rate.

#### 4. Conclusions and discussions

By using the regression technique and Granger causality in the analysis on the impact of the VAT rate under three scenarios on occupancy degree, in the period between 2004-2011, the following were observed: all correlations are inversly proportional in the sense that a rise of 1% of the 0% VAT rate triggers a modification in the other way of 2.35% in the occupancy degree, 1% modification of the 9% VAT rate triggers a modification of 2.16% in the occupancy degree, and a rise of 1% of the 24% VAT rate triggers a modification in the other way of 1.89% in the occupancy degree. The modification of the dependent variable analysed is 24% justified by the modification

of the independent variables, that are the VAT rates. This result indicates the indirect relationship, which is strong enough, between the analysed variables.

As can be seen the tax measures affected the local tourism. The largest increase in occupancy degree is recorded for a 0% VAT rate, respectively 2.35%. This is a result that authorities must take into account if they want to support Romanian tourism. The authorities should be applied reduced Vate rate in tourism services.

We conclude that Romania can be an attractive country for the European tourists and also throughout the world. This destination has been seeked by external tourists and had a developed domestic tourism which was supported by the Law of Tourism since the interbelic period. At the beginning of the 70's, Romania was already known on the market of the main European countries that generated tourism, such as Germany, UK, France, Italy, Austria or Belgium. But unfortunately in the 80's, this country had suffered a decline of the foreign tourists, trend that had gone even more in the 90's.

The main cause for this happening was the missing of small development investments, modernization and renovation of infrastructure (road, building), because of the process of privatization, inexistency of banking systems. So, Romania is moving slowly regarding the performance of the tourism industry.

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## The Role of Social Balance Sheet in a Modern Accountancy

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### Abstract

*Reporting social behavior of the company in a similar annual reporting of financial matters, supports the establishment of a social report (corporate social reporting) between the entity and the community to which it belongs. This analogy with accounting and financial reporting is imposed today in France, where the term retained by law is the social balance sheet. The practice of social reporting is also generally associated with the financial reporting: a growing number of companies worldwide publish, together with their financial situations, social data to supplement and clarify the financial information made available to shareholders and the public .*

*The economic environment is increasingly intertwined with the social one, so that the performance of a company no longer refers only to the financial one, being considered also the social one, and increasing the organizational value can no longer ignore the interests of shareholders, employees and business partners.*

**Key words:** social balance sheet, accounting, performance, costs, benefits.

**JEL code:** M14, M41.

### Introduction

The enterprise has represented and will represent, especially on free markets, a pace of conflict, to a lesser or higher degree. Conflicts can be regarded as normal and even desirable events and to a certain point as a factor of progress. Social responsibility is also a subject that arouses fierce controversy between a commercial company and the external environment, but also the internal one. Interpretation of the same economic

results differs for the social policies implemented and for those involved.

For example, shareholders appreciate a dynamically social policy, with favorable implications for medium and long term on economic and financial performances of the enterprise.

Worldwide, the social balance sheet is recognized as a tool to promote the amelioration of these conflicts.

### 1. The emergence and evolution of the concept of social balance sheet

The notion of social balance sheet has its beginnings in France, being presented in a law of July 12, 1977 as a specific document, standardized and mandatory for enterprises and units with more than three hundred employees covered by legislation on works committees. It appeared as the result of the Sudreau report regarding enterprise reform, the context in which public authorities wanted to establish a social dialogue on specific elements and objectives, based on objective indicators, which remain constant every year. Currently, the complexity of social problems involved in economic activities as the preparation of this balance is to involve a broader range of indicators and actors within the company.

After 1979 have emerged certain summary of the social balance sheet, ADIA Institute having a pioneering role.

Only after 1980, the social balance sheet data were effectively material for a socio-economic accounting of whose object is represented by the hidden performance and for a social accounting, whose object is to evaluate costs and benefits, such as the impact of measures to improve working conditions on productivity.

After 1990 have emerged empirical works which have tried to identify the most important variables into the external financial diagnosis, the problem being to identify

immediate or delayed associations between financial performance and some indicators extracted from social balance sheet: education, absenteeism, dismissals or work accidents indeed appear to be significantly associated with productivity and profitability.

Since 2000, based on American works in the field, it started the execution of rating the large companies listed on stock exchanges globally significant from their social balance sheet data.

## **2. Social balance sheet – a modern accounting tool**

Social balance sheet is defined as a report presenting the costs and benefits of an economic entity according to the environment into which they operate, in order to inform the various social groups involved. That consists of two key parts: the enunciation of a social policy, the objectives and measures for their implementation and a report on the adjusted value obtained by the entity and its distribution on the national economy.

The term “balance sheet” it doesn’t transform this report in which it means an accounting balance sheet. The social balance sheet is a document drafted as a table that contains a number of quantitative information only expressing the social status and working conditions in the enterprise. So, it must be understood in the sense of an inventory, a report similar to the Health Check.

Management control is essential in the approach of elaboration of the social balance sheet. In this regarding is necessary to share indicators related to the structural indicators, which expresses the patrimonial situation at a time (eg number of employees) and performance indicators, which present variations (eg promoted employees). Through their analysis can be drawing conclusions concerning the measures taken by the entity. For example, if 50-60% of employees were become aware, through the deployment of some special courses, on the need of compliance with the rules of health and safety work, the risks of labor accidents and the rate of the latter decreased by 10-15% it may be that there is a profitable relationship between the action and result.

By adding data from the social balance sheet, the effect of the efforts of the entity

may be translated as a reconciliation between results indicators and resource indicators (eg, impact of increased security spending to the rate of accidents or training expenses of raising qualification).

Using social balance sheet may differ according to the role and purpose. So, it may take the form of:

- an information tool when operating in environments in which the dissemination of its information. Benefits of a large dissemination are limited by the abstract of numbers, the absence of comments, so an essential condition is represented by the ownership of financial and accounting knowledge to understand and interpret the content of indicators and method of analysis. Without a prospective nature, social balance sheet is an incomplete instrument of information – it doesn’t present the draft amendments to staff levels etc. – and does not define the business strategy, instead provides elements of social policy evaluation, contributing to social diagnosis of the entity.
- an instrument of settlement of conflicts, in that it satisfies the need for accurate social information and facilitates the establishment of agreements between the various stakeholders.
- a social management tool, providing a diagnostic of strengths and weaknesses of the social subsystem of the enterprise. Remedial measures are then integrated into a comprehensive social planning and management.

Indeed, the data is not defined or treated in an identical manner from one company to another. For example, gross wages are sometimes in gross expression, sometimes in net expression; sometimes is taking account of the last salary of the year, sometimes reduced to a monthly average for that year, it may include bonuses or not...

## **3. Reflecting social costs and benefits in the accounting of enterprise**

Social costs are the main strategic target of social responsibility policies implemented by a company, having the role of compensation to the community when it caused some damage. In the same category are found also the cost of other stakeholders: investors,

creditors, customers, suppliers, employees etc.

Among the main social costs can be listed the safety and health requirements at work. The importance of this issue has increased in recent years, both social and economic reasons. Work accidents are transferring the responsibility on employees but also on the company. The costs of work accidents, but also the benefits of prevention activities, are illustrating the diversity of financial gains and losses, requiring social and economic assessment for such events. The determinants of social costs are identified according to the purpose of evaluation, the possibilities of entity to collect an appropriate amount of data, its economic activity, and stakeholder interests. For the employees, considered individually, the economic effects are difficult to express, especially injuries involving long-term sequelae after. When, following the accident, the victim fully recovers, having a limited period of disability, the costs may be expressed more easily. At the enterprise level, these costs are determined by the immediate effects on health of employees involved, but also on the production interruptions. It is noted so that the prevention activity determines not only to reduce potential damage but also technological modernization.

Consumption and production decisions of an entity are generally based on costs and benefits for it. Some decisions generate costs and benefits for other businesses. Thus, can be distinguished between private values and social values. In the same way can be distinguished private costs and benefits (generated for an entity by an activity undertaken by it) and social costs and benefits (generated for another economic entities or for community). Private benefits can take the form of income, when the company conducts its activities to maximize profit or satisfaction, when the activity is focused on customer needs.

Social benefits can be exemplified in different ways: when an entity uses in its work heavy machinery it concretizes the access routes to the headquarters or working points, obtain private benefit, protecting and facilitating the access for the engines. Private benefit, with reducing pollution and protecting the health of people living or working nearby constitute the social benefit.

Speaking of costs, typically the social ones, generated by an economic activity, are higher than the private ones because of shortcomings due to the natural environment.

Analysis from private and social costs and benefits is based on the notion of externality. This implies that the activity of an agent A brings services or disservices activity detrimental to an economic agent B, but the first does not consider these issues in his decisions on such activity. The agent A will direct his attention to the problems caused by agent B, only if he will require a compensation. If the latter benefits from the activity of agent A, then agent A has the right to seek retribution and will take account of benefits received in the decision to realize the activity. In both cases, the agent A has internalized his business benefits and costs and externalities arise when social costs or benefits are superior to private ones, resulting in negative externalities, which are positive.

Accounting is providing unable to translate in terms of social costs a malfunction, such as the absence of a worker or the reduction work motivation of staff. Absences, failure to technological specifications of the equipment or product quality, increase inefficiently the production cost.

#### **4. Using for a social rating**

The aim of this approach is to make a diagnosis, not by reference to social policies of the enterprise, but by comparison with the general and sectoral norms, in order to inform providers of funds and financial analysts about the risks involved in the management of the company. Arcimoles did not consider these associations sufficient to validate the utility and relevance of social balance sheet, but he admitted that some indicators are susceptible to announce the economic performance of enterprises, especially because of possible warning signals that indicate more problems than successes.

Social balance sheet provides the foundation for a social rating which may permit assessment of risk by investors and that, by its nature discriminatory, it's likely to operate businesses differentiation.

Indicators of social balance sheet analysis allow an evaluation of social policies of the

company or by an internal auditor or by an external consultant. Three stages can be distinguished in the process: a social balance sheet data analysis highlights the company's characteristics, evaluation of social policies and coherence between these policies and characteristics of the previous medium-term projection assess this coherence. In the latter case, the analysis should be based on internal sources of information larger than social balance sheet. By adding data from the social balance sheet, the effect of the efforts of the entity can be translated as a reconciliation between results indicators and resource indicators (eg. impact of increased security spending to the rate work accidents or training expenses of raising qualification).

## 5. Conclusions

The term “social balance sheet” may seem exaggerated; indeed, it does not involve a balance between jobs and resources or between costs and benefits and the document does not include information that allows articulated overall coherence. It represents an inventory balance is in the same way that one can speak about a Health Check; it alone is not sufficient to give a diagnosis, but provides elements that, after analysis, can contribute to a diagnosis.

The role of social balance sheet, as a mean of information and social reporting tool, is widely appreciated. Although many critics are sometimes strong, no one thinks about the cause (especially the unions), on the contrary, all parties concerned want to improve it, in the desire to stimulate the social debate. Considering the social balance sheet the disadvantage of a formal ritual than one depth. As a planning tool it can be estimated that in most companies with more than three hundred employees, social balance sheet in the development integrates social scoreboard, which is an interesting development.

A rigorous strategy of internalizing the externalities related to social impact of an economic entity has as result obtaining some economic benefits for the entity (direct interest) but also for stakeholders (indirect interest). Internalization of social costs directly affects the outcome of the current result (economic, social or environmental) by determining current costs and future obligations.

Cost-benefit analysis represent the method that determines the social and environmental performance indicators, parameters increasingly required of both internal and external environment of the company, to have good relations with those involved in its activities (employees, suppliers, creditors, etc.) but also with civil society (the community in which it operates and the general public).

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## 7. Acknowledgements

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# Integrating Sustainability into the Firm Accounting through the Environmental Balance Sheet

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## Abstract

*The economic practice has shown that speculative businesses are leading to tensions in the relationship with the natural environment, resulting in even endangering of the continuity. Economic prosperity can not exist without respect and concern for people, environment or community as a whole. Accounting modernisation, in the context of globalization and internationalization, should not assume only the development of new definitions, concepts and standards, but also the implementation of practical solutions to solve the problems faced by enterprises, third parties and the community as a whole.*

*This paper aims to present a recently introduced tool in the economic practice: environmental balance sheet. It also wants to analyze its role in presenting environmental performance of an enterprise as a factor for the economic and financial influence.*

**Key words:** environmental balance sheet, sustainability, performances.

**JEL code:** M41, Q56

## 1. Introduction

The idea of integrating a company's accounts with its natural environment occurred in the early 1970s. This concern of economists to consider environmental externalities has been observed since the '60s, but only ten years later was formally expressed by requiring of the report developed by the Club of Rome. However, the idea remained only at the level of intent until the late of the '80s, when the notion of externalities had passed the traditional accounting limit to the natural environment, so there was what is called the environmental accounting.

Over the passed century, characterized by industrialization, thick smoke and contaminated water were regarded as a necessary evil and even as a confirmation of the successful industrial activities.

Nowadays, civil society calls for protect the natural environment by reducing pollution and conserving natural resources. For this purpose are carried out more and more sustainable development policies, eco-efficiency for the environmental information dissemination. Socially responsible behavior is increasingly becoming a key success factor as differentiates companies on the market, the preferred being the ones that contribute to sustainable development. Not only the business partners but also the civil society are waiting from companies both high quality and measures to protect the environment by reducing consumption of natural factors and the volume of waste discharged or by obtaining biodegradable waste.

Awareness of these issues is a matter not dealt with locally or regionally, but globally. It might even say that, in fact, environmental problems are first expressed globally through the voice of some NGOs and associations working in the field, then try taking them to regional and national level. Environmental protection expresses all the actions taken under internal and external rules of the company, whether voluntary or compulsory. Compliance criterion is not an economic one, but aims to prevent or reduce environmental impacts.

## 2. Integration of environmental issues into accounting

Traditional accounting concerns the environmental issues from two perspectives:

- the functionalist approach, which ignores environmental issues in the accounting process, excluding natural resources or any others that can not be reliably

measured. Thus, people are considered more important than nature, but also the profit obtained more important than capital, tangible assets outweigh the intangible ones;

- the green approach reflects the preoccupations for environmental protection within the accounting process.

An environmental accounting may more accurately reflect the impact of human activities on nature and the environment has value only to the extent that people appreciate the results of exploitation of its resources. Thus, present serious problems such as exhaustion of deposits of oil or the disappearance of forest areas could be even partially resolved through a more effective use of these resources by traditional accounting. An evaluation of resources efficiency in the future may solve the current problems of the environment.

A comparison between environmental and traditional accounting is summarized in the table below.

*Table 1 – A comparison between environmental and traditional accounting*

<b>Traditional accounting</b>	<b>Environmental accounting</b>
General accounting	Negative added value and development of the environmental actions included in the traditional accounting
Analytical accounting	Life Cycle Analysis
Social accounting: collecting information in physical data (numbers, statistics...), leading to the presentation of a social balance sheet	Environmental report: collecting information in physical terms (the amount of pollutants emitted...) and monetary (the environmental investment costs) Sustainable development report: environmental and social data collecting

*Source:* Colasse, B., avec la collaboration de Cédric Lesage, *Introduction à la comptabilité*, Editions Economica, Paris, 2010, p. 749.

In other words, environmental accounting represents that method that measures an organization’s performance in economic terms related to the environment as a tool for identification and evaluation costs of projects

and activities that support biodiversity and human health. This information corroborated by management decisions to not harm the environment, such as the implementation of sustainable practices to conserve natural resources for future generations.

### **3. The economic performances reflected by environmental costs and benefits**

Environmental damage caused by a company and whose prevention or remediation remains under the responsibility of the community, are called externalities. Environmental costs occurs each time that the company will internalize these externalities by taking preventive or remedial expenses. The environmental expenses can involve either the production process (clean technologies) or the product itself (cleaner products).

This definition can hardly be applied in practice. On one side, the “clean” use of a product depends not only on the product itself but also on its use beyond the company and, secondly, in the absence of clear procedures, may be achieved some results almost absurd, for example: it is considered that since a product is safe, all costs incurred in production contribute to environmental protection.

Identification and recognition of environmental costs are significant in making positive management decisions. Thus, can be exemplified as environmental costs:

- costs of alignment with the environmental legislative requirements;
- environmental remediation costs, pollution control equipment, non-compliance fines;
- other costs involved in environmental activities, even if not explicitly required by applicable law.

There are also cases when it is difficult to separate the environmental costs for the health and safety or risk management. Here can be considered the costs of “clean” technologies, the costs of monitoring categories of raw materials and suppliers, etc.

Costs caused by the economic impact on the natural environment, include environmental costs and costs of repercussions. The first ones can be separated into prevention and restoration costs and the

repercussions ones in avoiding and treatment costs.

The rules governing these issues fosters internationalization of additional costs to the environment. Costs must be known by companies so that they comply with the environmental standards and conform with monitoring and reducing pollution costs and with the preparation of the documents and reports required. Entities need to understand the potential monetary rewards gained by implementing environmental performance, an important role having, in this sense, the work of professional accountants. They can influence the management decisions, may propose the implementation of economic policies that take into account the environmental damage from the use or natural resources. Economic activities should aim to reduce costs and waste, both natural and financial resources.

The implementation of environmental performance in large companies led to the identification of products and services necessary for the introduction of green business, able to adapt to environmental changes and maintaining good relations with funders, local communities etc. The organization that effectively monitors the environmental pressures, being concerned about the associated costs and benefits requires different types of expertise: technical, environmental, financial, accounting, marketing, management. Professional accountants have once again a significant contribution, because they have access to internal information, they can check their qualitatively level and can be used in investment decisions.

If the activities and resources used can be measured by charges then the costs and benefits of environmental management are more easily perceived by managers.

The most common costs induced by environmental impact are related to raw materials that affect the natural environment, from fines, penalties, waste management, products, etc. The generated obligations are related to the costs incurred by remediation of sites affected or by damage caused by disputes related to environmental impact. These obligations may also be of a fiscal nature, such expenses for carbon dioxide emissions (emission taxes), and green technologies generate tax revenue.

We can also talk about environmental assets, which according to the standards are included in the category of tangible or intangible and environmental liabilities. These are obligations that require future payments due to past events or compensation to a third party harmed by environmental damage and may be employed or potential. Into the financial statements must be recorded any environmental objective which results of operations involving other parties or train current and future financial obligations known and estimable. Environmental assets and liabilities are usually integrated into accounting posts, legal rules do not require separate presentation only for those elements that should be reflected separately in the notes.

Financial accounting theory does not recognize the environmental costs as part of production and administration costs of an enterprise so they are not recorded in specific accounts, but are considered overhead costs. So, there is a tendency of their separation of the products, processes or activities that cause them.

#### **4. Environmental balance sheet – a tool for information on the sustainability**

In the most developed countries, companies operating with an impact on natural environment must obtain the functioning authorizations from various authorities in the field. Usually, obtaining this approval is preceded by the development of an environmental balance sheet. This is a continuous improvement tool that offers, at a certain moment, the image of the reality on the economic activities impact on the environment and sustainable development as well as environmental performance registered by a company whereas.

Environmental balance sheet has certain similarities with the social one, firstly from the definition, both being monitoring tools, offering the opportunity to intervene to correct weaknesses. Secondly, the term “balance sheet” can be misleading. This is not the purpose of a balance sheet, a parallel array reflecting the amount of existing and recorded consumption, trying to maintain a balance. Equally as the social on, the environmental balance sheet represents a

report showing that effectively the present or future impact of a company's work on the environment.

According to the nature and size of business, the environmental balance sheet may take various forms:

- a simple characterization of the activity sheet;
- an extensive study, an analysis of available information on the state of the environment and economic activities conducted on a particular location;
- a study accompanied by technical investigations by sampling water, air, soil and various measures of the site.

Generally, an environmental balance sheet includes elements of:

- the activity natural site description;
- identification of the potential polluting, with the implementation of pollution scenarios confirmed or refuted by specialized measurements (soil, water etc.);
- safety emergency measures already implemented or planned for the future;
- monitoring the impact of the site exploitation, including a conservation program elaboration;
- determining the residual risk, by creating a conceptual scheme of the site.

Elaboration of such a balance sheet is based on environmental indicators used in environmental reporting. The OECD framework presents three types of indicators:

- “pressure indicators” that highlights the economic activities and social pressures on the environment and presents the causes of environmental problems (eg industrial production, energy consumption, waste produced);
- “status indicators” emphasizes physical changes or developments in the environment (eg air quality, nitrate concentration);
- “response indicators” showing the efforts made by a company to improve its environmental degradation or decrease (eg expenses for alternative energy, protection costs, recycling costs, penalties, fines).

An environmental assessment may be required also for reorganization or liquidation of a company whose activities has an impact on the environment, in addition to the

balance sheet and, where appropriate, of the social one. It is made either at the request of the manager, investors or to the syndic judge’s request, if necessary.

