REVISTA ECONOMICĂ
Supliment Nr. 3 - 2009

Revistă de teorie şi practică economico-financiară

SIBIU - CHIŞINĂU, 2009

THE INTERNATIONAL ECONOMIC CONFERENCE
„INTEGRATIVE RELATIONS BETWEEN THE EUROPEAN UNION INSTITUTIONS AND THE MEMBER STATES"
SIBIU, ROMANIA
MAY 15-16, 2008

ISSN 1582-6260

THE "LUCIAN BLAGA" UNIVERSITY OF SIBIU, ROMANIA
THE FACULTY OF ECONOMIC SCIENCES
Str. Calea Dumbrăvii No. 17, Sibiu, Romania
Tel: +40-(269) 21.52.43
Fax: +40-(269) 21.03.75
E-mail: economice@ulbsibiu.ro
Web: http://economice.ulbsibiu.ro

The submitted articles for the Conference were evaluated by the reviewers of the *Editorial Advisory Board of Conference* according with the criteria of: originality, presentation, linguistic quality, scientific significance, relevance to our journal.

CUPRINS

Lecturer phd. Monica Achim
Phd. Student Sorin Borlea
"Babeş-Bolyai" University of Cluj Napoca, Romania

THE BONITY ANALYSIS OF CUSTOMERS: REALITIES AND PERSPECTIVES

Abstract*: A main modality for prevent the credit risk' s banks is the evaluate of bonity entities. The determines the bonity entities is made based on the analysis of the economical-financial performance of customers, depending on the score obtained at measurable (financial) criteria and at non-measurable (non-financial) criteria. The financial criteria are obtained from financial statements that add in the historically dates.*
In this paper we expose a significant model of determining the bonity's client and we stress that it is very necessary to complete these dates with the other like: information about market values or information about future activities. The analysis of the company's future should be approached differently, according to the destination of the credit. In the case of credits for investments the bank has to stress the development perspectives of the company based on the feasibility study presented by the company. The capacity of reimbursing the credit will have to be appreciated through the point of view of profitability, market and products. In the case of credits for operational activities, the bank has to stress the cash flow adjusted to the inflation rate during the period of the credit.

Keywords: *banks, bonity, indicators, financial statements, historical data basis.*

JEL Classification: *G21*

A. Theoretical concepts about the bonity analysis of customers

Banks, in general, have to ascertain the clients' bonity which actually defines his/her capacity of sustaining debt service, respectively, to reimburse the credit on due time and to pay the corresponding interest, as well as to prove the existence of insuring collaterals.

In the context of the economic-financial analysis of clients, banks often come across the question to which specialists attempted to answer: can the trustworthiness of the client's ***historically*** determined trustworthiness be a convincing argument for a future crediting?

It is often said that the too high dependence that banks show in the crediting process on the trustworthiness indicators resulting from previous activities sometimes makes the decision of granting or rejecting future credits incorrect. From this point of view, it seems that, in the appreciation of a client's credibility through their past (historical) trustworthiness, ***there should be paid less attention to the post factum analysis*** and ***insists on future activities***, which, in fact, represent the object of the requested credit, with the purpose of obtaining the highest certainty in drawing conclusions.

The determination of the requester's possibilities of repaying the credit is, generally, an issue of economic analysis. Financial analysis refers to both ***the past of the company***, as well as to ***its perspectives*** or the business that represents the object of the requested credit

The future prospective financial analysis has to show the fund requirements of the company in their dynamics, to enable the checking of the reality of the credit request and to show the real possibilities of reimbursing the credit and paying the respective interests and commissions. Practice showed that separate interpretation, based on scoring, of trustworthiness indicators, without taking into account the interdependence and reciprocal influences between the elements determining the recorded level, might lead to erroneous conclusions, since, in this case, there is ascribed a major importance in the formulation of the judgment of trustworthiness indicators, these becoming decisive in adopting the crediting decision.