Managers, shareholders as well as other stakeholders, to which the company has a certain social responsibility, acquire, through accounting, information on the effects of economic growth on environmental opportunities. Ideally, all that means the impact of an entity on the community and natural environment should be presented in a separate accounting system. In practice, only a small part of the externalities are internalized, voluntarily or by coercion rules. Without this information, decision making system can not operate in a consistent manner in the conduct of business and capital management. Worse than the absence of an item is the erroneous internalization of which may directly affect the economic performance indicators.

So we can talk about an conventional accounting as an informational system in order to efficiently measure the past economic events and document the present economic performance.

## 5. Conclusions

Are expecting from the companies quality products and services, but also measures directed towards the social needs and environmental protection, such as a rational use of natural factors, as well as a low negative impact achieved by reducing the volume of waste discharged or producing biodegradable waste.

Tools such as environmental management accounting are useful for identifying externalities that will be treated as current income, through internalization, or will be transformed into future obligations.

To be relevant, information must comply with environmental standards integrated in the accounting (traditional accounting is primarily an information system on the financial situation of the company), the most important accounting principles to be considered are those of permanence methods, prudence and continuity.

The enterprise is often using on its production processes natural raw materials that are the result of years of geological evolution (wood, oil ...). The market prices of

these resources does not take into account geologic time scale accumulated for obtaining them. It might imagine a system of accounts to reflect the environmental costs evaluation to express in financial terms the use of geological time, regardless of market price of the natural resources. For example, the oil price would be expressed in terms of value and hours of labor time involved in obtaining it. Such an approach would be difficult now, but can not be excluded the emergence of management tools for this purpose.

Thus, with a descriptive character rather than prescriptive, the environmental balance sheet consists in a set of statistical tables that provide information about the environment, either in physical or monetary units, accompanied by a statement of the company's management about its environmental strategy and the means used in achieving the established objectives.

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# The Evolution of the Number of the Disabled Persons During the Period 2000-2011

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## Abstract

*In this paper I want to emphasize the evolution of the number of disabled persons. Having in mind this objective I took in mind three important issues such as: the infrastructure, the evolution of the number of the people in need and the structure of the people wich benefits from the system. Furthermore I manage to give valuable solution to increase the finance of the system and the capacity of the system te react in time to any demand.*

**Keywords:** social protection, budget, GDP

**JEL classification:** H60, I00, I 31, I38

## 1. Introduction

The romanian social protection can be analyzed as a system or by parts. According to the legal regulations can benefit by the national system of social protection each individual even if he did not pay any tax or contribution.

The source used to finance the romanian national social protection system is the taxes paid by employees and their employers.

Having in mind that Romania is a member of the European Union his citizens can benefit, in certain conditions stated by the local legal system, by social assistance according the the european directives and regulations.

Romania must do further progress to achieve the quality required by the european social protection system.

## 2. The structure of the system

The persons with diasbilitis enjoy from a special socail protection. The state ensure the achievement of an national social protection of equality of chances, prevention and

treatment of the disability, in order to ensure the participation of this persons to the effective life of the community, respecting the rights and the duties of the parties and guardians.

The National Authority of the Persons with Disabilities in the core of the public central administration wich coordinates, the activities of special social protection and promotes the rights of the persons with disabilities, elaborates the policy of the sector, the strategies in the domain of the promotion of the rights of such people affected by handicap, it ensures of both the control of the application of the legal regulations and the activities of special social protection.

Even than the National Authority of the Persons with Disabilities has in his schedule a High Comission which must asses the adult persons affected by any handicap, with decision making capacity in solving the appeals to the certificates of handicap issued with a clasiffication by the County Comission or the Comission of the Municipality of Bucharest, the trust of the public is still reduced.

The special social protection of the persons with disabilities, as an institutionalised form, it is realised in by bringing assistance, care, treatment, recovery, rehabilitation, professional formation and guidance, as well other services in specialised institutions.

Such institutions of special social protection are founded and function as public institutions and they can be:

- pilot centers;
- care and assistance centers;
- recovery and rehabilitation centers;
- integration centers for occupational therapy;
- protected family housing;
- day care;
- early intervention center;
- other forms.

In the area of this special social protection the efforts were focused on the development and the implementation of the public policy on the protection and both social integration and inclusion of the person.

Judging the social assistance network on 30 June 2011 the structure was as follows:

Figure 1. The national network of assistance of the disabled persons



Source: <http://www.mmuncii.ro/pub/imagemanager/images/file/Statistica/Buletin%20statistic/2011/Handicap%20sem%20I-2011-site.pdf>, accessed at 21 january 2012

The main objective was the creation and the development of the community social services system which could come in support to the institutionalised disabled persons, allowing them to live their life independently, being assisted by an support network.

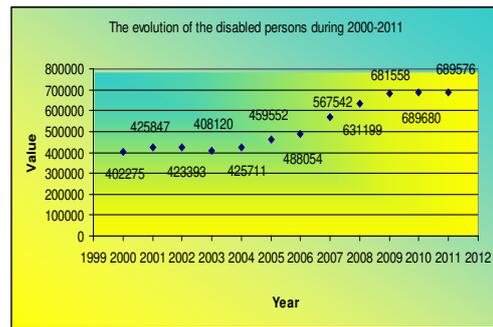
Now the social protection of the disabled persons can be made in two separate ways such as: in special institutions of the state and to their home.

### 3. Beneficiary

Also it is very important to analyze the evolution of the number of the persons with disabilities which benefits by this type of social protection. This way it is very important to analyze the statistics regarding the number of the people with disabilities during 2000-2011.

As it can be seen from the figure 2 the number of the persons with disability has grow year by year with an average of 26,118.

Figure 2. The evolution of the persons with disability during 2000-2011



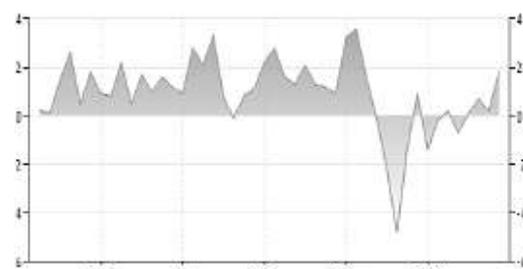
Source: The Ministry of Labor, Family and Social Protection

Having in mind this evolution it is very important to emphasize that from the year 2000 to 2006 the number of the disabled persons has grown only by 21,32 % meanwhile in the period 2006-2011 the growth was by 41,29%.

The highest rate of growth was recorded in 2007 when the overall number of the disabled persons has an extra of 16,28%. As it is shown in the figure 2 the number of the people with disabilities has an important evolution.

This evolution has been generated by socio-economic issues. Since 2000 the romanian economy has started the recovery process after a transition of an decade. After the year 2000 until 2008, as figure 3 show, the economy has started to grow in an sustainable manner. Both the employment rates and wages grow.

Figure 3. Romania GDP growth rate



Source: <http://www.tradingeconomics.com/romania/gdp-growth>, accessed at 22 april 2012

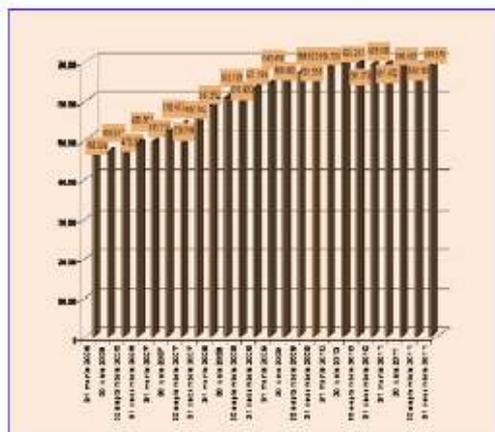
Since 2006 the number of the disabled persons grow because the amount for which they were entitled was better than nothing and most of the those entitled were old and without any hope to find a job until they achieve the age to retire to pension.

According to the figure 3 the number of the people with disabilities in Romania was at 31

december 2011 with 49,68% bigger than in 31 march 2006.

Overall we can see that each year the number has grow with an average of 45776,6 people.

Figure 4. The evolution of the numer of people with disabilities during 31 march 2006-31 december 2011



Source:<http://www.mmuncii.ro/pub/imagemanager/images/file/Statistica/Buletin%20statistic/2011/2011%20DGPPH.pdf>, accesed at 22 april 2012

The growth of the number of people of disabilities can be explained by three hypotheses:

- the benefits offered to this category of population are considered to be sufficient to show the locomotor or mental deficiency ;
- there are important changes to the colective mentality, the person with disabilities not being anymore stigmatised by the community;
- the economic-financial recession has determined the population to adopt a self preservment behaviour, each individual tries to ensure and preserve his welfare.

The number of people registrated with a disability has reached at 31 december 2011, 689,576 with a decrease of 107 beneficiars.

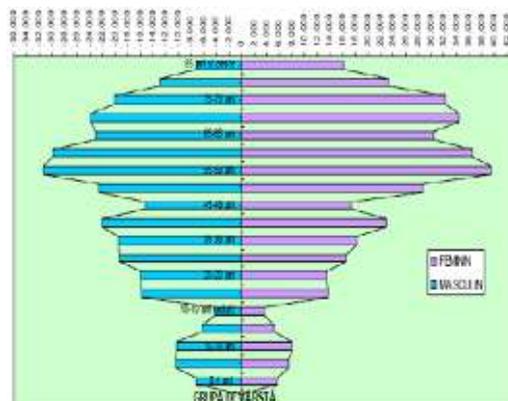
At 31 december 2011 from the overall number of the people registrated with a handicap 97,5 % (aproximately 672.403 people) are in the care of their families or they are living independently or are not institutionalised in an special institution and 2,5% (aproximately 17,173) are in the care of the public social assistance institutions for adult disability persons.

From the data published by the Ministry of Labor, Family and Social Protection I quote that the rate of the persons with disabilities is 3,22 which means than from 100 romanian

citizen 3,22 are registered with critical or not handicap.

Making an in depth analyze and having in mind, the age and gender of the beneficiary, we can observe that the majority of the persons registered with handicap is 54,1% female, 45,9 % being male, as figure 5 show:

Figure5. The group of people with disabilities by gender and age



Source:<http://www.mmuncii.ro/pub/imagemanager/images/file/Statistica/Buletin%20statistic/2011/2011%20DGPPH.pdf>, accesed at 22 april 2012

Also we can see that the most affected category of the population by an handicap is grouped during 18 – 65 years.

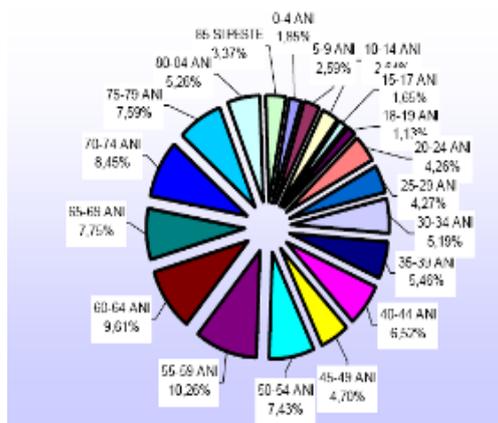
From the overall number (at 30 june 2011), of the persons with an disability 59,2% (aproximately 408,775 people) are grouped to the interval 18-65 years and 31,94% or 220,531 were grouped having over 65 years. Only 8,86 % were grouped having less than 18 years.

At 31 december 2011 the number of the persons with disabilities and age over 50 represents 65,46% from the overall of the adult persons.

Furthermore to the and of year 2011, 64,48% (405,761 persons)from the persons with disabilities were grouped 18-64 years, 35,53% over 65 years (223,545 persons).

The current proportio, by age, at 31 december 2012 was according the figure 6:

Figure 6. The proportion of the persons with disability by age at 31 december 2012.



Source: <http://www.mmuncii.ro/pub/imagemanager/images/file/Statistica/Buletin%20statistic/2011/2011%20DGPPH.pdf>, accessed at 22 april 2012

As it can be seen from the figure 6 at the end of 2011 8,73% from the disabled persons are children and 32,42 had more than 65 years.

The main issues are found to the group of people 18-64 years which had the biggest ratio, 58,85%. These people grouped 18-64 years lift the biggest issues to the state because they have the age to be employed but they are unable to do such things from serious causes.

Moreover the state must take measures to give these people a chance and grant, to the people able to work, facilities to be employee. Each state is responsible for the development and the level of life of his citizens and therefore takes measure to ensure the welfare of anyone.

#### 4. Conclusions

Having in mind the significant number of the persons with disabilities in Romania the Government must take measures to ensure to these people a good life and the support at demand. It is important to mention that the people in need can still be useful to the society and they still can give back added value to the society.

However the disabled persons can work in special conditions and they needs are special the state must coordinate the policy and his strategies to ensure the maximum employment of these category of population.

A solution can be the development of a series of state companies which will produce to the market. Producing on a reduced price

can ensure both, the state and to the people, the reduction to the state expenses and an extra income to the people in need.

The market it would be Romania and the goods could be sold on the free european market and to the state institutions to a preferential price.

Also it would be very important to emphasize that the persons which want to work should be left to work.

Nevertheless in Romania this resource is not used at his full potential, the light industry is still undeveloped and therefore the profit is reduced and the income to the state budget is low. I consider that only by using this persons and encouraging them to go to work and to produce goods the romanian society will achieve a higher stage of development.

I believe that the integration of the disabled persons is the next stage of development of the romanian society. The integration of this category of population would have only advantages to the society and to them.

One of the most important advantage in by nature financial, the expenses with the disabled persons are reduced and the funds can be used in other areas to encourage the national economy. The same result can be obtained through the social reinsertion of this persons.

The most important difficulty of the system lies on assuring the sufficient financial resources to create the equilibrium between the income and the expenses of the system. This equilibrium can be achieved in two ways:

- reducing the number of beneficiary and exposing the fraud from the system;
- assuring an adequate finance to the system and financing some public investment (light industry) for the disabled persons.

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## The Family Allowances in Romania During the Period 2004 -2011

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### Abstract

*In this paper I tried to present the evolution of the family allowances in Romania, identifying to each one the positive and negative trend. Also had in view and the abrogate allowances and I made a comparison between the 2 legal regulations which were in force during 2004-2011. I started this paper by identifying the conditions needed to be fulfilled to benefit by the family allowance right and after that I done an in depth analzye of each allowance.*

**Keywords:** social protection, budget, family allowance

**JEL classification:** I00, I 31, I38, J18

### 1. Introduction

The state allowance for children is a way of monthly financial support granted from the state to the families with children and it represents an universal right for each child and it is paid from the state budget according to the law 61 related to the state allowance for children from 1993.

The grant of the allowance for children depends by the age of the child, citizenship, the domicile of the parents and finally by the child scholastic situation. The right of allowance is granted for the under 16 year child and if the child takes a way of education the right can be paid until 18 years.

The kids which have a 1 or 2 grade of disability can benefit by the state allowance until 16 years. Also the disabled children can benefit by allowance to the 18-teen birthday, and after that they will be protected by the state social assistance. Until the age of 18 the disabled children which are in the family care can benefit by the state allowance in the amount established by law, with 100% increased.

The funds used to pay the child allowance

are supported from the state budget.

The keeper of the child allowance right in the child. The allowance is paid to one of the parents, by agreement with him, to the tutor, trustee or to the person to whom was given in foster care to grow, or by any case. After the child makes 14 years the allowance can be paid straight to him.

Besides the children born from the parents marriage, are still entitled the allowance, on the same terms, the children from the previous marriages to the husbands and which are in their care, the children from wedlock, which are recognized and to whom was established the affiliation by court order as well as the children in foster care according to the law.

The allowance is not granted for the 7 years children which are not going to school, exception being the sick children which are not attending the school from serious medical reasons which can be proved.

The child allowance is not paid in the months in which the holders of the right are for more the 15 days in foster care institutions or in social assistance institutions which assures the full sustenance. Plus the child allowance is not granted to the children which had their own revenues or to the children with a scholarship if they choose the scholarship. In this case the child allowance is paid during the holiday.

The Ministry of Education, Research, Youth and Sport has into his care the funds required to the pay of the child allowance for the following categories of children:

- children which are attending the school with age more than 7 years;
- children with medical issues which interrupt the school attendance from health reasons;
- children between 16 to 18 years which are attending school.

The birth allowance has as beneficiary the children mom for each one of the 4 alive children new born. The quantum of this

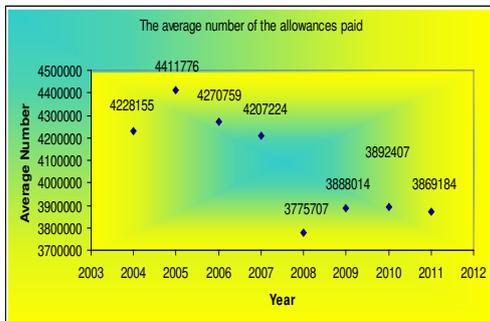
allowance is indexable, and the pay can be done to the legal representative when the mom cannot benefit by this right.

The supplementary allowance for the families with several children are paid from the state budget according the law 119/1997, the quantum of the allowance was different by the number of the children which they are in the family care.

## 2. The evolution of the family allowances in Romania

According to the data from the Ministry of Labor, Family and Social Protection the average number of family allowance beneficiary had the evolution presented to the figure 1:

Figure 1. The average number of the allowances paid



Source: The Ministry of Labor, Family and Social Protection

As shown to the figure 1 will see that the evolution of this indicator was not constant, the trend being given by the years of economic decrease and by the negative natural increase.

Also we will observe that starting 2008, the foreshadowed year of the global economic and financial crisis, the number of beneficiary of family allowance decreased by 10,26% in just one year.

Simultaneous with this decrease I found that during the period 2004-2007 the average number of beneficiary was almost constant, the data which were recorded not pointing otherwise.

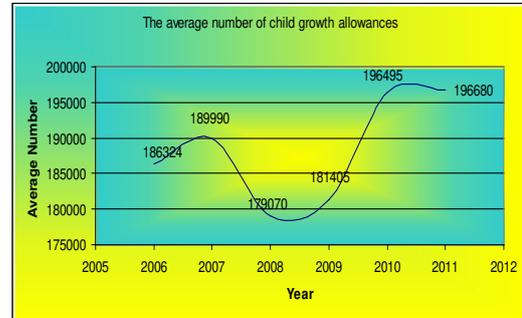
The variation during the period 2004-2007 reached - 0,49%. Analyzing in depth the statistic data I determined that, yearly, the average number of the beneficiary of family allowance has an average decrease by 55,958.

It is important to mention that during 2008-2011 the evolution was contradictory pointing both significant increase and decrease. Overall the growth was 2,48%. During 2008-2011.

Also we can note that the average number of the child growth allowance had a positive evolution. According to the data from the figure 2 the evolution of this indicator was as follows:

Figure 2. The average number of child growth allowances

Source: The Ministry of Labor, Family and



Social Protection

Having in mind the data from the figure 2 we can observe that the evolution it was not linear, the data has both periods with powerful increase and decrease. Overall I observed that during 2008-2011 the average number of the child growth allowances increased by 2846,6 beneficiaries.

Furthermore we can distinguish 2 opposite periods as follows:

— 2006 – 2008, period of decrease by 7,254 beneficiaries and in average by 3,627 beneficiaries;

— 2008 – 2011, period with an increase both at absolute level and average. Judging both, absolute and average, we can observe the increase was by 17,610 beneficiaries and the average growth was 5,870.

At the end of year 2010 the Romanian Government adopted the Emergency Ordinance no.111/2010 regarding the holiday and the monthly allowance for child growth which brings a series of supplementary regulations as follows:

— starting with the 1-st of January 2011 the persons which to the previous year of the birth of the child had 12 months revenues for which they paid income tax according to the law 571/2003 regarding the Fiscal Code, can benefit by the following rights:

1. vacation for child growth with an age less than 1 year as well and an monthly allowance of 75% from the average of incomes from the last 12 months. This amount cannot be smallest than 600 lei the maximum amount which can be paid being 3,400 lei. The persons entitled to this

allowance can benefit by an extra 500 lei if they come back to work until the first year of vacation is completed.

2. vacation for the child growth till the 2 birthday of the child as well as a monthly allowance of 75% from the average of incomes from the last 12 months. This amount cannot be smaller than 600 lei and bigger than 1200 lei.

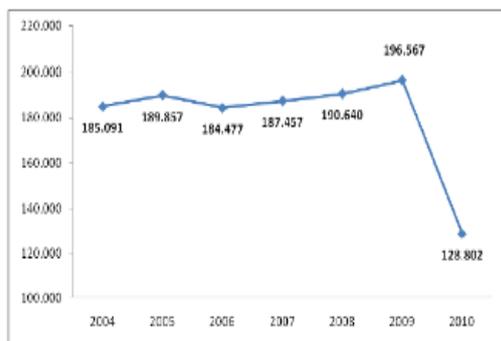
—for the disabled children the allowance is granted to the 3-rd birthday 75% from the average of incomes from the last 12 months and the amount cannot be smaller by 600 lei and must be less than 3,400 lei.

—for the people which they benefit by the Emergency Ordinance no. 105/2005, starting with 1 January 2011 the child growth allowance is paid in a quantum of 75% from the average of incomes from the last 12 months and the amount cannot be smaller than 600 lei the maximum amount which can be paid being 3,400 lei.

Having in mind that a central role to the family allowance was taken by the infant allowances we will take into consideration and this indicator, with data from 2004 to 2010.

According to the figure 3 the average number of had the following evolution:

*Figure 3. The average number of infant allowances beneficiary*



Source: The Ministry of Labor, Family and Social Protection

Taking into account the figure 3 we shall observe that the evolution was positive during the period 2004-2009, with growths from year to year, except 2006 where we observe a small decrease by 2,83 %.

Also we found that even the period 2008-2009 is considered affected by economic-financial issues and the world economies were in difficulty the infant allowance increase by 4,86%.

The data show the the average number of the beneficiary of infant allowances decrease in 2010, comparing with the value from 2009, with 66,765 beneficiaries which means that the indicator had a decrease by 34,48%.

This decrease was a consequence of the global economic-financial crisis.

Comparing with the previous values, eg 2004, the result from 2010 was with 9,3815.5 beneficiaries smaller.

Unfortunately due of the economic difficulties some of the family allowance were cancelled. The Government cancelled the following family allowances: the financial support for the family, the baby clothes, the infant allowance starting July 2010.

It is very important to mention that with the law 277/2010 according the allowance for the family sustainment a new allowance is instituted for the families with a low level of income an children in care.

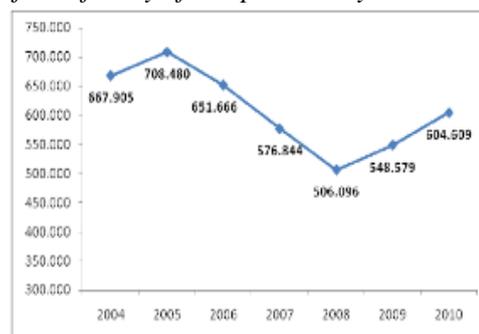
As well as the Emergency Ordinance no 105/2003 according the complementary family allowance for the monoparental family the law no.277/2010 impose the obligativity to the children to go top school in exchange for the allowance.

According to the law no 277/2010 are canceled the complementary allowance and the allowance for the monoparental family.

Also by the law no. 277/2010 was stipulated that starting 01.01.2011 will take into force a new allowance and 2 old allowance will be out of use: the complementary allowance and the allowance for the monoparental family.

Both of the 2 abrogate allowance were destined to protect the families with several children. Having in mind the complementary allowance the evolution of the average number of beneficiary was according figure no. 4:

*Figure 4. The evolution of the average number of beneficiary of complementary allowance*



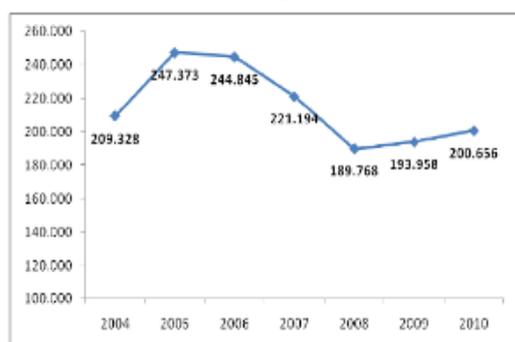
Source: The Ministry of Labor, Family and Social Protection

As it can be seen from the figure 4 during the period 2005-2008 the average number of beneficiaries decreased by 28,57%. Also starting 2008 we can observe significant growths as follows: by 8,4% in 2008-2009 and by 10,21% in 2009-2010.

Even if to the end of the period the data was positive, overall we can compute a decrease by 9,48% or in average by 10,549.33.

Judging the evolution of the monoparental allowance, figure 5, we observe that the average number of beneficiaries decreased by 1,445.33. Also we can observe, during 2004-2005, an increase by 18,17% and during 2006-2008 a decrease by 22,5%. From 2008 to 2010 we can mention an increase but only by 5,74%.

*Figure 5. The evolution of the average number of beneficiary of monoparental allowance*



Source: The Ministry of Labor, Family and Social Protection

Due of the law no 277/2010 in January the new allowance was not paid because the was established previously that the right of allowance is paid to the next month from the date of the demand, the holder of this allowance is the legal representant of the family.

### 3. Conclusions

Having in mind that the Romania's population is decreasing year by year due of an aging process and both the mortality and morbidity are at a high level the measures taken can create to the future of the state budget a disequilibrium.

We consider to be fit any form of social protection which will come into help to the families with several children, no matter of the structure of the family.

Also we believe that the law 277/2010 has a gap which must be as soon as possibly corrected, between the reduced level of the amount paid to the beneficiary and the real

amount needed to maintain a certain level of welfare .

Having in mind that any economic system is constituted from capable persons to generate added value it is important to take measures to stimulate the rate of birth and the occupancy of each individual.

Even on a short time the state budget does not support any expenses on a long term this measures can create some trouble which can be heavily to pass.

I suggest, as solution, a new strategy of social development on a long term. Only by ensuring the sufficient number of workers to the future the romanian people can achieve the level desired of welfare.

The strategy must be focused on 2 sides: the professional development of people and the encouragement of natality.

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# The Impact of Financial Leverage to Profitability Study of Companies Listed in Bucharest Stock Exchange

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## Abstract

*The present study examines the relationship between return on equity (ROE), leverage, size of firms and total assets turnover. A sample companies registered under Bucharest Stock Exchange were examined. The study employed regression method to estimate the impact of debt level on profitability (measured by Return on Equity or ROE). The empirical findings indicate that high debt level causes significant positive impact on ROE. Debt is used by many companies to leverage their capital and profit. However, debt is not the only factors that effect to leverage capital and profit.*

**Keywords:** Profitability, firm size, Total assets turnover, equity multiplier

**J.E.L. classification:** C10, G10, G30.

## 1. Introduction

Analysis of the determinants of firm's profitability is of utmost importance to all stakeholders of a firm, especially to its common equity investors.

Debt is one of the tools used by many companies to leverage their capital in order to increase profit. One of the best ways in which company increases its profit is through financial leverage. Financial leverage uses debt instruments so that the anticipated level return on the company's equity would increase. The level of financial leverage of a certain company is determined by getting the total value of debt and the equity and the ratio of debt.

The use of high levels of debt in the capital structure leads to an increase or decrease in the return on shareholders' capital (ROE). ROE refers to the monetary gain by shareholders in return for the capital they would have offered to firms. Debt is always desirable if a firm achieves relatively high profits as it results in higher returns to shareholders.

## 2. Literature Review

Empirical investigations of the relationship between profitability and firm size in the past have given varying results. The nature of the relationship between firm size and profitability is an important issue that may shed some light on the factors that maximize profits.

An integration of the above-mentioned literature implies that the relationship between firm size and profitability may be positive over some firm size ranges and negative for others. Moreover, once a threshold size is reached, additional increases in size may further separate ownership from control. These arguments suggest that the relationship between firm size and profit can become negative beyond the threshold firm size (Amato and Wilder, 1985).

Du Pont chart analysis can describe the relationship between profitability and the use of debt as reflected by return on equity ratio of a company. The proper use of debt can raise the return on equity ratio. This means that the company's management can make use of the debt to increase the profit. It also can indicate the ability of company's management to maximize its operation on assets in making profit (Brigham and Ehrhardt, 2005).

### 3. Model and Variables

#### The model

The study uses various sources have been used for data collection. The book value based yearly financial data from 2010 has been collected from the financial statements. Return on equity(ROE) is dependent variable while equity multiplier, total assets turnover and size are selected as independent variables.

All financial data is nominated in terms of Romanian coin. The basic estimation strategy is to pool the observations across firms and apply the regression analysis on the pooled sample. That is, a pooled OLS (POLS) equation will be estimated in the form of:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \mu \quad (1),$$

Where;

- Y represents Return on equity(ROE);
- X1 represents Equity multiplier;
- X2 represents Total assets turnover;
- X3 represents Size;
- $\mu_{it}$  = Error term.

#### Variables

##### Return on equity

One of the most important profitability metrics is return on equity (ROE). Return on equity reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. A business that has a high return on equity is more likely to be one that is capable of generating cash internally. For the most part, the higher a company's return on equity compared to its industry, the better.

One of the ways to measure the profit enjoyed by shareholders is by using return on equity (ROE) ratio. The reason is that ROE ratio is comparable between one companies to the other and can indicate the profitability of one industry with the other (Helfert, 2001).

ROE will be calculated by dividing net income with equity and multiply by 100.

We can analyze ROE using the traditional DuPont formulation which includes three components as follows:

$$ROE = \frac{\text{net income}}{\text{sales}} \times \frac{\text{sales}}{\text{total assets}} \times \frac{\text{total assets}}{\text{equity}};$$

$$ROE = \text{Profit margin} \times \text{Total Assets Turnover} \times \text{Equity multiplier}$$

There are three components in the calculation of return on equity using the traditional DuPont model; the net profit margin, asset turnover, and the equity multiplier. By examining each input individually, we can discover the sources of a company's return on equity and compare it to its competitors.

It is possible for a company with terrible sales and margins to take on excessive debt and artificially increase its return on equity.

**Equity multiplier** determines the use of additional resources that can lead to increase the financial profitability of equity and is calculated as the ratio between total assets and equity of credit institution.

The equity multiplier, a measure of financial leverage, allows the investor to see what portion of the return on equity is the result of debt.

One of the best ways in which company increases its profit is through leverage. Leverage uses debt instruments so that the anticipated level return on the company's equity would increase.

Hypothesis 1: Debt positively affects company's profitability.

##### Total assets turnover

The operating performance of a firm is examined with the use of operating efficiency ratios. Efficiency ratios scan how the firm uses its assets and capital measured by sales generated by various asset and capital components.

The total asset turnover ratio measures the ability of a company to use its assets to efficiently generate sales. This ratio considers all assets, current and fixed. Those assets include fixed assets, like plant and equipment, as well as inventory, accounts receivable, as well as any other current assets.

Hypothesis 2: Total assets turnover positively affects company's profitability

##### Size

Size is considered a key factor that can influence the financial structure of the firm. Firm size has been suggested to be an important variable related to the leverage ratios of the firm. It is also argued that relatively large firms tend to be more diversified and thereby less prone to bankruptcy. Shah A (2005), and Rajan and Zingales (1995), suggested the negative relationship between size and leverage of

the firm. While there are many different proxies for size, in this study, the natural logarithm total assets of the firm is used.

Hypothesis 3: Firm size positively affects company’s profitability

#### 4. Empirical Results

##### Descriptive Statistics

Table 1. Descriptive Statistics

	ROE	Equity multiplier	Total assets turnover	Size
Mean	0.2662	1.6716	0.7089	17.9487
Median	0.0425	1.3448	0.6953	18.0965
Maximum	17.5490	30.7016	3.0738	24.1898
Minimum	-0.1151	-55.2911	0.0457	13.8660
Std. Dev.	1.7554	6.7620	0.5065	1.61233

Table 1 provides the descriptive statistics of return of equity, equity multiplier, total assets turnover and size.

The return on equity vary widely among the companies analyzed, fluctuating between a minimum of -0.1151 and a maximum of 17.5490. The average of this rate was 0.2662 with a standard deviation of 1.7554. The average level of the return on equity is low, meaning the

shareholders get a remuneration close to their minimum requirements.

##### Regression Model Results

Table 2 presents the results of pooled regression analysis, in which OLS method. The model explains almost 26 % of variation in profitability, with significant F-statistic. So, this means that choice of profitability is mainly defined by these three variables, more definitely by two variable- equity multiplier and size.

Table 2. Results of regression analysis

Dependent Variable: ROE

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Equity multiplier	0.1200	0.0228	5.2512	0.0000
Total assets turnover	0.0969	0.3053	0.3173	0.7516
Size	-0.2494	0.0955	-2.6104	0.0105
C	4.4747	1.7256	2.5931	0.0110

Table 2 shows that p-value of total assets turnover is 0.7516. So, the coefficient of total assets turnover implies that it is statistically significant at the 75.16 percent level. Thus, we can say that based on p-values, in our model for listed companies just equity multiplier and size is statistically significant, and rest determinants are statistically insignificant.

Equity multiplier is positiv correlated with Profitability/ROA (0.1200; Table 2) but it is statistically significant. The results accepted any significant relationship between leverage and profitability. This suggests that equity multiplier of all companies significantly affects profitability of firm.

As far as debt ratio’s relation with profitability of the selected companies, there was a significant positive. This indicates a high positive influence on profitability, confirming Hypothesis 1.

Table 2 reports that the beta value of explanatory variable tangibility of assets is 0.0248 with the negative coefficient sign.

To test whether there is influence toward firm size partially to ROE, t test is used. Through the result from data processing, the value of t statistic obtained is equal to -2.6104, and the level of significance is 0.0105 (sig.<5%). This shows that there is significant effect between firm size and ROE. Thus, the current study does not support Hypothesis

3, as the effect of size on profitability, measured by ROE, is significantly negative at the 0.05 level

#### Examination of correlation

A correlation analysis was performed to verify a possible association between and among the variables, in order to test whether there is any linear correlation between and among the variables. Co-

Table 3. Correlation Matrix of Independent Variables

	Equity multiplier	Total assets turnover	Size
Equity multiplier	1	0.0906	0.0308
Total assets turnover	0.0906	1	0.0448
Size	0.0308	0.0448	1

## 5. Conclusions

Through this study, we analyzed a sample Romanian firms by using a pooled regression model to measure the determinants of return on equity. We have selected three independent variables with purpose to see their effect on profitability. In the analysis, we have found the affect of equity multiplier, total assets turnover and size (all are independent variables) on the return on equity (dependent variables) position of the company. With the help of regression, we find that only two characteristics- equity multiplier and size determine the profitability. We have found that equity multiplier and total assets turnover have the positive relationship and size have the negative relationship with the profitability.

Firm size has significant effects on profitability measured by ROE . However, firm size showed significant negative relation with profitability (ROE). Bigger firms may be more oriented towards meeting the goals of bondholders than meeting the stockholder needs.

In conclusion, ROE is the most comprehensive measure of profitability of a firm. It considers the operating and investing decisions made as well as the financing and tax-related decisions.

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linearity explains the dependence of one variable to other. When variables are highly correlated they both express essentially the same information. The highest correlation is positive 9.06% between equity multiplier and total assets turnover, second highest is 4.48 % between total assets turnover and size.

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# Financial Structure in the Context of Corporate Governance

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## Abstract

*The company financing decision defines one of the most controversial areas of research in corporate finance theory. Identifying the optimal capital structure involves determinants of financing policy but also aspects that relate to corporate governance practices adopted by the firms.*

*Studies of corporate governance focus on how corporate capital providers make sure that they gain from the investment in the company. Since managers are tempted to exploit weaknesses in the management contracts in order to increase their utility, the shareholders must carefully monitor them.*

*The scope of the present research is to make a review on current corporate governance models and practices and also of their impact on firm financial structure. It also aims to develop links between the various financing sources and firm value, under the operation of corporate governance mechanisms.*

**Keywords:** corporate governance, financial structure,

**J.E.L. Code:** G32

## 1. Introduction

Shareholders-managers conflict was analyzed in various studies, many of them giving it dramatic dimensions. In the last decade of last century, a new theory was launched, that managers will not the bankruptcy of the business even if liquidation would be preferred by investors. Thus, a high level of indebtedness will support the

liquidation decision, bankruptcy being more probable. A higher leverage is associated with a high value of the company and with a low probability of reorganization after filing for bankruptcy.

## 2. Corporate Governance: theory and practice

The concept of corporate governance refers to the coordination of interests of various stakeholders of the company: shareholders, managers, employees, creditors, customers, suppliers, state, etc. In every business environment, a set of specific relations between natural or legal persons who have an interest ("stake") in business manifests itself. In any entrepreneurial activity, business management or governance should take into account the conflicts inherent in the corporation created by the coexistence of this many interests. The most important conflict of interest, in terms of value and impact on corporate performance, is one between the owners and the company managers. The agent theory shows that the manager is concerned not only with maximizing the property of the owners, but also with the maximization of its own utility function. Therefore, the need for proper and strict supervision on how managers perform their contractual duties is necessary.

However, such a measure may lead to decreased management performance, creating a tense atmosphere in the workplace who could lead to overall weak financial performances. The first studies on corporate governance system emerged in the '30, based on research by Berle and Means. They analyzed the separation in value creation between ownership and management [1]. This scientific concern arose in the context of

the decline of traditional family owned firms, whose owners were also the managers.

These companies were subsequently replaced by companies with dispersed ownership, with a clear separation between ownership and control. Shareholders provide the financial funds to managers, in order for them to efficiently run their businesses. Agency problems are caused by the difficulties encountered in ensuring that investors will not be deprived of the funds allocated or that they will not be wasted [2] on investment projects with negative net present value.

The shareholder-manager relationship is defined through an agency contract, but this contract is always incomplete: it is impossible to predict accurately the likelihood of different consequences of this the relationship. In pursuing their own interests, managers will exploit the various "gaps" in the contracts. Thus, in the debates regarding corporate governance, managers "play" a very important role: they are the main "actors" that directly influence the value creation process and also have the ability to influence the distribution of wealth in the corporation.

Persistent conflict problems between shareholders and managers are clear signs of poor corporate governance, reflected in: restricting current operations, reduced profitability and dividends paid; lower quotes for company shares, excessive mobility of staff, etc. As a final effect, the company can go into bankruptcy and liquidation. In an optimistic scenario, the company can be the subject of a takeover by a competitor and management will be replaced by the new owner in order to improve general activity.

In the economic literature there are still many controversies about how appropriate or inappropriate various corporate governance mechanisms are. It is generally considered that the governance systems applied by USA, Germany, Japan and Britain companies are considered to be better, considering a worldwide hierarchy. On the other hand, in countries that are still in transition to market economy or in the underdeveloped ones, corporate governance mechanisms are practically non-existent [3]. The most representative definition of corporate governance is the one provided by experts of the World Bank as it pertains not only to how

corporate governance can be implemented, but to the affected areas as well [4]. To that end, corporate governance is a combination of laws, regulations and codes of conduct adopted voluntarily, that provide the opportunity for the company to do effectively achieve their goals and, at the same time, to ensure the generation of long-term value for its shareholders and society.

In developed economies of the world, corporate governance rules define the basic components of the business. In order to increase competitiveness and the quality of information provided to capital markets, in each country a code of corporate governance was adopted. This consists in a set of principles, standards and good practices of governance, which are only optional [5].

Studying the mechanisms of corporate governance is relevant only for large organizations where a clear separation between ownership and management exists. The legal form of this type of arrangement is that of joint stock companies, mostly listed on organized capital markets. For small organizations where only a few investors are involved in coordinating the business, corporate governance is reduced to a role of harmonizing the company relationships with employees, creditors, suppliers, etc.

### 3. Corporate governance models

Analyzing the enterprise governance structures of developed countries permits to identify specific characteristics in the Anglo-Saxon, European and Asian models. The literature identifies three main models: of corporate governance [6]:

- a) the traditional model;
- b) the co-determination model
- c) the stakeholder model

a) The traditional model is specific to the North American economies and runs on three levels: shareholders, administrators and managers. Manager's authority derives from the administrators. Under U.S. law, the right of shareholders to influence the activity of the corporation is limited to the election of board members.

Shareholders have no right to directly influence management's business decisions (eg dividends), but may act only indirectly, namely through the board ("board of

directors"), to change attitudes and decisions of managers. But the shareholders can decide to stop financing the company by refusing an eventual increase in equity. Without the financial support of the shareholders, in extreme cases, the Board could replace the Chief Executive Directors or other members of top management. [7]

b) The co-determination model is specific to Western European economies. The participants are ranked on four levels: shareholders, administrators, managers and employees. This model is representative for Germany, whose economic system is based on social co-determination, meaning that different social groups seek to raise the overall social welfare [8]. Compared to the traditional model, this one introduces a system of participatory management and the assumption that business risk is lower for shareholders than employees. The shareholders ultimately can not diversify their investment portfolio, but can make recommendations to Board to reduce risks, through a democratic decision-making process.

c) The stakeholder model is specific to Southeastern Asian economies and it is also characterized by four hierarchical levels. It differs from the co-determination model by the complexity of the relationships formed within. The model gives a high importance to each stakeholder and does not clarify the extent of their rights and obligations. This maintains a balance between decision making levels and the underlying structures.

Although these models are specific to large companies, they may apply to the smaller size enterprises, listed on stock exchanges. [9]

In Romania [10], as in other countries of Central and Eastern Europe, companies are characterized by a corporate governance model based on internal control of management and employees. If a company requires additional external funding it must make a choice between equity and different forms of debt (eg bonds, bank loans, cash credits). In an efficient capital market, the price a company expects to pay to access these sources are normally reported as a gain in risk for the securities issued by the company. The debt price tends to be less than equity, since the loans are less exposed to company-specific risks. In addition, if the

companies can not honor their obligations (principal and interest) they have the option of filling bankruptcy (liquidation), in which the control over its assets is transferred to the creditors.