In every day practice, there is often noticed that, even if the activities performed by the economic agents are quite profitable, the flawless debt service towards the bank, the calculated value of the "past" trustworthiness indicators enable the framing of credits only in the performance categories D and E, respectively in "doubtful" and "loss". This leads to the situation in which the decisions adopted by banks are not always favorable to clients and, therefore, companies are not able to obtain credits, either because of insufficient trustworthiness, or high credit cost resulted from the calculations.

The financial connections emerging between banks and their clients create an ***extremely complex phenomenon.*** That is why it is necessary to analyze them attentively.

In order to perform the analysis of the economic-financial standing of a client requesting bank credit, there are several relevant types of analysis available to the bank:

- the analysis of accounting costs, in evolution;
- cost, profit, income analysis;
- indicators analysis;
- profitability threshold analysis;
- the analysis of predictions through fund and cash flows.

Generally, any system of indicators used in the analysis of clients' trustworthiness should include in its construction four groups of indicators:

- indicators of the financial standing of the company;
- indicators of resource administration;
- indicators of financial yield and profitability;
- indicators of the company's market value.

The establishment of the rating of trust can be done based on the **analysis of the economic-financial performance** of customers, depending on the score obtained at **measurable (financial) criteria and at non-measurable (non-financial) criteria.** Depending on the total score the credit will be enclosed in one of the next categories of financial performances

- Category A– the financial performances are very good and allow the falling due payment and the interest rates, anticipating their sustentation in future;
- Category B– the financial performances are good or very good, but can't be maintained on long term;
- Category C– the financial performances are satisfactory only that they have a clear tendency of comedown in the future;
- Category D– the financial performances are low and are obviously periodic, on short lapse;
- Category E– the financial performances reflect losses and there are some certitudes that the credit rates and interest rates can't be paid;

B. Raiffeisen Bank analysis system

We choose this bank for exemplification because we appreciate that Raiffeisen Bank has the most development analysis system in the bank system of Romania.

In the elaboration of the study we have used data from the financial situations of S.C. Gamma S.A. within the last four years of activity of the entity.

General information regarding the company S.C. Gamma S.A

S.C. Gamma S.A was founded in 1920 and its activity consists of producing hardware.

S.C. Gamma S.A is a joint-stock company, with entirely private capital and headquarters in Baia-Mare, T.Vladimirescu Street, 19, registered with no. J/12/13/1991; it is an open company, rated at Bucharest stock market and the Shareholders' Register is public.

The policy of the company refers to maintaining the identity of the commercial society and strengthening its position as main producer and supplier of faucet hardware for interior plumbing within the country and abroad, as well as the promoting of the company's products on the external market, basing on the report quality/ competitive price.

Credit paper realized by the S.C. Gamma S.A includes the following:

* Synthesis of the paper
* *Name of the company*: S.C. Gamma S.A
**Type of business:* the production of equipment for the processing of food, drink and tobacco
* *Structure of organization*: SA
**Type and purpose of the loan*: financing the current activity
**Sum of loan*: 40.000EUR
**Percentage and source of reimbursal*: 100% cash – basis activity
**Interest rate*: 17/year
**Date of credit reimbursal*: December 2009
* *Term/date of final reimbursal*: 48 months/October 2009
* *Credit analyst*: X
* *Type of guarantees*: gage.

Raiffeisen Bank groups economic agents into **five categories** of trustworthiness, basing on a multicriterial evaluation system. This bank delimits the expected levels for some indicators according to the

industry, especially commerce and production. The indicators with changed values are **"Operational profit margin" and "Shareholders" equity ratio".** These indicators will be presented below as adapted to S.C. Alfa, that is, as indicators specific the production industry.