It's worth mentioning that shareholders can increase their potential earnings if they can convince lenders to lend the company with other funds (for example, to convince that the cash flow distribution is less variable than in reality). If the company goes bankrupt, losses will be partly taken by lenders (because of the limited liability of the shareholders). Otherwise, additional returns will go to shareholders, who have invested less capital. Thus, they will get higher returns compared to shareholders of companies without debt or with a lower borrowing rate.

The question arises whether the financial leverage creates value, increases the value of the company or simply increases the risk (implicitly the returns) for the shareholders. These issues are central concerns of corporate finance since the publication of the famous theorem of irrelevance by Modigliani and Miller in 1958 [11]. The model proposed by these authors, states that on a perfect market, without transaction costs and taxation, financial structure of firms will have no impact on their value. Thus, decisions on capital structure will impact very little on the distribution of value among various interest holders in the companies.

These decisions will change the expectations of shareholders about the return-risk relation, but will have no impact on the total value of the company. But this perfect market model has no relevance in determining a choice of financial structure techniques for real-world companies. The model also implies that corporate governance is irrelevant in a perfect and complete market, in which all stakeholders can trade among themselves equally. It was found, by empirical means, that companies normally have a stable financial structure over time. More post-Modigliani Miller research have developed models of optimal capital structure involving maximizing firm value, in the context of achieving a compromise between the benefits of tax savings due to debt and equity costs.

The most prominent model of optimal financial structure is that proposed by Jensen and Meckling in 1976 [12]. According to this

model, in a market with zero taxation, but with heavy agency costs, capital ownership and financial structure are not independent of each other, but are chosen to minimize agency costs. Jensen and Meckling have been pioneering the development of agent theory and the theory of "optimal contracting". However, the model is based on some strong assumptions: all economic agents are rational entrepreneurs and the financial markets are efficient. Thus, agency costs will be borne ultimately by the shareholders. Agency and bankruptcy costs have a negative impact on the firm's value; on an information efficient capital market, the present value of these costs being reflected in the prices that providers of capital (shareholders, creditors) are prepared to pay.

Corporate policy initiatives have focused on agency costs associated with equity. Because debt requires regular interest payments (and refunds) it has been demonstrated that high level of debt may be important in order to reduce agency costs associated with equity in companies that register consistent levels of available cash flows that otherwise would be consumed by the management on investment projects with negative net present value [13]. These considerations are reflected in the model of "free cash flow" by Jensen (1993).

Other studies have examined the ways in which corporate managers, acting in the interests of shareholders may seek to transfer risks to other stakeholders. Also, the underinvestment issue, raised by Myers [1977] must be taken into account: shareholders may be losing if management invests in a project with positive NPV and the company suddenly enters into bankruptcy. Under these circumstances, the benefits of the project go to the creditors [14].

#### 4. Conclusion

In summary it can be stated that corporate governance (the manner in which discretionary actions are directed towards meeting the executive interests of shareholders) has economic importance only in a world characterized by equal agency costs.

The "Market timing" theory has According to this theory there is no optimal

capital structure, the firms capital structure being defined as the cumulative result of previous attempts from the company to synchronize its efforts of raising equity with the markets.

According to the briefly presented studies, debt is a valuable tool to manage and control companies, to obtain performance expected by shareholders, along with corporate buyouts, venture capital investment companies, and acquisitions of companies on credit. Among these factors corporate governance has a key importance because it allows shareholders to replace managers from office if their results fail to rise to the owner's expectations.

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# Banking Regulatory Standards Basel III

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## Abstract

*Basel Committee issued on December 16, 2010 text Basel III standards framework, which reports on worldwide regulations for capital adequacy and bank liquidity. It is estimated that the rules will help achieve financial stability and promoting economic growth. Combined with a framework of global liquidity, will significantly reduce the likelihood and severity of banking crises in the future by covering the area of micro elements and macroprudentiality.*

*The Framework sets out measures to improve the quality of capital, better risk coverage, measures to promote capital construction, which can overcome periods of stress without large gaps and introducing two global liquidity standards. Standards will be implemented gradually so that the banking sector could realize structural changes in economy without jeopardizing credit. Alongside the consolidation takes place the euro area whose main objective is to reduce credit risk in sovereign lending economy.*

**Keywords:** capital adequacy, systemic risk, financial stability, capital anticiclelic, fiscal consolidation

**J.E.L. classification:** F30, G01

## 1. Introduction

The financial crisis has highlighted weaknesses in the financial system in developed countries in the face of adverse economic conditions. In the EU, Basel II regulation in force could not prevent severe turbulence in financial markets which also imposed massive intervention at the state level for capitalization of banks in difficulty. The consequence has been strong growth in sovereign debt and fiscal deficits have now

turned into the biggest threat to world financial stability. In this context the Basel Committee on Banking Supervision (BCBS) has initiated significant reforms to the Basel II framework that focuses on the definition of capital treatment of counterparty credit risk quantification leverage financial year and the standard for liquidity –acidity in the world. Attention has focused on state banks and financial institutions framed in level 1 of systemic risk .ECB defined it “is the inability of institutions to fulfill their obligations on time and thereby cause failure of other institutions to meet its obligations on the due date. Such a situation can lead to contagion effects (for example, major problems of liquidity or credit), endangering the financial system and confidence in it. Inability to meet its obligations may be due to financial and operational problems”.

## 2. The main framework provisions

### *Reform of capital and liquidity*

- Prudential treatment of minority interest in a subsidiary bank . Parent bank will allocate a minimum proportion to its share capital to minority interest.
- Significant investments in unconsolidated joint financial institutions such as rights of mortgage, financial assets and deferred tax as a result of timing differences. Component of a bank Tier 1 of capital is limited in relation to these three elements in each case to 10% of the bank`s common equity.
- Investments in other financial institutions. Given the situation during the crisis banks were abolished restrictions on the deduction of net short positions (sale) of long positions (buying) when calculating the deduction for unconsolidated investments.

### *Treatment of counterparty credit risk*

- relaxation of the provisions relating to the hedging instruments of credit risk;

- raising the threshold from 25 billion to 100 billion USD for the correlation adjusted assets;
- market valuation of bank assets as capital market model;
- acceptance of guarantees only central counterparties (CCP) falling within risk in the range 1- 3%.

#### **Capital ratio**

One way to bypass of Basel II was off-balance out of risky assets. Subsequently imposed that these assets be subject to standard conversion factors of 10% of credit exceeding the ceiling canceling out of balance. Another important concern especially derivatives traded on the OTC, which is equivalent for a loan .

**The minimum capital ratio tier1** for banks indebted to set 5% level who was applied in bank stress tests. One of acute problems in dealing with banks was that of transparency under the pretext of bank secrecy. The crisis highlighted the need for extensive real-time information for supervisors. The new regulations provide for the level of debt and its components in the monitoring period 1 jan 2011- 31 dec 2014, then the debt will periodically publish reports which will become a requirement since 2018.

#### **Countercyclical capital buffer formation.**

Before the crisis banks amid relaxed attitude towards risk ,have adopted strategies procyclical,who not taking into account a possible deterioration in the economic environment. The event captured crisis banks without capital reserves to provide the necessary protection in optimal performance of lending. Avoid future disruptions credit cycle and the liquidity of the stock of capital required to set aside.

Measures aimed at:

- ✓ minimum capital reserve to ensure functionality during times of severe stress;
- ✓ macroprudential measures to deal with excess credit demand.

The role of vision BCBS capital reserves is to protect the banking sector during the transition periods for excess credit growth which is associated with a high level of risk in maintaining the flow of credit in the economy and avoid insolvency in times of financial stress. Each jurisdiction is free to determine the capital buffer provided that decisions are announced in advance before 12 months to allow banks to comply.

Changing the upper limit is justified only when it is establishing or provides credit growth and excessive accumulation of risk occurs at the system level. Internationally active banks will be the buffer for each geographical location, depending on the exposure to credit risk. This requires an exchange of information between the bank's home and host authorities operating under the supervision BCBS will develop the methodology necessary.

#### **Global liquidity standards**

One of the most pressing issues caused the crisis is liquidity. Migration of global capital is determined by interest rates and the growth prospects of the geographical area. In principle liquidity analysis target commitments by duration:

- **short-term** coverage is optimal 30 day liquidity to extreme stress;
- **long-term** funding level is determined in relation to *stable sources of funding* (at least one year), the "liquidity profiles" of assets financed off balance sheet exposures.

**Liquidity coverage ratio (LCR)** is calculated as: **LCR = (Active high quality) / (30days net cash outflows) ≥ 100%** Class „quality assets” include those rated as less risky assets in stable markets,such as cash reserves of central banks, state debts in the currency of the country of operation, etc. Corporate bonds can be included in this class by developing a quantitative impact study which are adjusted corresponding situation at a time. Cash is appreciated qualitatively on a funding model with stability criteria as deposits ,the coverage and security.

**Net rate of stable funding** is calculated by comparing the availability of financing needs on a one-year horizon:

**NSFR = stable funding available/necessary stable funding ≥ 100%**

*Available funds are calculated by weighting so stable:*

- 100%** - capital level 1 and 2,preferred stock and debt falling due > 1year;
- 85%** - stable short-term funds and funds from the sale of retail assets under 1mild. euros per customer;
- 70%** - funds from sale of assets with low retail;
- 50%** - unsecured deposits.

Refunds central banks are excluded to avoid addiction banking.

**Stable financing need** (RSF) is calculated also by taking into account both weight and the off-balance sheet items:

**0%**-cash, securities  $\leq$  1 year, loans to financial firms  $\leq$  1 year;

**20%**- sovereign credits from central banks, BIS, IMF, etc., at least AA rated securities risk considered 0%;

**50%**- gold, listed stocks, corporate bonds rated from AA to A maturity less than one year, loans to non-financial institutions with maturity less than 1 year;

**85%** - retail loans;

**100%** - other assets.

Coverage liquidity and stable net lending rate will receive optimum values based on detailed rules for calculating "liquid assets", treatment sovereign commitments, operational requirements and the introduction of a "level 2" liquid assets. Credit Switzerland conducted a study showing that its net rate stable funding would require european banks to attract long-term funding aprox.1300 billion euros.

### 3. Results overall quantitative impact study

Basel III rules are based on a *comprehensive global quantitative impact study* (QIS) to correctly assess capital adequacy standards. Banks selected for study were sorted into two groups depending on the impact of systemic risk.

*Group 1* included 94 banks that clasified Core Tier 1;

*Group 2*, which included a sample of 169 less systemically important banks.

First group is the highest level of systemic risk and the selection criteria were: minimum level capital of 3 billion eurors; have good portfolio diversification and active internationally.

#### *Study hypotheses:*

✓ Estimaof future developments of the banking system and was based on data from the end of 2009;

✓ Profitability of banks was analyzed two scenarios who have focused behavioral responses such as changes in capital or balance sheet composition. QIS results are not comparable with the economic assumptions that are based on predictions, taking into account management actions to mitigate

negative impacts and include estimates based on analysts private information.

#### **Study results**

▪ Capital rate as the average for group 1 was 5,7%, compared with the minimum requirement of 4,5%. For group 2 the average rate was 7,8%. For all banks in Group 1 to meet the new requirements is required additional capital estimated at 165 billion euros and the amount required for Group 2 is 8 billion euros.

▪ Minimum capital plus capital buffer is the minimum requirementof 7% (capital minimum 4,5% and 2,5% capital buffer). For banks in group 1 at the end of 2009 the deficit was 577 billion euros and 25 billion euros for group 2.

▪ The average coverage ratio of group 1 was 83%,and of group 2 was 98%.

▪ Average NSFR for group 1 was 93%, and for group 2 was 103%.

Deadlines are set to meet standards for 2015for LCR and 2018 for NSFR. Location below the minimum of 100% is necessary to achieve these standards ,*suggests that a large number of banks are vulnerable to liquidity in times of stress.* The Basel III objectives focuses capital and liquidity standards that will gradually rise to a high quality to reduce unstable funding structures. The transition period provides sufficient time for banks to move to new standards in a manner consistent with economic recovery.

### 4. A new capital standard

**Minimum capital requirement** will be raised from the current 2%, to 4,5%, phased in by january 1, 2015.

*Tabel nr.1. Capital requirements (%)*

	Equity after deduction	Tier 1 Capital	Total Capital
<b>Minimum capital</b>	<b>4,5</b>	<b>6,0</b>	<b>8,0</b>
<b>Buffer capital</b>	<b>2,5</b>		
<b>Minimum and buffer capital</b>	<b>7,0</b>	<b>8,5</b>	<b>10,5</b>
<b>Cyclical capital</b>	<b>0 – 2,5</b>		

*Source: www.riskcapital.com*

**Tier 1 capital requirement**, which includes equity and other financial instruments qualified stricter criteria, will increase from 4% to 6% over the same period.

**The buffer capital** is calibrated to 2,5% of equity after the application of deductions. The purpose of this type of capital is to absorb losses during periods of financial and economic stress.

**The cyclical capital** is set between 0-2,5% of equity applied in accordance with national circumstances. Purpose of this reserve is to protect the banking sector during periods of excessive credit growth that leads to the accumulation of risk in the system. Countercyclical buffer appear as an extension of *buffer preservation capital*. These capital requirements are supplemented by a leverage ratio of risk that will be used to accurately assess the range of banking risks. A first test, performed in several times, considered a minimum rate of 3% of capital tier 1. Based on the results and made final adjustments. For systemically important banks developed an integrated approach could include combinations of capital surcharges, contingent capital and debt relief. Since the start of the crisis, banks have undertaken substantial efforts to raise capital. However, preliminary results of the impact study shows that large banks will require a significant amount of additional capital to meet new requirements. Smaller banks, which are particularly important fit the SME – sector lending, for the most part already meet these higher standards.

*National implementation* of Basel III by member countries will begin on January 1, 2013, they are required to translate the rules into national law before that date. Starting January 1, 2013, banks will have to meet the following minimum requirements in terms of risk – weighted assets (RWA):

- equities / RWA = 3,5%
- capital Tier 1 / RWA = 4,5%
- total capital / RWA = 8,0%

Total RWA calculation is based on a complex weighting system that takes into account credit risk (MR) and operational risk (OR):

$$RWA = \{12,5 (O.R + MR) + \beta * \text{SUM} [w (i) A (i)]\}$$

where  $w (i)$  is the risk weight for asset  $A (i)$ .

Credit risk is the sum of different asset classes, each weighted by appropriate risk weight. The multiplication factor ( $\beta$ ) is esti-

mated at 1.06, based global quantitative impact study (QIS) and will be updated periodically.

*Tabel nr.2. Timing of implementation*  
*Source: www.riskcapital.com*

**Requirement for minimum equity and Tier 1** (systemic risk) will be introduced gradually between 1 January, 2013 and 1 Jan.

	13	14	15	16	17	18	19
	Implementation period ian 2013 – ian 2017						
Minimum equity	3,5	4,0	4,5	4,5	4,5	4,5	4,5
Buffer capital				0,6	1,2	1,8	2,50
Equities , plus buffer capital	3,5	4,0	4,5	5,1	5,7	6,3	7,0
Adjustment covered		20	40	60	80	100	100
Minimum capital Tier 1	4,5	5,5	6,0	6,0	6,0	6,0	6,0
Total minimum capital	8,0	8,0	8,0	8,0	8,0	8,0	8,0
Total minimum capital plus buffer capital	8,0	8,0	8,0	8,6	9,1	9,87	10,5
Capital Tier 2	Gradual elimination in 10 years from 2013						

2015 when it will stabilize at 4,5% and 6%.

**Total capital requirement** remains at 8,0% and may be supplemented by Tier 2 capital up to their elimination within 10 years.

**Regulatory adjustments** currently accepted maximum limit of 15% for investments in financial institutions, mortgage rights and the deferred tax timing differences. Since 2014, the ceiling will rise to 20 % and will increase annually in line, so the 2018 deductions will be 100% .

**The buffer capital** will be gradually introduced from January 1, 2016 and end of 2018. It will begin with a rate of 0.625% of RWA to January 1, 2016 and increase annually thereafter by an additional 0.625%, to reach the final level of 2,5% of RWA on January 1, 2019. Countries with excessive credit growth should consider accelerating the creation and countercyclical capital buffer.

**Tier2 capital instruments** to be phased out in a horizon of 10 years since January 1, 2013 decreasing at a rate of 10% annually.

In addition, instruments to be redeemed will be removed from their actual due date.

**Capital instruments** that meet the following three conditions are: issued by a corporation Tier 1; are treated as equity in accordance with accounting standards in force, are recognized as part of Tier 1 capital in accordance with national law will be removed gradually from equity and capital will be placed in category minimum capital Tier 1, from 2013.

**Liquidity coverage rate (LCR)**, after an observation period of minimum standard will be introduced on January 1, 2015.

**Net lending rate steady (NSFR)** will be subject to observation from 2012 and will apply the minimum standard in 2018.

Monitoring during the transition period is intended to examine the implications of these standards for financial markets and economic growth.

## 5. Estimated impact of economic growth

Introduction of new rules sparked a wave of reactions from the banking groups. Extension is in fact an old dispute: regulated versus free enterprise. It is hard to believe that this issue will reach a consensus once, but global financial evolution itself requires regulation and free enterprise must be manifested in this framework.

Basel Committee on banking supervision initiated a study showing the following:

✓ decline in GDP in the G-4 owing to increased regulatory level - **0.38%**, in a period of 4,5 years.

✓ decline GDP in the same area and period without introducing new regulations - **3.1 %**.

The conclusion of the study show that sacrifices optimal and results much higher benefits. These benefits result not only from a stronger banking system in the long-term but also a greater confidence in the financial system. Over a period of time, the positive effects of rules requiring banks to increase the quality and quantity of capital and liquidity reserves will exceed the costs by increasing the soundness of the financial system and reduce the probability of another crisis like the recent bank which was the worst in 1930. The report of the IIF Washington organization, which represents more than 400 financial companies in more than 70 countries said that keeping the old

financial rules would compromise the establishment of *aprox. 9,7 million new jobs*.

## 6. Conclusions

Fundamental regulatory and supervisory reforms are currently underway – both international and european – the causes which led to the current financial crisis and prevent their recurrence. In this context, *a range of policy approaches have been developed* in order to to alleviate the burden on taxpayers and *minimize the future use of public funds to rescue financial institutions*. To improve *crisis resolution mechanisms* to reduce moral hazard and build financial buffers against possible future crisis, the G20 meeting in June 2010 in Toronto, is committed to developing a new policy framework . In this context *financial sector should contribute to fair and substantial risks and possible government intervention* where they repair the financial system. Countries intending to implement measures for this purpose should meet a number of principles :protecting taxpayers ;reduce risks in the financial system; ensuring the flow of credit both in times of growth and crisis; considering the circumstances of each country, promoting confidence in the financial system,creating national systems in the *financial sector will bear the net cost of a crisis financial*.

Likewise ruled and the European Council: member state should introduce systems of taxes on financial institutions to ensure fair competition and set incentives to reduce systemic risk. Such fees should be part of a credible resolution framework. So far, eight EU countries have introduced a number of charges: Germany, France, Latvia, Hungary, Austria, Portugal, Sweden and United Kingdom. Wide national tax already is large. Thus the application of a global tax on financial transactions as a means of reducing the size of the financial sector and discourage excessive risk taking.

The European Commission has proposed a fee of *gross financial activities (FAT)*, to be levied on profits and wages ,which could be adapted to **changes** in behavior of banks, bot could be the most effective way to raise money to strengthen the public balance sheets,which were severely affected by the financial crisis. Some countries, France, Austria și United Kingdom, introduced a

threshold over which banks are subject to tax. Many countries such as Hungary, have expanded the scope of the tax and other financial institutions such as insurance. As interpreted EU, collection of taxes is directly related to the objective to recover rescue costs (contribution ex-post), or long-term establishment of a rescue fund (contribution ex-ante). *Impact on moral hazard, however is uncertain*. On the one hand, excessive risk costs incurred will be immediately supported by the financial sector. This approach is fair if the funding is affected, at least in part, the sources of systemic risk, such as excessive leverage, taking risks and maturity mismatches, etc. *Examples of different approaches*: rate proportional to the size of financial institutions (Germany); different rates for different types of institutions such as insurance companies, brokers and dealers (Hungary); lower rates for long-term financing (United Kingdom). On the other hand, there is a rescue fund may induce moral risk circumvention because there is a safety net for the financial sector is explicit. Ex-post tax system is already used by some states. An example of temporary taxes on bonuses paid in the financial sector in the UK and France in 2010. As a tax based is used, as appropriate, net liabilities, equity and other financing sources. *Parameters of tax, the rate and scope*, differ considerably from state to state.

This raises the problem of distortion of competition in the short-term as long as banks have cross-border activity. On this issue, the European Commission agreed that "in accordance with Council's report, there should be further coordination between different tax systems to avoid double taxation". In all member states that have bank charges, there are different approaches to the institutions that fall within the scope of the tax base. This variety of approaches leads to a lot of overlap and possible tax lacune. Potential risk of double taxation is particularly high when member states introduce new charges to cover subsidiaries in other countries.

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## Bank Stress Tests Methodology Used in the Euro Area

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### Abstract

*The current financial crisis imposed farms interventions of the state and banking authorities especially in economically developed areas. Difficulties of american financial system were moved rapidly around the world, most affected was euro area whose banking system is closely related to the american with an exposure of 60%. Therefore the ECB were taken immediately measures to rescue the financial system and prevention for such situation is not repeated in future. One of the most important tools developed is the “stress test” which check, especially, european banks` ability with border activity to face a new crisis. Test methodology is based on the comparative analysis of the banks evolution simulating two scenarios. Construction of basic scenario was done on statistics collected by the end of 2010. Based on these were issued medium-term forecasts on macroeconomic developments for the euro area and EU. Adverse scenario is built in order to capture macroeconomic developments worldwide. The reasoning takes into account interactions between world economies which transfers at global level both incentives and negative aspects. The results obtained revealed the gradual consolidation of the banking system.*

**Keywords:** bank stress test, systemic risk, reference level of capital, sovereign risk, margins of adjustment.

**J.E.L. classification:** F30, G01

### 1. Introduction

Stress test, which is based on methodology developed by the European Banking Authority (EBA), is an important tool of surveillance used to evaluate *european banks resistance to severe financial shocks*. Objective methodology is to develop a single

instrument for preventive detection of vulnerabilities of banking sector in E.U. and on this base taking appropriate measures for approach deficiencies. The test is applied in a coherent way to european banks assigned to the systemic risk *Core Tier 1*. According to the ECB definition, *the systemic risk* “is the inability of an institution to fulfill their obligations on time and determine by this the inability of other institutions to meet its obligations on the due date. Such a situation can cause contagion effects (for example: major problems of liquidity or credit), threatening the stability of financial system or confidence in it. Inability to meet its obligation may be due to financial and operational problems”. Classifications of ECB placed U.E. banks on two levels of systemic risk:

✓ Level-1(**CoreTier 1**), includes large banks who have a capital of *3 billion euros*, are *well diversified and internationally active*. They represent *65% of E.U. banking assets*.

✓ Level-2 (**CoreTier2**) includes *169 other smaller banks and less active internationally*.

The stress test aimed primarily banks at the level 1, which, by volume and transactions value that runs can transmit in banking network contagion effects large both domestically and across border, which would affect financial stability at planetary scale. Generally the test is designed to verify banks capacity to deal with systemic risk both in predictable economic evolution and in conditions of manifestation of the crisis phenomena. He opted for a standardized form of test to become an instrument of comparison between banks.

In this sense are built two scenarios in the period 2011-2012:

➤ *basic scenario*, which is forecast for the time horizon considered for macroeconomic developments for the euro area and E.U.;

➤ *adverse scenario*, which takes into account confounding factors most likely to

manifest globally and are calculated as deviations from the basic macroeconomic scenario.

The first stress test was performed in 2010 and used a total of 149 informations on trading activity and banks` balance sheets, so a low degree of transparency , comparable to that before the crisis. Actually the banking opacity is considered one of the major causes that triggered the crisis. The low level of banking supervision allowed to bypass rules as if Basel II norms. Conclusion of the test in 2010 was that the financial stability need much more data,situation was corrected in 2011 when was requested 3200 informations. In this context put the question of the compliance banking secrecy. Between one that led to the crisis and a real financial stability for the latter option was chosen.

*The main features of the stress test Core Tier 1 for 2011:*

- benchmark capital 5%;
- assumptions and clear definitions for building scenarios, basic and adverse;
- rules for determining the quality of capital;
- treatment of exposure to sovereign risk and the financial banking book;
- treatment of financing costs and administration;
- adjustments to sovereign exposures when market developments is adverse;
- treatment of interest income;
- treatment of risk-weighted assets (RWA) in the trading book;
- using historical averages of 5 years to determine trading income;
- establishment and use of provisions and reserves.
- offer unprecedented transparency in the E.U., using 3200 bank informations including sovereign risk leading to increased *market confidence* and the construction of an instrument of comparability of great accuracy.

## 2. Comparative analysis of stress tests in 2010 and 2011

Both tests were conducted on a sample of 90 banks from 21 E.U. countries, assigned to level 1 of systemic risk. Were applied two standard scenarios imposed by the methodology and was used as a benchmark 5%. The difference is the quantity of data used. At the

end of the 2010, a total of 25 banks were below the reference threshold of 5%, and 16 above but very close to this threshold. Most banks (51) were in the range 7,4–8,9%. European Banking Authority has set a deadline for improving the financial situation, in April 2011.

*Tabel nr.1. Test results*

CT-1	2010	2011
< 5%	25 banks	8 banks
5-6%	14 banks	16 banks
>7%	51banks	66 banks

*Sursa: European Banching Authority*

During this period banks involved in stress test have increased their capital by 60 billion euros. Capital increases are consolidated banks concerned, situation reflected in repeted stress test in 2011 when the number below the reference threshold was reduced to 8 (one < 2%, two between 3-4%, five between 4-5% ). There remained a significant number of banks in interval 5-6% which in any event of unforeseen systemic risk can fall below 5%. Other banks have a sound financial condition shockproof large hovering ranges: 5-6% - 16bn, 6-7% -18 bn, 7-8% - 11bn, 8-9% -12bn, 9-10% -7bn, >10% -18bn. Compared with 2010, when the maximum was 8,9%, not more than 37 banks have exceeded this threshold.

### Conclusions test in 2011

Extent of the investigation has surprised all *financial* and *business risks* that may occur in the E.U. banking system;

- strengthening the banking system in terms of equity positions or other financial or non-financial transactions;
- cover risks, including the sovereign, may be made in situations of extreme manifestation of adverse assumption.

### Actions following the E.U. banking supervisors .

- presentation to 15 october 2011 of plans for banks situated below 5% to exceed this threshold;
- strengthening the banks positioned in the range 5-6%;
- submitting *reports* to the EBA (*february și june 2012*) on implementation recovery plans that provide a detailed overview of measures taken;

- measures to *strengthen capital levels of banks in the country of origin standards provided*: extending funding maturities, increasing liquidity and developing contingency plans if necessary.

### 3. Treatment exposures.

**a) Treatment of exposure to sovereign risk and financial ones.** Fundamental credit analysis evaluate the scenarios impact on sovereign debt in the banking book based on the *probability of loss (PD)* and exposure to *credit risk (LGDs)*. Standardized risk calculations cover both *expected losses (EL)* and the *loss calculations(UL)*.

**b) a coherent approach to sovereign risk exposure and financial ones:**

- AAA/Aaa highest level of credibility;
  - AA / Aa2 la A-/ A3
  - BBB + / Baa1
- CCC the lowest level credibility.

Credit rating agencies provide periodic assessments of country risk. Last rating in June 2011 for EU countries, reveal a consistent recovery after crisis, with no notation CCC, and the outlook is regarded as "stable". Romania, for example, is framed on the BB+ (Fith Rating) which corresponds to a probability of loss of 3,34%.

**c) Treatment of financing costs:**

- *interest rate tend to increase*, which apparently has a *positive impact* on profits, but requires a careful treatment of interest received from loans and capital costs involved for the purchase.
- supervisors create control devices applicable to financing on the interbank market especially when the border is.
- *retail financing and official costs of financing*. EBA recommends that guidelines for the retail lending rates: application rate on *overnight* loans, and for *deposits* the reference would be *half the expected cost increase official financing market and half of the increase of the spread of sovereign loans*.

**d) Adjustments to sovereign exposures:**

- periodic assessments of sovereign bonds and the spread whichever reveal some significant short-term changes which require periodic reconsideration of the portofolio.
- changes of portofolio not automatically imply optimizing macroeconomic scenario *which is designed to understand the impact*

*of hypothetical changes in extreme circumstances the banks.*

**e) Treatment of risk- weighted assets (RWA).** Quantitatively they have reached a weight of 40% in portofolio following crisis. *Quality assurance process* revealed important differences between internal estimates and therefore offered a model to estimate the adverse scenario. It suggests applying a *scaling factor of 2,5*.

**f) Treatment of interest income in the trading book.** Because trading shocks occurs *instantly*, the methodology, allows to calculate the average income trading their last five years for all financial instruments. Reference used to determine *appropriate levels of interest income* on sovereign exposures in the trading book: applying a minimum two year adjustments to sovereign exposures or adjust existing *different exposures according to maturity*, and then include interest income of the trading risk-free rate.

### 4. Basic macro-economic scenario

Basic scenario construction was done on statistics collected by the end of 2010. Based on these were issued medium-term forecasts macroeconomic euro area and EU accept the new value the years 2011-2012. The main indicators considered representative are:

**a)** GDP was estimated amid continuing *economic recovery in the EU*, which at the end of 2010 was above forecasts. It is estimated an increase of 1,5% and 1,8% for euro area and 1,7% and 2% for the whole EU. Note that if recovery is a certainty at the aggregate progress of member state are not uniform.

**b)** With the economic recovery *situation on the labor market begins to stabilize in the EU*, with a modest improvement over the orizont. *The unemployment rate will decrease from 9,5% to 9% in 2012*. General conditions are rated as stable but implementation of policy measures taken in response to the recession and structural adjustment is conducted at a slow pace that does not give the possibility rapid improvements in this market.

**c)** *Price increase* is estimated to be modest at EU level, of 2% and 1,75%, for the euro area of 1,75% for both years. Inflation will be kept under control even if there is an

upward trend in commodity prices, agricultural products, administered prices and indirect taxes in some member state.

d) On a global environment fund return, concomitantly with the consolidation of public deficits member state begin to decline. In 2010 half of EU member state have reduced deficits decreased compared to 2009, and the next period all states shall take measures in this regard. For the EU overall, expects a deficit of 5% of GDP in 2011 and 4,25% in 2012. A further fiscal consolidation is necessary to improve the policies adopted which are essential to establish a solid basis for sustainable growth and creating jobs. Turbulence on sovereign debt market have disappeared in the absence of strong political action may recur.

e) Changes in interest rates forecast reflects investor concern that financial asset prices will rise. Short-term interest rate in the euro area are expected to rise gradually to 1,5% and 1,8% and in the long-term to 2,5% and 2,7%.

f) Based on U.S. monetary policy and projections for the euro area is expected to trend exchange rate EUR/USD around 1,39.

Tabel nr.2. Expected evolution

Indicators (%)	2011	2012
<b>EU – 27</b>		
GDP	1,7	2
Unemployment	9,5	9,1
Inflation	2	1,75
Public deficits	5	4,25
<b>EURO AREA</b>		
GDP	1,5	1,8
Short-term interest rate	1,6	1,8
Long-term interest rate	2,7	2,7
Unemployment	10	9,6
Inflation	1,75	1,75
Public deficits	5	4,25
Report EURO/USD	1,39	1,39

Source: European Banking Authority

Ascending phase of economic recovery have yet seen in moderation. If in terms of increased exports, the traditional first step of recovery, was solid, the next phase of investment demand, is still a modest evolution.

## 5. Adverse macroeconomic scenario

Adverse scenario is constructed to capture macroeconomic developments worldwide. The reasoning is considering interactions between world economies that the global transfer incentives and negative aspects. Scenario time horizon is 2011 and 2012 and captures the deviation of macroeconomic variables that have value in the basic scenario. Scenario represents *pessimistic variant* synonymous with a return to the forefront of the causes of economic and financial crisis generated it. Of the many possible causes have been retained as having a major negative impact following:

The high level of sovereign debt in the EU is in unstable equilibrium;

- ✓ Drastic reduction in world demand caused by a severe recession the U.S. economy;
- ✓ U.S. dollar depreciation against other currencies.

a) *Aggravation crisis* sovereign debts in EU will have profound effects on domestic demand and the effective functioning of financial markets. *Worsening fiscal position and their reluctance to strengthen the economy will enter a state of uncertainty effect which translates into loss of confidence of investors and consumers.* It is assumed that average interest rates on long-term euro area will grow by 7,5% and 6,6% in the rest of the EU. The effect on sale price will drop, estimated on average by 15% in euro area, and with 14% for the EU as a whole. At long-term government bond rates and sale prices believed to be modified in the first quarter of 2011 and then remain constant. *Housing prices* will fall differently in each country according to local trust level. With the worsening crisis in the EU *sovereign debt expected return tensions on european money market*, contributing to short-term interest rates on interbank markets by 12,5% similar with the scale was in period of deep crisis. Impact on domestic demand shocks sovereign extends to consumption and investment will decline in the euro area by 1,4%, and 4,5%.

b) *The severe recession of north american economy* is due to specific damage confidence following the introduction of restrictions on government spending. The shock will be transmitted to the rest of world economies and the EU preference. The

effects translate into lower private investment and consumption by 2,2% and 5,6%.

c) *U.S. dollar depreciation* is estimated at 4% in nominal terms. Basic materials and oil, which is related to the currency trading to experience price increases. A study in the euro area shows that the effect of spreading the oil price increase to 80 euros/barrel average price induces a mean price of energy products, with 38%.

Consider these shocks in the banking system testing will reveal its resistance level and allow preventive measures.

## 6. The event effects of adverse scenario in euro area and EU

Analysis of negative effects on EU countries combined effects of specific environmental impact external shocks transmitted through trade and financial channels.

a) *EU specific shocks* have strong effects on european GDP that would reduce by 1,3% and 1,5%. Transmission impact of EU specific shocks in external environment involves a reduction in real GDP in the world by about 1,5% in 2011 and 0,3 % in 2012. As a result of damage to EU exports in world GDP will decrease by about 2% on average for both years.

*Tabel 3. General effects combined, deviations from the basic scenario.*

Area/ Country	GDP growth		Inflation rate		Unemployment rate	
	2011	2012	2011	2012	2011	2012
EU	-2,1	-2,0	-0,6	-1,3	0,5	1,4
Euro area	-2,0	-2,0	-0,5	-1,1	0,3	1,2
Non-euro area	-2,4	-1,9	-0,7	-1,9	0,9	2,3
DE	-3,1	-1,5	-0,4	-1,0	0,1	0,6
FR	-1,2	-1,6	-0,3	-0,7	0,1	0,6
RO	-1,5	-1,7	-1,4	-2,6	0,1	0,4

*Sursa: European Banking Authority*

b) *The impact of negative changes in the external environment.* Their EU propagation will reduce GDP by about 0,8% and 0,5%, and HICP inflation increased with 0,5%, and 0,7% for both years. Combined these two sources of shocks generally have the effect of a reduction in euro area real GDP by

about 2% in both years. *The combined probability* of risk event listed is estimated as follows: for GDP, less than 1% in 2011 and about 4% in 2012, and for inflation of around 10%. The side effects listed on the manifest with *large government bond yields and house prices.* Depreciation yields bonds, calculated as a deviation from the reference basic scenario, is for the EU of 6,58%. Housing prices will drop, across the EU -3,8%.

## 7. Market risk parameters

The stress test requires banks to make a projection of gains and losses from trading various financial instruments: interest rates, exchange rates, commodity prices and capital, volatility and dividends. All they cover a large segment of the market and therefore requires the calculation of risk parameters calibrated by the ECB under adverse macroeconomic scenario. The parameters considered representative of the macrofinancial level, will be introduced for each case in model market risk equation based on *Standard information criteria combined* to ensure that banks bear the shocks in accordance with economic-theory. As the forecast horizon covers two years and trading is designed as an instantaneous event risk, the parameters are set within a mapped value of minimum/maximum accepted during the forecasting period (2011-2012).

Parameters for emerging markets have been calculated on a sample of countries considered sufficiently representative and to elaborate an overview over a long period of time. The risks who affects the group "other developed countries" have been calibrated as a weighted average of shocks in the euro area, U.S.,UK ,and Japan (G-4). For market risk parameters to consider a dispersion 0,25/0,75 *to the basic forecast.* Percentile choice is motivated by the need to take into account a possible excess of market risk and to mitigate the impact of uncertainty on model results. *Market risk parameters* pentru depend on the assumption for each scenario considerate evolution of macro-financial variables.

### *Assumptions of basic scenario*

- european stock prices are expected to record a decrease to 15%;
- american dollar will depreciate by 11% against the major currencies;

- short-term interest rates will increase by 12,5%;
- euro area sovereign bond yields will rise on average by 7,5% in the long term;
- commodity prices remain capped;
- market liquidity and counterparty credit risk are calibrated separately on other documents prepared by EBA.

At *macroeconomic level* increased risk of commodity price shock and other transient expression was estimated at 5%.

#### **Assumptions of adverse scenario**

Risk scenario are calculated as deviations from the basic macroeconomic specific scenario. ECB prepared for the standardized approach, risk tables with values for each EU member parts-sell credit, foreign exchange and sovereign bonds. For example, *euro area sovereign bonds will register a growth* in average interest adverse scenario of 5,1% for maturities of one year and by 7,6% to maturity of fifteen years. Romanian state bonds maturing in 10 years will have a cost of 8.7% lower than states such as Spain (14,6%).Greece(17,1%) and Ireland (19,1%).

*Margin adjustment construction is influenced by two main factors :increased credit spreads are rising sovereign risk –free interest rate of the base. Treatment of sovereign debt exposure, having baths large share they hold in portfolio assets must be analyzed under two distinct aspects: overall risk of interest rate differential between the rates as country-specific credit accordance to standard tables produced by the ECB. To sovereign risk exist indirect exposure, for positions CDS (credit default swap) which are protection contracts of credit risk. These contracts are the favorite target of speculative attacks and acts therefore the risk of default or event of interest rate risk.*

## **8. Conclusions**

The financial crisis has fundamentally changed the thinking and approach to economic phenomena . If the event until crisis is considered sufficient for a sustainable intervention by certain macroeconomic levers to combat the negative effects was used in a series of *unconventional measures* , general administrative tasks such as stress testing , Basel III regulations , provision of funds to combat future crisis ,etc . An important

aspect is to use stress tests to a incredible amount of information that were previously combined under the umbrella of bank secrecy

Perpetuating an attitude opaque when humanity supports dramatic effects of the crisis would mean total loss of credibility of the financial system . Risks induced by the financial crisis on real economy and sovereign debt level will show the long term and will require costly .

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## Innovation in Financial Services – A Theoretical Approach to Sustainable Structural Change

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### Abstract

*The present paper presents a theoretical analysis of the approaches on innovation as a determinant of organizational change. A relevant area where technology has produced many effects, bringing the need for innovation in services offered is the financial sector. Following a review of theories on innovation and its propagation, the paper presents the impact on payment systems, highly affected by innovation especially in recent decades and the impact on banks, which occurs much more specifically in the form of structural alteration.*

**Keywords:** Innovation, electronic finance, payment systems, banking systems

**J.E.L. Classification:** O31

### Introduction

From an organizational point of view, innovation can be defined as the adoption of new ideas for the foster organization ([1]). Modern literature on innovation begins however with Abernathy and Utterback, developing further through the contribution of authors such as [2], [3],[4], [5] [6] and [7]. Innovation is defined as a combination of invention and marketing, forming the basis for competitiveness ([8], [9]), namely "the adoption of ideas that are new to the organization that adopts them" ([1]). There are several types of innovations: technical, administrative, product or process innovations ([10], [11]). It is extremely important to identify not only the transformation of technological innovation of products, but also new ways to provide

services, by incorporating the information, processes and new procedures in the conduct of normal activities.

[5] speaks of, an “active inertia”, where companies that do not use their innovative potential may face a situation where unused innovation sources are sources of organizational rigidity, and even limiting their ability to enter new, small markets , ([12]). Disruptive innovation has been considered a creator of new markets, each proposing alternatives to value, with notable observations [13] on the way in which “architectural” innovation destroys current capabilities. Technological development usually consists of periods of experimentation, in which exploration and assimilation of new information is essential, followed by periods of acceptance and implementation of a dominant design. In these circumstances, we can identify several elements:

New market entrants have an advantage because they have fewer innovative constraints

In industries with high change rate, there is a “window of opportunity” rather than a benefit from first entrance, in which the first in may lose ground to other competitors with higher adaptive capacity and appropriate resources.

The opportunity to create new capacity is limited

Firms entering a market, in the “learning windows before the emergence of a dominant design, are less at risk of leaving that market ([14]).

The concept of industry or sector is a constraint in the disruptive innovation period ([15]), causing the existence of unidentified

risks, particularly by failure of companies to identify candidates in a fair way .

A commoditization can be seen as markets matures, usually caused by persistent excess capacity, increased competition, availability of capital, the desire to increase economies of scale and the existence of exit barriers. ([16], [17])

The competition increases in the, “intangible” domain, unlike previous periods in which competition was at the price level or product respectively service performance.