Table no.1 Reiffeisen Bank indicators system

Nr.	Criteria to evaluate	Percent	Values	Degree
Calitative criteria				
1	Management quality, business strategy and received collaterals (others then those accepted for diminishing the exposal towards the debtor)	21%	see table 2	
2	Shareholders structure	4%	See table 3	
Quantitative criteria				
1	General liquidity	18%	>1,5 1,2-1,5 1,0-1,2 0,8-1,0 <0,8	1 2 3 4 5
2	Solvability	18%	>1,5 1,25-1,5 1,0-1,25 0,8-1,0 <0,8	1 2 3 4 5
3	Operational profit margin	12%	>10% 7-10% 3-7% 0-3% <0%	1 2 3 4 5
4	Interest covering coefficient	18%	>4 3-4 2-3 1-2 <1	1 2 3 4 5
5	Shareholders' equity ratio	9%	>60% 50-60% 30-40% 20-30% <20%	1 2 3 4 5
-	Client risk	100%	-	-

As far as the qualitative criteria are concerned, there are specifications in norms regarding the attribution of values.

Table no.2: Score attributed to „Management quality"

Nr. crt.	Criteria	Evaluation
1	Experience in the industry, leading team, clear business strategy, good reputation	1
2	Experience in the industry, leading team, business strategy in formation, good reputation	2
3	Limited experience in the industry, leading team, business strategy in formation, good reputation	3
4	Limited experience in the industry, new leading team, business strategy in formation	4
5	Dependance on one man, lack of strategy, limited experience in the industry	5

Table no. 3: Score attributed to „Propriety structure"

Criteria	Evaluation
Majority held by a strong international company	1
Majority held by a medium international company	2
Majority held by a weak international company	3
Majority held by a strong local company	1
Majority held by a medium/weak local company	3
Majority held by states from category A and the Romanian state	1
Majority held by B category states	4
Majority held by management	2
Majority held by population	3
Majority held by investment fund	4
Clear issues with shareholders / disputes with owners	5
Shareholders structure unknown	5

As a result of obtaining the values and framing the indicators in different levels, there is obtained a score function as sum of the degrees resulting from framing the company in the criterial system and the balance coefficients.

According to the rating obtained, a company requesting a credit may be framed in one of the following categories of financial performance:

Table no 4: Categories of financial performance

Balanced result of the client's rating	Client's rating (financial performance)
1,00 – 2,00	A
2,01 – 3,00	B
3,01 – 4,00	C
4,01 – 4,50	D
4,51 – 5,00	E

In the case of S.C. Gamma, the situation of the indicators is presented below:

Table no 5: Criteria of financial performance applied by Raiffeisen Bank -in thousands-

Nr.crt.	Indicatori / An	2004	2005	2006	2007
1	Non current assets	83956013	82780573	88367988	90426033
2	Shareholders' equity	100666169	107341045	109694424	110969792
3	Circulates assets	74169530	96991602	106089639	109737232
4	Inventories	35193858	50402523	55349825	60275903
5	Advance payments	363052	232533	167520	120493
6	Current assets (3+5)	74532582	97224135	106257159	109857725
7	Total assets (1+6)	158488595	180004708	194625147	200283758
8	Debts <1an	53817769	70798268	82916479	87385700
9	Advance payments	1689268	1865395	2014248	1928266
10	Current debts (8+9)	55507037	72663663	84930727	89313966
11	Debts>1an	0	0	0	0
12	Provisions for risks and expenses	0	0	0	0
13	Total debts (10+11+12)	55507037	72663663	84930727	89313966
14	Turnover	182840895	208990783	207654344	237987571
15	Result from operational activities	20417789	18012104	12274442	13812476
16	Interest expenses	7454647	7943275	6259130	4995051
16	**General liquidity** (6:10)	1.343	1.338	1.251	1.230
17	**Solvability** (7:13)	2.855	2.477	2.292	2.242
18	**Operational profit margin** 15:14)	11.17%	8.62%	5.91%	5.80%
19	**Interest covering coefficient** (15:16)	2.739	2.268	1.961	2.765
20	**Shareholders' equity ratio** (2:7)	63.52%	59.63%	56.36%	55.41%

Following the data from the table above we may notice that the trustworthiness indicators calculated by Raiffeisen Bank for S.C. Gamma S.A. had a slightly descendant evolution. Still, there is a better interest covering in the latest year, with an ascending trend.