A company must use a wide range of business development strategies such as alliances, joint ventures, licensing, capital investments, acquisitions and mergers, to perform optimally over the life of a technology. The intended purpose of these strategies is to ensure capacity, forming alternatives to internal growth of organic nature. Potential, feasibility and effectiveness of such measures are determined by the context in which they are applied, such as use of network effects, the emergence of innovative clusters, academic influence or effectiveness of government policies ([12]).

Government policies directly and indirectly affect the availability of critical resources and development of new capacities by reducing the risks for other participants by promoting dominant designs and standards, intellectual property protection, transforming the state into a first adopter of new technologies, offering tax advantages for risky investments or increase efficiency, transparency and openness of markets.

Turning innovation into value depends on a number of dynamic elements that can be grouped into three categories ([18]), namely:

**1. dynamics at the organizational level:** acquisition and allocation of resources, technical efficiency, filtering information, response to innovation, capacity development, competition and profitability

**2. dynamics in the market:** *increasing competition*, market entry and exit of firms, technological evolution, risk aversion or sympathy, the emergence of dominant standards, adoption of new technologies

**3. contextual level dynamics:** network effects, social change, expansion of market opportunities, the effects of government policies, academic influence, availability of resources, the emergence of innovation clusters.

## The impact on payment systems

Regarding the developments in payment systems, there have been identified three types of innovations that can increase efficiency, namely: technological, regulatory and financial innovations. Technological innovations may include payment processing facilities consolidation, outsourcing of operations, checks modernization, decentralization of payment systems. These translate into fewer facilities in order to benefit from economies of scale and cost reductions. For example in the United States this consolidation has been made, and in Italy, the central bank replaced Memoranda adjacent to Ingresso nad Retail payment systems with the BI-REL system starting from 1998. The same can be observed in Spain, with the replacement of provincial clearing houses with the National Electronic Clearing System in 1996. TARGET system in Europe is another example of efficiency, based on voluntary use by central banks of a unified platform, shared with the major objective of ensuring cost-effectiveness (ECB, 2002).

Hybrid systems, such as the Paris Net Settlement (France), New Clearing House Interbank Payment System (USA) and RTGS Plus (Germany), dominated for a while the national payment systems. Classified into two categories by, they aim to finally reduce the risk of closing the transaction and reduce the cost of liquidity for payment systems with high values and include:

“**CNS - continuous net settlement**” - with net continuous compensation - similar to “**DNS - deferred net settlement**” - different net clearing systems, but using an electronic algorithm that checks if the net amount of flow of a participant fits within the balance of his account, and if the conditions are met, allows payment. “**Queue - augmented RTGS**” - clearing systems for more payments simultaneously. Subcontracting of the management system to an outside entity has as objectives the reducing costs, the gaining of experience or the reduction of the impact of of non-essential functions of Central Banks (Sveriges Riksbank, 2002), as is the case with the compensation scheme in New Zealand whose hardware system was moved outside the national territory (Reserve .Bank of New Zealand, 2001)

In contrast, there is a relatively large number of central banks that prefer to operate under their own inter-bank RTGS systems in order to maintain financial stability and market confidence. Technological innovations can be identified in the modernization of processing checks, including using the Internet, or in the permissiveness processing of multiple compensations, which significantly reduces time for processing and allows the provision of information in real time. In relation to the theory of networks there can be identified approaches such as the case of Finland where interbank funds transfer systems are based on network type infrastructure, which are integrated with banks' payment systems

Innovations in regulations focus on creating a policy framework to improve the efficiency of payment systems. These include:

1. Legislative changes - legislation can be explained by clearly defining the role of central bank in the payment system. The central bank may designate a system of strategic importance and therefore may require more stringent control regime over it, or take measures to collect statistical data and information.

2. Transparent pricing policy - as in the United States. The degree of transparency or opacity of pricing is one of the criteria of heterogeneity between central banks worldwide.

3. Cost calculation applications - helps better management and resource allocation. These - applications can be of two types: systematic or ad hoc. An example is the systematic approach of the U.S. Federal Reserve PACS system (Planning and Control System), which has three major objectives: to identify the total costs of services provided in a uniform manner for all central banks, accounting integration costs and budgets and providing consistent basis for measuring the performances of central banks.

4. Associations of payments – often with a non-profit association regime, they help the industry cost-sharing and promotion of private initiatives to improve the efficiency of payment systems. This type of organization can be found in Australia, Canada and Britain, with similar institutions in Korea and Ireland.

5. Measures of value migration - involves removal of high value transactions from the retail area to operations with large values in order to reduce systemic risk. This involves setting ceilings for payment systems under retail.

Financial innovations are focused on creating liquidity in payment systems with high values and in compensation systems. These may include the potential use of private substitutes for central bank funds to offset transactions. Also in the financial innovations category, the hybrid systems can also be included.

### **The impact of electronic financial transactions on banking**

One fast-growing industry in the financial sector refers to banking products and services packages, and is known as on-line banking. To maintain market share, many “brick-and-mortar”(banks with exclusive presence in the “real world”) have become “click-and-mortar” by adding the Internet to their methods of delivery. Specialized studies revealed that all the world's top 100 banks are offering online services for companies or individuals. Advantages of adopting Internet banking solutions are multiple: both prices and costs involved in their production are reduced. The fact that each customer can pay bills and check the online personal account reduces the time needed for processing a check after it was filed or required to pay, which amounts to an increase in efficiency of up to 25%. For example, if the client (be it individual or a company that accepts checks as a means of payment for products and services) and the check processing bank then sends it to collect funds, they will get faster over the Internet than by that of traditional means of transmission (fax, telex, etc.). Reducing this time period allows the release of funds that so far were blocked, while simultaneously reducing a company's claims. To the extent that these claims are recorded in the company's account far faster than before it can receive interest on a longer period of time. Another advantage is that information on account of personal accounts is always available, regardless of the work program of the bank, usually transfers being allowed even while the physical offices are closed. Also, the Internet enables banks to

increase their customer base, by having access to a much wider area than that which could be achieved by subsidiaries created. This may be a risk because it increases the level of competition that banks generally face, especially since the online market and participants are non-existent in the "real". This increased competition leads to the need for augmentation of the range of products and services, many of which need to be adapted or designed specifically for virtual area, such as, for example, credit cards online with instant acceptance. There are a number of risks of accessing on-line banks (non-click-and-mortar or online only), the most frequently mentioned being that of insecurity. Another risk is that the value of a subsidiary will decrease, but not to zero, as expected in the reports of the "Internet era" (1995-1999), having in mind the not so impressive evolution of exclusively online banks. Since the late '90s, the Bank for International Settlements (BIS), proposed a series of basic principles for reducing risks in the systems of electronic banking services and products, namely:

The Creation of a system of tracking electronic banking activities

1. Creating a process management system of subcontracting the relationships and dependencies with and third parties

2. Segregation of duties, databases and applications between the electronic system and the rest of the banking system (measure which was given up once the full integration of e-banking among the bank's usual activities)

3. The existence of measures and control the electronic authorization

4. The existence of the possibility of a clear audit of the electronic system, specifically the e-banking transactions

5. Authentication of each entity and counterparty data from the electronic banking

6. Responsibility for each transaction carried out online

7. A system of comprehensive security control system

8. The integrity of transactions and information on e-banking

9. Complete and transparent information on electronic banking

10. Maintaining client information privacy principle

11. The existence of continuity and contingency plans to ensure availability of electronic banking systems

12. Incident Response Plan

13. The role of the supervisor to ensure a clear and correct image on the management structure, internal controls and contingency plans of e-banking activities.

As we mentioned, there are two types of banks, which perform their daily activities using the Internet as a means of delivery:

Hybrid banks (click-and-mortar), comprising on-line services with the "real" and banks existing exclusively on the Internet.

Hybrid banks enjoy a well-known brand name, which gives confidence in their services among customers. Banks such as Wells Fargo or Bank of America provide banking and other financial services through their website, applying for a monthly subscription service makes it possible to use online bill payment service, or a commission, both of much lower value than if the transaction is done through traditional means. Physical presence is supported by a network of ATMs, especially the existence of local branches 'real', giving the client safety. By implementing an online solution, small, local banks, have the ability to reach national customers with quality services, generally using a sub-contractor to establish on-line connection, which reduces costs compared with a large bank, which usually builds its own platform.

The second type of bank is the one existing only on the Internet. The first of which we can say that is really an online bank is the Security First Network Bank (SFNB), which began trading in 1995 in Atlanta. In addition to assuming a pioneering role in terms of Internet banking, the company acquires two others they buy, and create a new company: Security First Technologies = S1, which was converted into one of the most important infrastructure providers for financial institutions offering a product called Virtual Bank Manager, used in most of the top 100 banks worldwide. Such banks record a lower profit margin than the spread between interest on loans and deposits, their costs are located at levels up to 10% of revenues, compared to brick-and-mortar banks or click-and-mortar where the minimum is 25%. They must accept

electronic deposits, because do not have a physical branch network and a transmission by mail would mean an extension of the period of processing the deposit, which is contrary to the principles of existence of such banks. The fact that they do not have brand presence as the brick-and-mortar or click-and-mortar banks makes such a bank to invest in Internet advertising and promoting their products and service packages much more than do other types of banks. To limit these costs, which in most cases, reduce the profit margin obtained by controlling cost and physical cost savings, some banks or entities providing electronic banking products and trying to establish a physical presence, as is the case E \* Trade, which placed "interactive kiosks" where deposits are accepted. Other Internet banks offer their customers the possibility to use cards issued by them in existing ATM networks of "traditional" banks ", most times the fees that the client has to pay for ATM use being reimbursed by the bank. Another option to attract customers is to provide a minimum threshold of funds in the account, much lower than for physical banks.

One of the main products offered by banks is credit to individuals and businesses. Before implementing the Internet version, the search for favorable credit terms to all bank in the area of action of the customer was a long process, consuming time and money. As with other products, characterized by price and technical features, the electronic network made it possible to compare products in a very limited time and with minimal resources. An example of a company that provides online credits is E-Loan, where you can get real estate loans for buying cars, small and medium business and credit cards. The whole process of obtaining the loan is supported by a consultancy service, which allows users to ask questions or make comments on aspects of the product, the responses being prompt, some coming of the electronic support system (similar to Office Assistant package Microsoft Office) or from consultants employed by the site if the system does not recognize the question or has difficulty in giving adequate response. E-Loan is a "white label", site bringing together several products offered by banks and credit companies in their behalf, acting only as an aggregator of demand. There are also sites

that offer products of their own. This strategy is preferred in the case of less complex products, such as bill payments (customer pays the invoice to the local government via Yahoo! Finance site, without knowing that it follows the money trail to reach its destination as long as he receives a payment confirmation from local government). When E-Loan arranges a loan application provided by an affiliate, the client benefits from a program offered through the site that can follow the evolution of credit, namely the E-TRACK. Similar programs are used by websites selling physical products, such as Amazon.com, where customers can track delivery of the product purchased. When it comes to credit the aim is to track documents, the moment and the administrative area in which they need to be approved.

### **Conclusions**

The literature offers a wide range of theories, models, strategies and development on innovation, seen as an effective way of acquiring organizational sustainability. Financial sector is one of the most affected sectors by continuous innovation, both in the services and the structures that are the basis of the business models. Innovation has specific ways of propagation and financial systems (banking and payments) are, by their network structure, extremely favorable to the pervasive and massive propagation of innovation. The paper identifies organizational changes in the international payment systems, in banking structures, and establishes for capital market investors behavioral alterations meant to facilitate innovation, and through it, the sustainability of those systems.

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## Money – Between Medium of Exchange and Institution

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### Abstract

*As one of the most debated economic concepts, with the biggest egos caused both in theory and in practice, but also one of the oldest realities, historically speaking, of the human society, it was inevitable that the money be portrayed us in different instances, depending on the emphasis on its functions (medium of exchange, measure of value, tool for preserving value), on the forms it wears, on the content revealed by the analysis of indicators and monetary aggregates (money supply in circulation), on the institutions which regulate it or on the relations that condition or intermediate it. Of all these instances, two stood in the centre of debates and of the theoretical and empirical approaches which animated the economic thinking: money as a medium of exchange and money as an institution.*

**Key Words:** money, liquidity, medium of exchange, institution.

**J.E.L. classification:** B11 ; B12 ; B13;

### 1. Introduction

Monetary phenomena are in a permanent interdependency with phenomena in other areas of the economy and shows differences in terms of the nature and conduct, from an economic and social system to another and from one stage of economy development to another. To understand the meanings of ideas promoted by various monetary theories is necessary to fit them in the general context of economic theories concerning the functioning of that economy.

Accompanying our daily life, the money strongly reveals its social function. However, it remains an extremely complex concept, difficult to define and quantify. Defining currency can be done both in an indirect

manner, highlighting the functions they fulfil, but also in a direct manner, by revealing its content.

The functional (transactional) approach of the concept of money concerns the functions it performs. The antiquity has given us in the person of Aristotle not only one of the most prominent philosophers of humanity but also an accurate analyst of political community and its institutions. Within the contents of two representative works by the great philosopher (*Ethics Nicomahica* and *Politics*), are found defined the three main functions of money to which frequent refers the Classic School (Smith, Ricardo, Marshall):

- medium of exchange
- measure of value
- tool for preserving value

Modern analysis emphasizes that money can fulfil these three essential functions due to a property which was admirable revealed by J.M. Keynes: liquidity by excellence. Because of this quality, money represents for its owner a set of options. Unlike the other goods which are characterized by a degree of rigidity in terms of choice in their use, money provide to its holder a great opportunity to have a choice: at any moment in time it can be changed on other goods and services, it allows cancelling of debts, it can be saved etc.

In terms of content, the money approach based on analysis of indicators and monetary aggregates (money supply in circulation) offers two definitions of this concept. Thus, in a narrow sense, money include cash, time deposits and traveller checks, while in the broad sense, it also includes other quasi-monetary assets, being defined as the assembly of means of payment generally accepted in the exchange of goods and services or in the regulation of a debt.

There is an approach to the definition of money which aims to describe its features as

reflected in daily life. Money appears as a social convention, being widely accepted as a medium of exchange (in exchange for goods and services) within a community. Money is a belief shared by those participating in the exchange, by appealing to it they decrease its cost (with materials and time) comparing with the situation in which, every time, they should find a vehicle to make the exchange possible. Result of the individual initiatives (and further wearing the social robe), money becomes a widely shared belief; money becomes a religion [10].

## 2. The main economic theories about money

As historical evolution, the economic theories about money promoted or the neutral role or its active one in economic and social life. In this respect, between the value of money approach and the considerations concerning its role in economic systems, different correlations can be highlighted (sometimes even opposite), depending on the economic theories in which the monetary concepts are developed [5].

In view of the ancient philosophers, the value of money was conferred by law, being ignored the issues related to the pricing mechanism or to the relationships that emerges during the exchange between money and other goods. However, the ideas of ancient and medieval thinkers were the first attempts of quantitative approach of the monetary phenomena.

The issues ignored by ancient thinking began to show interest to the analysts of monetary phenomenon starting with XIV-XVII centuries with the appearance of a new economic doctrine - mercantilism - which emphasized the role of trade, the protection of gold and silver resources and the development of state. The representatives of this doctrine, militated for determining how the state to procure as large quantities of gold and silver. Spanish mercantilism (bullionism) promoted the prohibition of leaving the country of the precious metals and the increase of exports to facilitate the input of gold and silver. In this respect, the School of Salamanca (Francisco de Vitoria, Domingo de Soto, Azpilcueta Martin, Luis de Molina) is representative.

In France, Jean Babtiste Colbert (general

inspector of finance - France's Louis XIV) initiated protectionist measures for industry and trade development as a means of promoting exports. In England and Holland, mercantilism (commercialism) considered the abundance of money as the key of nation prosperity and promoting of foreign trade as the premise of its assurance. The main representatives: Thomas Mun (one of the creators of mercantilist system), William Petty (with three significant works for economic and monetary theory, *Treatise of Taxes and Contributions* - 1662, *Verbum Sapienti* - 1665 and *Quantulumcunque concerning money* - 1682) and James Steuart. Mercantilist concept was the basis for formation of national monetary system with gold and silver as essential standards.

French mercantilist precursors, the physiocrats (Richard Cantillon, François Quesnay, Anne Robert Jacques Turgot, Pierre Samuel du Pont) claimed that the wealth of nations comes from productive work. According to modern economic theories, one of the major weaknesses of the physiocrats is the idea that only agricultural labour is valuable. The physiocrats saw production of goods and services as a consumer of agricultural surplus, while modern economists consider them as productive activities that increase national income. Physiocrats were the first well-developed economic doctrine.

It was immediately preceded by the first modern economic school, the Classic School that debuted with the publication in 1776 of the famous work *The Wealth of Nations* of the great Scottish philosopher and economist Adam Smith. Other important representatives of Classic School: Jean-Baptiste Say, David Ricardo, Thomas Malthus and John Stuart Mill. British classical economists have noted the controversy between the British Banking School and the British Currency School.

These parallels are discussed recently by proponents of endogen theory of money (Nicholas Kaldi) and monetarists (Milton Friedman). The monetarists and members of the monetary school argue that banks can and should control the money supply. According to their theories, inflation is caused by excessive supply of money of the banks. According to supporters of endogen theory of money, the money supply automatically adjusts to demand, while banks can only

control only the terms of the loans (e.g. interest rate).

According to the metalist conception, in order to serve as a measure of goods, money must have a metal base, a stable monetary system being unthinkable if the functions of money are not performed by precious metals.

Opposed to this theory, of monetary nominalism exclude the metallic basis of the money value, defining money only as a simple calculation unit. Driven by the formation and the institutionalization of banks, the nominalism (Stewart Muller, Hawtrey, Schumpeter) is dominated by the ideas of dependency between the amount of money in circulation and the quantity of goods and services, as well as maintaining the function of money as a measure of value even in conditions of sublimation of the monetary instrument. The nominalist theory became prevalent in modern economics as the quantity theory of money.

The realistic conception starts from the marginal utility of money as merchandise, focusing on the fact money meets a need which represents the demand, being an instrument of transactions, while money supply depends on the production of precious metals. J.S. Mill, British philosopher and one of the most influential liberal thinkers of the nineteenth century, supported these ideas, but unlike the first classics, he minimized the role of money in the economy, saying that nothing is more regardless than money.

With its *General Theory of Employment, Interest and Money* (published in 1936), J.M. Keynes initiated an economic doctrine that argued for an active role of public sector in economy, achieved not only through monetarist actions of the national banks, but also by a vigorous fiscal policy, both measures being meant to be a counterpart to what he considered the relative inefficiency of the private economic system and economic cycles generated by it. In *Treatise on Money* (1930), Keynes draws a distinction between investment and savings, arguing that in case the saved money exceed the amounts invested (which can happen if the interest rate is too high), is registered an increase of the unemployment rate and the economy go into recession.

One of the main critics of Keynes was Milton Friedman, American economist and statistician which remained in the history of

economic thinking as the leader of the Chicago School and promoter of a macroeconomic policy called monetarism. This current of thought was characterized by maintaining the quantity theory of money and by the new modern expression attributed to it. Friedman believes that all economic flows must be conducted by adjusting the volume of money, which is seen as an essential lever of monetary policy.

In 1871, in *Principles of Economics*, Carl Menger (founder of the Austrian School) believes that the appearance of money led to more efficient transactions and thus it made possible the development of the social institution of money. Austrian School considers money as a medium of exchange and value by the transfer of time and space, the monetary system being developed as a result of the amplification of trade relations and of the establishment of the state monopoly. Representatives of this current thinking are: Friedrich A. Von Hayek, Ludwig von Mises and J. Schumpeter. Hayek and his supporters agree with Milton Friedman in terms of inflationary growth caused by a policy of reduction the unemployment below its equilibrium level or by the monetary levers. One of his criticism both to Keynes and Friedman is the fact that analyzes are performed globally, ignoring the effects of monetary growth at the microeconomic level.

### **3. Money as medium of exchange**

In literature there are a large number of supporters of the view that the basic function of money is to allow separation in time of purchase of sale, allowing the transaction without double coincidence of desires or needs, which is a specific requirement of barter.

Money as a medium of exchange is used not because they have an intrinsic value, but because - and not only to the extent that - can be exchanged for other necessary goods. They have facilitated the specialization and division of labour because no manufacturer could not focus (specialize) only on a single product (being forced to produce other goods necessary for subsistence) if he had not been convinced that he produced a good which could be easily changed, through money, in other goods that he need.

In this respect, at the late 18th century, Adam Smith promoted the idea that specialization of production was the driving force for the emergence of a medium of exchange, arguing the fact that each individual producer will not consume everything he produce and he will want to consume goods made by other manufacturers. But in order to accomplish this fact, the trade was necessary and the commercial relations between manufacturers had to appear. He believes that without a referee of the market, some manufacturers can engage in direct trade to purchase their consumer goods, while others may engage in indirect trade relations and could keep goods for further exchanges for providing of consumer goods.

The theory of marketability promoted by Carl Menger aims to explain the origin of money, on the assumption that people accept certain goods based on the belief that others have the same desire. Among the factors that limit the degree of "marketability" of a commodity, Menger included the intrinsic values of products such as for example the cost of their storage. Evolution of money appears as a learning process that occurs over generations, in which "the practice and habit" but also imitation of successful traders was essential [6].

Paul Einzig signed on the same line stating that the primitive man is not a rational and calculated creature; his progress in adoption of money is often unconscious. But, comparatively, the primitive communities have the capacity to imitate each other their currencies and to learn from the mistakes and the achievements of their ancestors or neighbours.

It is therefore suggested that the money is established by the exchange and so it is primarily a means of it.

#### **4. Money as institution**

The approach in terms of institutional currency is not new, this theory benefit over time from its own supporters. In the literature there are many theoretical approaches but also focusing on quantitative nature which emphasises the importance of money for the economic activity considering its unique role as institution.

Viewed from this perspective, the

economic affairs are the monetary ones because money is not a simple passive insignia (symbol) of economic activity existence, but because it has an active role in shaping the characteristics of such activities. Wesley Mitchell was one of the authors who have aimed to highlight the active institution role of money that has shaped the human activity in a definite pattern. He insisted on the necessity to avoid the separation of the monetary aspects from the economic science.

Currency becomes one of the most important aspects of the human society because it models the native habits of thought. Instead of being a machine to do their job quickly and conveniently, in its absence (though less quickly and less convenient), use money carry its own distinct and independent influence [8] on what we want as consumers, on our ability to plan and on our ideals as citizens.

In approaching this concept, Luke Fantacci (Italian economist and historian) avoided the mechanical, simplified meaning specific to the neoclassical conception, considering money as a "human" institution, with a historical evolution and with diversity and vivacity which generates many theoretical challenges.

The Italian economist developed his concepts about the institutional nature of monetary evolution as a response to the dilemma previously generated by another Italian historian Carlo Cipolla, regarding the reason of historical trend of depreciation of money. While Cipolle proposed an explanation based on various causes, Fantacci put this phenomenon into account of the institutional evolution of the money and especially of its dual character.

In the modern economy, monetary phenomenon institutions (rules, organizations, procedures, tools) represents in extended sense the money, not being able to provide a definition of monetary phenomenon than by its institutions. But considering the fact it is a human creation, is subject to transformation, evolution, causing the variability of monetary phenomenon, and monetary theory.

#### **5. Conclusions**

Money is a way of thinking. The ability to understand the money during its historical

evolution is tied to our ability to reintegrate concepts and discourses that have defined and described monetary issues. It is therefore impossible to distinguish between monetary history and the history of thought.

A general definition of money should allow the operationalization of its use for analysis of the specific economic problems and should establish a dividing line between money and other money substitutes. Usually, in defining this concept, start from the three basic functions of money: medium of exchange or payment, measure of value and tool for preserving value.

Although this definition is widely accepted in the literature, it hides some of differences expressed through debates occasioned by more sophisticated approaches on how money should be defined. Some of the subtleties attempt an argumentation of necessity to define money as an institution, others, on the contrary, tries to prove that money medium of exchange is the most productive definition of this concept.

The money impact on the exchange development, on the social and economic life and on the history, generally was quite exceptional. Professor Mises (Austrian School representative) believed that rational economic activity became possible only through widespread adoption of a medium of exchange; recognition of this fact has led to the concept of price.

The role that money plays in the formation of economic phenomena was extended by the hypostasis (the concept) as institution of it. In fact, money has played an important role in economic activity, not only as a passive tool, but as an active force.

The overlap between ideas concerning the different hypostasis of money led to a better recognition of the assertion that the currency is an essential element in economic affairs.

The money is the expression of evolution of the social and economic life whose main protagonists are we humans. Over time, forms and hypostasis of money were evolved and diversified in pace of evolution of society.

An analysis in terms of forms on which currency he dressed highlights the tendency to its dematerialization, its transformation from metal coin with intrinsic value, to scriptural (electronic) money that became a necessity of modern economy.

Similarly, we can say that hypostasis of money (including the medium of exchange and the institution) and respectively the afferent theories have followed the same route. If initially the money came to support the exchange, favouring the development and facilitation of trade relations between individuals, causing also the division of the socio-economic activities, then, as amplification of business, at these primary needs joined and diversified others such as: reducing costs, reducing time transactions, their safety, treasuring desire, increasing the personal wealth.

At the beginning the money was produced privately, but its minting was monopolized gradually, first becoming the prerogative of the petty rulers, and then kings, emperors and finally governments, under which the foreign currency flow was reduced to a minimum, to the exchange rate, subject to a legal regime more or less restrictive, which affected the connections between different regions of the world market, separating the nations and "unbalanced" the international division of labour.

The following questions arise:

- In the present, the modern society is a creation of money or we still can say that we have control since the money is however a creation of man?
- What functions fulfil money earned from financial markets or currency speculation?
- In terms of institutionalization of money (especially of government interference), how close we are to perfect money and how close to a money "mediator of the global financial crisis" considering the existing global financial interconnections?

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# Companies’ Bank Lending in European Union: Principles, Forms and a Brief Analysis of Competition

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## Abstract

*Banking role in ensuring a proper functioning of the financial and monetary mechanism by facilitating performance of the cash flows in correspondence with the flows generated by the companies was the reason that bank (creditor) – company (debtor) relation was on a permanently attention of theorists, politicians and practitioners from all around the world. The countries from European Union have gone through a significant economic and financial transformation during the last decade. The purpose of this study is to examine the main components of the companies’ bank lending and also to analyse the evolution of the competition in terms of bank lending, in European Union, during 2005-2009 period. Section 1 presents the general principles of the companies’ bank lending; the second section researches the main forms of bank loans. The third one analysis the evolution of banking competition and the last one concludes.*

**Key words:** European Union, bank lending, competition, companies.

**J.E.L. classification:** E44, E51, G01, G21, G32.

## 1. Introduction

The economic development of a nation it is influenced in a significant way by the functioning of the financial and economic mechanisms which are facilitating the performance of cash and financial flows in correspondence with real flows from an economy.

The banking activity cannot be separated by the social-economy one, seen as a system. Those activities are in a dependency report and there are influencing each other. That’s way the banking mechanism has to be understood and assimilated as an element of the general development strategy of each country (Trenca, 2003).

By the position of financial intermediary, the banking system represents an important link of the national financial system, having a significant impact on the economy, in general, because it is providing the monetary resources that companies need to expand and to develop. The mutations that have a permanently place on the financial and monetary market, considering the developing of the disintermediation phenomenon, failed to diminished the fundamental role of the banking credit in economy.

The management of the credit activity has as main objectives to protect the company’s investments and to optimize the cash flow. An important function of the credit activity’s management it is represented by the lending credit control. Graham and Coyle have approached the credit control in terms of decision making required by credit dimension, on the one hand and on the other hand in terms of fulfilment the negotiated terms and conditions.

Credit control is necessary to avoid the lack of liquidity as a result of excessive investments and to achieve on optimum equilibrium between profitability and the risks it involves. Structurally, lending management is seen as a system consists of the following elements: the management of the cycle payments/receipts, establishment of the secure payment methods, credit

insurance, planning and organization systems, risk management, credit analysis, credit policy, credit limits and credit terms.

## **2. General principles of the companies' bank lending**

Banks have a crucial role in economic life, they are: facilitating the commercial transactions, both internal and external ones, providing payments and foreign exchange, involving in investment projects, either by placing or administration of the cash from economy.

In all the relations established between banks and companies an important place is occupied by the lending relations. Although lately there were significant changes on the financial and monetary market, by the development of the financial disintermediation, both in our country and at international level, bank lending is still the first choice for financing the company's current and investment activity.

The companies' bank lending is an important component of the banks' investment policy, both in terms of workload and also in terms of profit. Each loan can have multiple positive effects on the bank's activity and financial situation:

- First, it can be a quality investment. In this case, the bank, on the one hand, ensures certain income from interest and commission, and on the other hand, since the risk of the loan to enter in default is low, will not appear the problem of raising costs because of the provisions;
- Secondly, it will be a collateral revenue-generating for the bank: the charges of the related operations that will result (payments, foreign exchange);
- Third, is a good opportunity for cross selling of the whole range of products and services offered by the bank: internet banking, payroll agreements for company's employees, different types of debit and credit cards and other lending product for the company's employees, saving tools;
- Not at least, it can mean a marketing success – if the customer is a company known at a regional, national or/and international level – that can turn into a business one by attracting new customers (partners or not of the credited company).

In other words, the bank's stability and the

accomplishment of the solvability and liquidity indicators depend by the quality of the credit portfolio. This is the reason that determines the bank's management to show a special attention to the lending activity, following, on one hand, to fund the lending decisions on rigorous analysis of the credit risk and on the other hand to constant monitor and strict administration of the credit facilities granted.

Eligible companies for bank loans must fulfil some minimum conditions, such as:

- Are legally functioned and established;
- Have paid up share capital and perform legal activities according to the articles of incorporation;
- Fulfil reliability requirements: profitability, solvency and liquidity indicators;
- From the analysis of the revenue and costs budget to result that they have possibilities to repay the loan and the related interest;
- No records in Central Credit Register with outstanding amounts to other banks or to other financial institutions at the credit requirement date, and if included they have to prove that those debits aren't very old;
- Have included in their object of activity, and detailed in incorporation act, the operations that are the object of the credit requirement;
- Fit within the bank's maximum exposure to a single debtor for the requested credit, according to the National Bank's prudential and the bank's internal regulations;
- The required loan will be secured with bank accepted collateral in terms of type and value;
- No records in Payment Incidents Bureau at the credit requirement date.

## **3. Main forms of the companies' bank lending**

Lending of the companies by banks has two major forms:

Releasing the financial funds to the companies, by operations booked in balance sheet accounts

In this case, the bank directly involves in financing of the companies' business whether it is about their current activity (purchasing of raw materials necessary for the production processes, payment of suppliers of goods, pre-funding or post-funding of the contracts

for works or services, paying the overdue amounts towards public budget, etc) or investment projects (financing and/or refinancing of the expenses generated by the erected of new administrative, logistic or production premises, developing of the residential projects, purchasing of means of transport or technological equipment) which aim to increase the company storage or production capacities, upgrading or rehabilitation of the existing ones.

Issuing of commitments to provide financial funds to companies, by operations booked in extra-balance sheet accounts

In this category are included the follows:

- letter of guarantee;
- letter of credit;
- bank avail.

All these variants are the expression of the direct implication of the bank within the companies’ socio-economic life: the bank resumes (as long as there are no requests for enforcement of the issued commitments) to offer guarantees needed for obtaining the necessary financing from other banks or financial institutions or even from their business partners.

The substitution of the decision to offer some lending products to companies must start with more precisely identification of their needs but also considering the risky involved by each company. These two elements combined must guide the loans officer in choosing the most suitable product, helping him to structure the transactions in the most convenient way both for bank and company.

From the company perspective, the concordance between the contracted banking loan (in terms of amount, periods, disbursements conditions, pricing etc.) and the objectives of its own financial policy has a considerable, direct impact on the company’s cash-flow:

- Obtaining significant discount from suppliers corroborated with increasing of the company’s sales volume (with positive effect on its market share), in case of the loans for financing of the current activity or letter of guarantees (payment guarantees, performance bonds etc.);
- Increasing and/or modernizing of the production capacities, in case of the credit facilities granted on medium or

long terms;

- Improving of the financial position by improving of the levels (values) registered by the main financial reliability ratios.

Having in view the impact that the lending activity can have on the economic-financial situation of banks and companies, it is very important to be based on an analysis system that efficiently integrates the economic criteria with prudence indicators.

**4. Analysis of bank competition in terms of lending volumes in European Union**

The increased banks’ need for a stable financing led to an intensification of the competition within European Union during the financial crisis. More than that, the competition outside the EU temporary increased because of the emerging of a group of Icelandic banks within some of the members during 2007 and 2008 with pricing that sometimes exceeded the market average considerably.

The competition was also increased in some of new members (Bulgaria, Hungary, Lithuania and Slovenia) partially because of the catch-up process generated by the accession to European Union but also because of the entering of the most important financial groups on the national markets with a direct impact materialized in diversification of the lending products offers.

*Table no 1 – Total loans in EU between 2005 and 2009*

Country	Total loans granted by the credit institutions to non-financial institutions (mil. Euro)				
	2005	2006	2007	2008	2009
<b>BE</b>	363	388	417	402	372
<b>BG</b>	9	12	19	25	26
<b>CZ</b>	41	52	67	77	80
<b>DK</b>	390	447	504	554	550
<b>DE</b>	3,023	3,053	3,142	3,229	3,163
<b>EE</b>	8	11	15	17	16
<b>IE</b>	333	404	481	481	441
<b>GR</b>	148	167	199	220	214
<b>ES</b>	1,278	1,602	1,860	1,986	1,969
<b>FR</b>	1,701	1,887	2,157	2,290	2,319
<b>IT</b>	1,280	1,423	1,724	1,809	1,848

<b>CY</b>	28	31	41	54	58
<b>LV</b>	10	15	21	23	21
<b>LT</b>	9	12	18	21	19
<b>LU</b>	145	159	192	203	186
<b>HU</b>	46	56	65	76	73
<b>MT</b>	11	14	20	25	21
<b>NL</b>	926	1,006	1,067	1,102	1,156
<b>AT</b>	327	349	377	420	415
<b>PL</b>	78	96	133	158	175
<b>PT</b>	209	231	258	282	291
<b>RO</b>	16	28	42	51	50
<b>SI</b>	17	21	29	34	35
<b>SK</b>	15	21	26	31	31
<b>FI</b>	117	131	148	165	166
<b>SE</b>	325	404	443	425	459
<b>UK</b>	4,550	5,090	5,815	5,117	4,980
<b>MU 15</b>	9,921	10,892	12,140	12,734	12,686
<b>MU 27</b>	15,404	17,116	19,284	19,280	19,136

Source:<http://www.ecb.int/pub/pdf/other/eubankingstructures201009en.pdf> consulted on 07.02.2012;

The interest ratios started to decrease in many countries during 2009 highlighting a smooth diminish of the competition conditions between some of them, on the one hand, but also being linked by other factors such as the decreasing of the central banks' ratios, on the other hand.

The main structural evolutions within European Union continued in accordance with the years before triggering the financial crisis. Consolidation of the banking system and a better utilization of the resources, measured by the capacity indicators, continued on medium term, and the concentration degree remained close to the level registered during the previous years.

The increase of the banks' assets stagnated and the volume of loans registered a decrease for the first time during the period 1999 – 2009 because of some factors which influenced both demand and offer of credit funds. Nevertheless, the first noticeable signs of increase registered at the end of 2009.

## 5. Conclusions

The companies lending is a complex activity which is based especially on the viability analysis and business realism of the companies to be lend, in order to identify and to evaluate their real possibilities assumed through the credit contracts, the repayment of the principal at the maturity date and the related interest. The determination of a company's reliability is the result of a specialised bank's department and it is realised through an analyses based on the principles that ensure consideration of all relevant aspects for the company's financial and economic activities. This includes both a financial analysis of business activity based on its financial and accounting documents and also non-financial aspects of the organization, its management, ownership structure, commercial policy, market outlook and received guarantees.

The competition favors innovation, reduces costs, increases efficiency. As a consequence, it generally enhances the competition level of the banking system and the economy. Encouraged by the competitive environment, the banks offer such products and services which are highly competitive regarding quality and price. The banks play an important part in allocating the economic resources. On top of all that, they have a decisive influence in assets' transformation, in insuring liquidities and access to the payment services. The banks are the key to the economic growth and development.

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## Aspects of Social Care Institutions for the Elderly in Romania

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### Abstract

*In Romania social welfare institutions for the elderly protects elderly people in need and is an alternative to home care. Although the institutionalization of people involves some costs, however it is needed when the elderly persons have no home and they require constant care, that can be achieved at home, but no one can administer, they have no legally binding or they cannot fulfill their duties because of health, economic situation or family services and have no income. An important role was played by the NGO's that have been the model for social institutions due to the fact that they benefited from the Western states experience in social services for the elderly. Today, the NGO's provide home services for the elderly.*

**Keywords:** social institutions, organizations, elderly, social services, institutionalization, funding.

**J.E.L. classifications:** J14, J17, J18.

### 1. Introduction

In sociology, the concept of institution has two meanings. A broad sense, which involves a system of rules governing social area-family, kinship system, the system of political leadership, and school, the complex formed by all schools, courts, and a narrow sense including public systems such as: government ministry, municipality, county council. Social institutions are a crucial structural element in the system because it provides on the one hand, protection for persons in difficulty, and on the other hand, a good organization of the system included in the social systems from the EU. We recognize two types of institutions: the ones with responsibility for social care and those that are specialist in this field. The delegation of responsibilities at the local level needs

financial support from the local councils to develop institutions, specialized services and benefits. The common feature of modern social work is to develop the local level, in local communities. Currently, in Romania, the central and institutional levels are developed, but the local county, where we can find many beneficiaries of the social assistance is less developed. The second category of social institutions are the specialized institutions that operate as public or private and provide housing, care, protection, rehabilitation for the elderly, disabled, children and other people in need. These institutions are established by the county budget or local budgets and are being subordinated to the general welfare departments or the local council.[1]

Organizations have emerged from the intersection of collective action strategies to aggregate individual skills. The industrialism made the organizations the fundamental structure of action and interaction, although modern forms of organization and pre-existed in the ages that preceded it. The organization supports several meanings: the organization is always specialized, that is it has a mission which is associated with certain objectives, and the differentiation of missions and objectives is associated with technical expertise. The organization is an interaction structure, governed by formal and informal collective action generators (units). In social care we meet both the concept of institution and the one of organization. They both provide structural frames in order to initiate and carry out human interactions. The institutions formulate rules and the legal frame for the interactions and the organizations create strategies and promote actions and interactions.

Between institutions and organizations are established relationships that take at least three forms:

- Institutions are the legal base of the organizations. They sustain the organized functioning of the collective agents.

- By their performance, organizations become agents of institutional change.

- The main property institutions reproducibility. Through routine or routine patterns of behavior and relationships, institutions promote constancy.

The organizations reproduce the institutions, but they also change them, because the organizations are not dependent on institutional constraints but on other organizations and constraints that are related to the scientifically and technologically development, the distribution of wealth and income, the orientation of political interests. [2]

## 2. Social services for the elderly

The social system is represented by all institutions and organizations with social functions, programs and specific interventions by professionals, for individuals in need, and the legislative framework on which they are based. Social services, the most important structures of a social system can be: community social services, general services for home care, family or community, specialized social care services for home care and for the specialized institutions such as special schools or hospitals.

In the American social care system we find the concept of human services, in the Anglo-Saxon ones the concept of social care, in the African countries and in several Arabian countries—the concept of community development. Law No 17/2000 on the protection of the elderly defines the elderly person as "the person who has reached retirement age established by law" and it also mentions "older people receiving services and social benefits". Under the legislation, the elderly are defined by legal criteria of the standard retirement age. In this respect, the elderly are: women who are aged 57 years and 5 months, men aged 62 years and 5 months.

According to Law 17/2000 the conditions in which an elderly person can receive welfare services are: no family, no home and no opportunity to secure housing on their own resources, no income or the income is

not sufficient to provide necessary care; they are unable to provide social and medical needs due to physical or mental illness.

Elderly dependency is due to insufficient resources, but also to diseases that disrupt health: cardiovascular diseases and, degenerative diseases, diabetes, asthma, arthritis, lung problems, reduced mobility. In Romania, assessing the degree of dependency of the elderly is now done in accordance with "National Grid to assess the needs of older people", due to GD no.886/05.10.2000. For older people who are hospitalized in social units-health there is the Order No. 491/27.05.2003, "Evaluation grid for medical-social people that are hospitalized in medical - social care units".[3]

The national grid that evaluates the needs of the elderly identified three levels of dependence by assessing functional status, sensory and psycho the elderly.

## 3. Forms of elderly care

### 3.1. Home care for the elderly

Since the 60's in both the social and the political environment there was the tendency to keep the elderly at home appreciating that institutionalization would exclude the elderly from the wild life and such would induce a feeling of isolation. In order to keep the elderly at home are taken into account aspects such as: physical and mental health of elderly (high dependency care versus opportunity); the tolerance of the family and availability of community services: home care services (help households, information, nursing, geriatric), rehabilitation services (functional rehabilitation), services for terminally ill patients (especially those at end stage), social centers to coordinate services, services providing hot meals at home (meals on wheels), social canteens, day care, nursing home.[4]

A very important role in caring for the elderly is family's who should receive information and counseling services to maintain elderly in the family, information about: physical and mental changes in old age, diminishing resources and adaptation of the elderly specific diseases of old age.[1]

Each locality, taken separately, has its own resources and moreover, has its own rating system and it often dispose of certain forms

of aid, where possible. One can distinguish two categories of care: efforts directed against disability and functional disorders, and adjustment to disability living environment.