In order to frame this company in one of the trustworthiness categories, qualitative criteria have to be noted too. Taking into account the fact that the company has had for 14 years a stable leadership that succeeded to maintain the company as the main producer of hardware in the country, we will note the criteria Management's quality with maximum score, 1. Taking into account that the majority of the shares is held by the Association of Employees and Leadership Members S.C. Gamma S.A., we will note the criteria Shareholders structure with 2.

The situation of the score obtained by S.C. Gamma S.A between 2004-2007 is presented in table no.6:

Table no. 6: Rating of S.C. Gamma S.A. company between 2004-2007 in points

Nr.	Criteria to evaluate	Percent	2004	2005	2006	2007
1	Management quality	21%	1	1	1	1
2	Shareholders structure	4%	2	2	2	2
3	General liquidity	18%	2	2	2	2
4	Solvability	18%	1	1	1	1
5	Operational profit margin	12%	1	2	3	3
6	Interest covering coefficient	18%	3	3	3	3
7	Shareholders equity ratio	9%	1	2	2	2
	Balanced score	**-**	**1,58**	**1,79**	**1,91**	**1,91**
	Trustworthiness category	**-**	**A**	**A**	**A**	**A**

According to the received score, S.C. GAMMA S.A. was put during the four years taken into account in category A (standard). This means that a credit given to the company would not imply deficiencies and risks that could endanger the administration of the debt service as stipulated in the credit contract.

However, there can be noticed that S.C. Gamma S.A falls towards the B category of trustworthiness (under surveillance). This constant deterioration of the indicator has to be taken into account especially in the case of long term credits.

Analyzing in comparison, solvability ratios and general liquidity ratios, there can be noticed that while solvability has a much higher level then estimated by the score of the bank, general liquidity is under the optimum level. This means that the liquidities of the company are caught in fixed assets. If we analyze the profitability ratios, also decreasing, we are able to draw the conclusion that the investments made did not bring the foreseen profits, having a decreasing marginal productivity.

In conclusion, the company should have to analyze a new evaluation of intangibles and eliminate the unproductive ones, as well as to eliminate inventories with reduced sales and maintain those that bring the expected profits.

C. The analysis of the company's bonity: limits, perspectives

The analysis methods used today are based on a series of concepts and techniques that form the center of the technical and quantitative analysis of credit base.[1]

Banks manifest a high dependence in their decision regarding credit on trustworthiness indicators and the collaterals of the requester, but these indicators do not express reality; even if they would, this should represent only 'a business card' of the company, while collaterals should be regarded as an insuring method, not a certainty of recovering credit.

Management's quality, the efficiency of the company and business certainty should represent decisive factors in making the crediting decision.

The purpose of analyzing the history of the company has to be that of evaluating the performances of the company, risk and management.

[1] Stoica M, *Bank Managementr, Editura Economica, Bucharest, 2000, pg. 64*

In practice, there are two tendencies regarding the calculation technique of the company's performance based on trustworthiness indicators: either basing on the balance sheet, profit and loss account and corresponding annexes drawn according to the methodology elaborated by the Ministry of Finances, or based on the balance sheet and the restructured profit and loss account, which, according to some specialists, could enable a more rigorous fundament for trustworthiness indicators, as well as the calculation of other indicators (net treasury, required working capital) specific to countries with developed market economy.