Assuring the maintenance at home for the elderly:

- Improving housing conditions is a prerequisite for maintaining quality home because living conditions of the elderly are often inadequate (old building without central heating, outside toilet, no hot water).
- The household aid is for elderly a physical, moral and social work. In addition to performing household work, also acts to maintain personal control with the outside world and a personal relationship with it.
- In France, the authorized intermediary services are realized by certain associations mandated by the older person through a contract to make the administrative procedures in his behalf.
- Home care services are nursing home care services most commonly in western European countries. They must ensure continuity of care on weekends. In some countries they are fully funded by health insurance (France). Treatment is prescribed by the doctor making the request directly to the care service and the service distributes a nurse and a nurse care, usually immediately, without prior house insurance.
- Tele-alarm is a device that allows the elderly to have help in any situation that he needs. The device shaped as a pendant, a bracelet, a watch cap, a pump or a pear is worn continuously and the elderly triggers the alarm if there is a problem. The call arrives to a listening center that helps the person in need. 2-3 persons appointed referees who may be family members, neighbors or doctor ensure the permanent availability. The elderly has the right to closure the device and he has to pay the monthly tax for it. There is the possibility that some pension houses or humanitarian organizations to finance part of the expenses.
- Meal at home or "hot meals on wheels" is performed by a service that brings home a full meal, balanced, ready.
- Supervision and care home sickness ("garde-disease") in which the patient has the possibility to appeal the placement office of

the jobs at home, providing home care in case of illness (e.g. in France).

- Other services: clothes, troubleshooting, shopping provided by legal associations born from a neighborhood or rural areas solidarity. [5]

### 3.2. Institutionalization for the elderly

The law 17/2000 on social assistance for the elderly gives the main criteria for the access of the elderly in a home care. Thus, an elderly person would require institutionalization in the following conditions: they require constant care, which can be achieved at home, but no one can administer, has no legally binding and they cannot fulfill their duties because of health, the economic or family services; the elder doesn't have his own home and income.

According to the law no. 17/2000 on social assistance for the elderly, a special home for the elderly is the social institution with legal status, providing adequate housing and food medical care, recovery and rehabilitation, occupational therapy activities and leisure, social and psychological care. According to data from Ministry of Labor, Family and Social Protection in the first half of 2010 there were 131 homes for the elderly, with a total capacity of 7122 seats. From the total capacity, 25 with a capacity of 1570 respond to DGASPC, 52 with a capacity of 3734 respond to the local council and 54 with a capacity of 1818 seats are subordinated to NGOs.[6]

The estimated number of dependent elderly people is about 450,000, of which at least 140,000 would be in a state of dependence degree; this means that formal care provided by qualified staff is extremely underdeveloped in Romania. Financing the social programs for the elderly is made from funds from local budgets, the state budget or foreign funds. Under the legal framework in force, medical services at home may be settled through sickness fund, on a supporting file, to be approved within a week minimum.

The funds distributed through transfers from the state or local budget are used by organizations for:

- The payment for the caregivers or other employees.

- The acquisition of sanitary materials;
- Purchase products for the home table or other material assistance.

Table no 1. The amounts spent in 2009 for services for the elderly in Romania under MLFSP (the latest data released by MLFSP).

Financing (lei)					
No.	Centers	Local budget	State budget	Beneficiare's contributions	Other sources
1.	Homes for the elderly	105 502 314	2 803 142	29 049 230	18 802 618
2.	Nursing and support center	129 966 474	44667 646	17 441 833	5 195 457
3.	Rehabilitation center	163 666 084	33 342 736	7 720 333	7 726 404
4.	Day center	994 372	13 445	67 418	339 165
5.	Protected housing	-	-	-	-

Source: National Council of the elderly, Analizez and reports 2010-2011, Socio-economic situation of the elderly in Romania and EU countries – Present and development perspectives.

In 2010 MLFSP, based on the law no 34/1998 the granting of subsidies for the social services for older people worth 8,505,408 lei 19,999,905.28 of the total grant from State budget. 61 are home care social services for a number of 5679 beneficiaries, with a contracted value of 4,614,644 lei, 26 are residential centers for a total of 1,087 beneficiaries, 15 are day centers for a total of 923 beneficiaries and 5 are social canteen for a number of 227 beneficiaries. In conclusion, from 322 subsidized social services in 2010,

107 were for the elderly, representing 42.53% of the funds allocated for grants. Associations and foundations are established as Romanian legal persons, private, non-profit and are accredited or licensed to provide social services. Associations and foundations can receive subsidies from the state budget through the budget MLFSP if they grant social services for people from several counties.

#### 4. Conclusions

Social services for the elderly should become a priority for social policies in Romania, especially since the life expectancy of the population has grown, on the one hand, and on the other hand we know that this segment of the population becomes more vulnerable as it gets older. In Romania an important role is the informal care provided by children, elderly relatives or neighbors but when they are missing the elderly should require admission in a center. About the home care, there are NGO's initiatives because the state didn't involve for financial reasons and also because of the Romanian cultural context where the family of the old person feels compelled to give him care.[7]

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# The Implications of Public Indebtedness on Public Expenditures in Romania

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## Abstract:

*In this article we analyze which are the mutations of public debt stock and public debt service on the structure of public expenditures. We use functional classification of public expenditures and observe their evolution by using multiple regression equation in order to emphasize the shifts of public expenditures as a response at public debt service and its stock variations along with other macroeconomic indicators which bear a significant influence on public expenditures dynamic.*

**Keywords:** Public debt, public debt service, public expenditures, functional classification of public expenditures, public expenditures mutations.

**JEL:**H50, H62, H63, H68, H69.

## 1. Introduction

In order to function the public sector requires an important amount of financial resources, intended to maintain normal functioning of the state apparatus. Implicitly the growth of public sector has imposed the demand for increasing financial resources.

As a consequence of higher public expenditures compared with smaller tax revenues the question of budget deficit covering arise. State involvement and the growth of public sector along with welfare service widening has increased the need of important amounts of financial resources to cover public sector expenditures. As long as the tax revenues didn't cope with increasing

spending, the governments were constrained to find new sources of funding – public loans.

Our main goal in this research is to analyze the implications and effects of public debt and it's servicing obligations upon the provision of public utilities.

We focus our attention on public debt and public expenditures and the relations between the public debt and the provision of public goods and services, analyzing the implications and the shifts of public expenditures composition as a response to the stock of public debt and it's service charges in total public expenditures. Along with public debt burden we use a series of macroeconomic indicators which have an significant impact over the composition of public expenditures.

Our research relates on Romanian economy taking in consideration the period of transition from centralized to the market economy, namely the period between 1990-2010, where we analyze the public indebtedness process and its impact over the public expenditures.

The structure of the paper include firstly the data and methodology used to test the mutations of public expenditures structure under public debt stock and its service variations and secondly we debate the results obtained where we focus our attention upon the impact of public debt and service burden over the composition (functional classification) of public expenditures and its evolution.

## 2. Literature review

Through our analysis we try to answer the following questions: *How does public debt*

*servicing affects public expenditures composition?*

In situation when public loans crowd-out private capital, the economy will go bankrupt if the mechanism of financing public deficits through public loans fails. From this statement we can understand the importance and the long-run effects of government austerity. In situation when public sector has defaulted, austerity measures are required and fiscal policy has to be responsive. The application of austerity measures can be operated only if the private sector can sustain and can respond proper to the budget constraints.

In situation of bankruptcy, government have two main solution to act, either they cut spending or they increase taxation. *Kannan and Pillai* (2001) consider that public utilities optimal provision, and the rationale of this supply can be placed in a simple classic framework where if the benefits of productive efficiency outweighs the cost of allocative inefficiency, then the society will have a welfare gain from maintaining the natural monopoly organization of a public utility.

*Buchanan* (1962) in his debate about the Public principles of debt, stress that public debt issue has normally been conceived as appropriate only for the financing of genuine public investment. The classic consider that access to debt issue might lead to irresponsible spending decisions on the part of legislative assemblies and executives.

*James Buchanan* at the question: *When should the government borrow?*, the author answers that it should borrow only to finance long-term or capital investment projects which are expected to yield benefits over future time periods. A very important statement made by Buchanan is that “it becomes essential that some method of financing the debt service and amortization be adopted at the time of the initial decision. It is the height of folly to allow individuals to choose a bond issue to finance a long-term project within corresponding means of paying the service charges”.

Another option when government could borrow is the issuance of public debt used to finance self-liquidating projects, meaning by this projects which will directly yield to the government a money return sufficient to service and to amortize the debt, when a

project is self-liquidating, then sufficient funds are earmarked for debt obligations.

*Greiner* (2004) sustain that “*the decline of public investment as a result of rising public debt is not too surprising*“, given the fact that once the government decide to finance the majority of public spending with an important amount of borrowed resources, which bear interest and has to be repaid at maturity affects the resources left for other public spending categories, once the stock of public debt is a significant one. Our analysis have a literature background, where empirical studies of the determinants of public debt were carried by several authors: *Ugo Panizza, Lima and Forslund* (2006; 2011) in their research paper use empirical data to study public debt characteristics in developing and emerging countries and the correlation between country features and domestic debt share. In addition, the authors find that bond market development is positively correlated with: trade openness, total public debt, institutional quality and the lack of capital controls.

On the other hand, *Madhavi* (2004) analyses the effects of external public debt burden on the composition of public spending using an panel sample of 47 countries for 1972-2001 period. The main findings of the paper are that high public debt levels are accompanied by high interest payments, fiscal austerity and changes in spending priorities that will require important shifts in budget shares of various spending categories. Particularly, the pattern of adjustment in spending mix, is influences by the burden of debt , which invariably changes the composition of spending in favor of interest payments and displace the share of nonwage goods and service category.

*Dreher et al.* (2008) test the implications of globalization over the government restraints, and analyze the effect of globalization upon the composition of government expenditures. The authors employed two different datasets and various measures of globalization to analyze the influence over the government expenditures. Regarding to the impact of globalization and external factors over public expenditures, *Gemmell et al.* (2007) has obtained the same results. In their paper, the research is based with two assumptions, the compensation and the efficiency hypothesis, that are supposing

that globalization affects both total and the composition of public expenditures in different ways.

In analyzing the relation between public debt and social expenditures *Lora and Olivera* (2006), the authors find that higher debt ratios reduce social expenditures, not just because of extra cost in interest payments, but because they are associated with cuts in total expenditures that affect the social sectors. Debt creates important shifts in social expenditures mainly because it reduces the room for further indebtedness.

*Fosu* (2008) analyze the impact of external debt-servicing upon the composition of government expenditures. The main findings are the same with *Lora and Olivera* (2006) where debt-servicing burden produce negative shifts of public expenditures, in particularly the social sectors of health and education and from public investment.

The changes of public debt service are deleterious on social sector, with a strong mutation in financial resources allocation where one standard increase in public debt burden is equal with a reduction of nearly one-third of share allocation to the social sector.

*Signe Krogstrup* (2002) analyses the effect of asymmetric debt service obligations on primary spending in EU countries, the authors main findings are that high debt countries have smaller public sectors and higher taxes, particularly in the short-run, and low debt countries have a bigger public sector and low rate of taxation.

*Krugman* (1988) debates in his paper the issue of building stock of public debt, reaching the point of debt overhang problem when “the expected value of potential future resources transfers is less than its debt”.

Particularly for developing countries the problem is more acute when inherited debt is larger than the present resource transfer that their creditors expect them to make in the future. First negative impact of debt overhang is the less incentive effect of countries to invest, mainly because an important amount of public resources is already absorbed by debt-servicing obligations as well as principal repayment on maturity.

To cover repayment and the interest, are needed future tax revenues raises, and a given tax revenue must be allocated and

diverted from other productive destinations that may affect economic growth and social welfare.

### 3. Data and methodology

Following the structure of this paper, in second part of our analysis we focus on the supply of public utilities, for which analyze we substitute it with its value expression – the public expenditures. From this point of view we intend to analyze the impact of the public debt and its service upon the composition of public expenditures, noticing the main shifts in public expenditure structure as a response to public debt burden. We use as principal repressors public debt to GDP and public debt burden, introducing also a set of control variables, which are macroeconomic indicators used as public expenditures determinants.

The method used is Two-Stage-Least-Squares (TSLS), the explanatory variable is the share of public expenditure in total public expenditures  $EXP_j$ , where  $j=1,2,3,\dots,J$  expenditure category.

The categories of public expenditures is given by COFOG - Eurostat classification of public expenditures, the functional classification, comprising: 1. General Public Services; 2. Defence; 3. Public Order and Safety; 4. Economic Affairs; 5. Environment Protection; 5. Housing and community amenities; 6. Health; 7. Recreation, culture and religion; 8. Education; 9. Social Protection.

The control variables used in both regression equations are: PDET/GDP – gross consolidated public debt to GDP; PDET(-1)/GDP- previous period gross consolidated public debt to GDP; DS2/GDP – debt burden measure with government constraint effect; DEFPRIMAR/GDP – the primary deficit of public budget to GDP; GDP – the real growth rate of GDP; RATINFL(-1) – the previous period of inflation rate; UNEMPL – the rate of unemployment expressed to total labor force; CURACCDEF- current account deficit to GDP; TRADEOPEN – trade openness expressed as sum of Total Imports with Total Exports to GDP;

The equation which estimates the impact of public debt and other independent

variables mentioned above on public expenditures is:

$$EXP_j = \alpha_1 + \beta_1 PDET / GDP + \beta_2 PDET(-1) / GDP + \beta_3 DS2 / GDP + \beta_4 DEFPRIMAR / GDP + \beta_5 GDP_{growth} + \beta_6 RATINFL(-1) + \beta_7 UNEMPL + \beta_8 CURACCDEF + \beta_9 TRADEOPEN + \varepsilon_1$$

The data used for this regression equation is for 1995-2010, addressing Romania, as an example of developing countries, for the COFOG classifications of public expenditures, we use the Eurostat and

AMECO datasets, and control variables we use the World Development Indicators database from World Bank.

#### 4. Discussion of results

Regarding the 10 equations results (see Table 1), we have obtained a high degree of determination where R-squared is on average 0.95, that enable us to see how fit are our variables in explaining and determining the dependent variables.

Table 1 Estimation using multiple regression equations for public expenditures, functional structure

Variable	CULTURE	DEFENCE	PUBLIC ORDER	ECON AFFAIR	EDUC.	GEN.PUB. SERV.	HEALTH	HOUSING	ENV. PROT.	SOC. PROT.
C	0.4558	0.1166	-0.0373	0.0954	0.0424	0.4002	0.3767	0.6557	-4.2223	-0.0433
PDEBT	-0.1179	-0.0181	-0.0106	-0.0221	-0.0068	-0.0292	-0.3827	0.0431	-0.1241	0.0023
PDEBT(-1)	-0.1237	-0.0693	0.0016	-0.0563	-0.0024	0.4950	-0.2636	0.0840	-0.1211	0.0040
DEFPRIMAR	-0.0529	0.2142	0.0207	0.0257	0.0746	1.2616	0.2210	0.0580	-0.1020	-0.0922
DS2	-1.8796	-0.5094	-0.3122	-0.2943	-0.0929	0.6476	-0.8033	-0.2288	-0.4834	-0.2348
GDP	0.0411	0.0229	-0.0188	-0.0010	0.0066	0.2224	-0.0559	-0.3894	0.9704	0.0027
RATINFL(-1)	-1.6983	-1.0064	-0.4173	-0.1584	0.0939	-4.0350	0.4344	-0.1109	0.1207	0.1689
UNEMPL	1.5189	0.1699	-0.0699	0.2066	-0.0225	-2.8340	0.1220	0.0156	-0.0873	0.0254
CURACCDEF	-0.2377	-0.0019	0.0699	-0.0302	0.0128	0.5003	0.0056	-0.0118	0.0382	-0.0122
TRADEOPEN	-0.0744	-0.0206	0.0212	0.0025	-0.0018	0.2381	-0.0227	-0.2731	0.1341	-0.0077
R-squared	<b>0.9991</b>	<b>0.9738</b>	<b>0.9843</b>	<b>0.9999</b>	<b>0.9801</b>	<b>0.9998</b>	<b>0.9999</b>	<b>0.9982</b>	<b>0.9781</b>	<b>0.9998</b>
Adjusted R-squared	<b>0.9914</b>	<b>0.7379</b>	<b>0.8429</b>	<b>0.9988</b>	<b>0.8007</b>	<b>0.9976</b>	<b>0.9985</b>	<b>0.9824</b>	<b>0.7812</b>	<b>0.9985</b>
S.E. of regression	<b>0.2470</b>	<b>0.1625</b>	<b>0.2202</b>	<b>0.0090</b>	<b>0.0698</b>	<b>0.2148</b>	<b>0.0305</b>	<b>0.0239</b>	<b>0.3690</b>	<b>0.0041</b>
Sum squared resid	<b>0.0610</b>	<b>4.1286</b>	<b>6.9622</b>	<b>889.1877</b>	<b>50.4635</b>	<b>459.9686</b>	<b>744.9492</b>	<b>63.1195</b>	<b>4.9676</b>	<b>727.6222</b>
Log likelihood	<b>12.9602</b>	<b>0.3656</b>	<b>0.2865</b>	<b>0.0260</b>	<b>0.0112</b>	<b>0.0362</b>	<b>0.0284</b>	<b>0.0974</b>	<b>0.3357</b>	<b>0.0288</b>
F-statistic	<b>128.6624</b>	<b>189.8665</b>	<b>1.0000</b>	<b>1.0000</b>	<b>1.0000</b>	<b>1.0000</b>	<b>1.0000</b>	<b>1.0000</b>	<b>1.0000</b>	<b>1.0000</b>
Prob(F-statistic)	<b>0.0683</b>	<b>0.3173</b>	<b>0.3173</b>	<b>0.3173</b>	<b>0.3173</b>	<b>0.3173</b>	<b>0.3173</b>	<b>0.3173</b>	<b>0.3173</b>	<b>0.3173</b>

\*Source: authors calculations.

In all equations we found that public debt ratio and debt burden has a significant impact over public expenditures. Most affected negatively by the debt service are Recreation, culture and religion, Defense and General Public Services.

On the other hand the ratio of debt and previous period debt to GDP(existent stock) has an negative impact over Health expenditures and Environment protection.

Current account deficit has an negative impact over Economic Affairs and Recreation, culture and religion. Increasing and prices instability has an strong negative impact over Defense, Culture, Economic Affairs, General Public Services and Public order and safety. Unemployment increases public expenditures with Health, Social protection and Housing and community amenities, and has a decreasing effect upon Education, Environment protection and General public services.

## 5. Conclusion

In this article we analyzed the mutations of public debt and its service on the structure of public expenditures, taking in consideration the functional classification (COFOG). Regarding the shifts suffered by the functional structure of public expenditures, we found strong negative impacts, mostly from public debt service and secondly from the increasing public debt to GDP ratio, as well as other macroeconomic indicators. We may conclude that increasing public indebtedness corroborated with high levels of inflation and unemployment, public expenditure composition suffers important shifts from productive to unproductive categories, which represents a final consume, which doesn't yield future income necessary to finance the public debt obligations. The negative effects by producing important mutations in public expenditure structure are deeper for fragile economies like developing ones, mostly because developing countries are more prone to crisis and the path to recovery is much more difficult than for high industrialized countries.

Even if public deficit represents an instrument to stimulate economic recovery and to boost growth, public indebtedness for unproductive spending, in a irresponsible way, leads, as empirical analysis prove, to sensible shifts in public expenditures compositions, leaving less room to finance important categories of expenditures like health, education, public investment and other public spending that have an positive effect on economic growth.

We may say that the size of government is a public choice, but it's composition is open to policy and option debate. In present days, of recession affecting economies across the world, which can be characterized by liquidity shortening and serious government restraints in face of public debt crisis, the need for healthy public policies which promote efficient public spending is fundamental.

Analyzing the principal determinants of public expenditures, and splitting between productive and unproductive expenditures, a country can improve its economic performance by changing the mix between the two categories of expenditure.

The majority of developing countries in front of a budget constraint face a hard decision to be made – which component of the public expenditures should be cut? Health? Education? Infrastructure? Defense?

The answer is given by the contribution of above categories of public expenditures to economic growth and development.

Analyzing the composition of public expenditures by regressing it through the impact of public indebtedness and other macroeconomic indicators enable us to provide some future prospects of economic growth and the direct or indirect impacts of public debt over the economic growth through the shifts in public sector spending.

After analyzing the impact of public debt service and its stock on public expenditures, we can say that even if public indebtedness in developed countries is the usual way to finance public action that boost economic growth and development, there are significant risks that are accompanying this process. Given the specific instability of developing economies, like Romania, which can be proven by the evolution of other macroeconomic indicators included in our analysis (inflation, unemployment, current account deficit, economic growth) public debt and its cost may not lower economic growth but also may embezzle the whole purpose of public loans.

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