Irrespective of the approach, these methods of evaluating credit risk have at least the following **limits:**

- Bank do not take into account the **market value of assets and liabilities**, but consider them at their accounting value, so the liquidity, solvability and profitability indicators are not necessarily according to reality;
- Even if banks require from credit requesters a series of documents, such as: projection of resources and placements, treasury plan, business plan, feasibility studies, marketing studies, contracts etc., **the analysis of the company's future has a small role** in the crediting decision. In fact, the historical analysis based on trustworthiness and collaterals are the basis of the crediting decision, even for investments.
- **Bank doesn't take into account the specific of activity and implicative industry norms (crops - sectional analysis).**The differences in specific of activities can affect certain financial ratio. It is a good practice to compare the financial ratio of a company with those of **its major competitors** not with a single value for entire economic domain.
- **The need to use judgment.** The bank must use judgment when performing ratio analysis. A key issue is whether a ratio for a firm is within a reasonable range for an industry, with this range being determined by the analyst. Although, financial ratio are used to help asses the growth potential and risk of a business they cannot be used alone to directly value a company or determine its creditworthiness. The entire operation of the client must be examined, and the external economic and industry setting in which is operating must be considered when interpreting financial ratios. [1].

<u>The analysis of the company's future</u>

The purpose of analyzing the company's future is that of showing the risks of the business the bank is crediting, the identification of all the resources for recovering the credit, de sustaining of the business by the shareholders, the company's accessibility on the market and the costs of entering a new industry.[2]

This information should represent "the core" of banks' long and intermediate crediting policy. Even if banks require from credit requesters a series of documents, such as: projection of resources and placements, treasury plan, business plan, feasibility studies, marketing studies, contracts etc., the analysis of the company's future has a small role in the crediting decision. In fact, the historical analysis based on trustworthiness and collaterals are the basis of the crediting decision, even for investments.

This approach on the analysis of the credit base determines the banks to make erroneous decisions the led to the accumulation of a large amount of delayed credits in the portfolio of the banks.

In practice, there can e noticed that, even if some clients request credits for risky businesses, the bank gives them the credit due to their trustworthiness and collaterals; other clients, who request credits for profitable businesses are not able to obtain it due to their inadequate trustworthiness.

The analysis of the company's future should be approached differently, according to the destination of the credit,

In the case of credits for investments, the bank has to stress the development perspectives of the company based on the feasibility study presented by the company. The activity of the company has to be profitable, both for enabling the reimbursement of the credit and for allowing the company to consolidate its own funds. the capacity of reimbursing the credit will have to be appreciated through the point of view of profitability, market and products.

In the case of credits for operational activities, the bank has to stress the cash flow adjusted to the inflation rate during the period of the credit.

<u>The evaluation and completion of the accounting information with market values</u>

The strict use of the information from the financial statements may lead to the determination of a erroneous diagnosis regarding the company requesting the credit. That is why the analysis of the company's trustworthiness may lead to incorrect results.

[1] Greuning H.V., *International Financial Reporting Standards, Practical guide,* , Ed. Insitutul Irecson, *Bucharest,* 2004,pag 28

[2] *Idem,, pg. 70*

The accounting convention, as well as the historical cost, accounting prudence and others, rise questions regarding the credibility of accounting in terms of real, market values.

The main critique is brought to the historic cost, since the sum invested in a project is not relevant to the estimation and calculation of the economic value.[1] The economic value is determined more by the net profit that can be obtained from the investment, then by the sum of money invested in purchasing assets.

Therefore, the balance sheet can not be an indicator of value. However, it can be an indicator of the capital invested in the business by shareholders and creditors. Transforming capital into value depends on the management and the profitability ratio obtained. This is an issue that can not be solved by the balance sheet, but by the market, especially the capital market.

Accounting provides a retrospective, or at least contemporary, informing on patrimony and results. The value of the business is not merely the result of the present and past activities. It is also given by its more or less promising future. Consequently, in order to obtain a complete reflection of the economic-financial perspectives of the company it is necessary to complete the accounting information with the procedures specific to the economic evaluation.

Another aspect is the fact that financial statements reflect only those sides of the company's activity that can be expressed in monetary patterns. But its value includes or it is due to some elements harder to quantify or unquantifiable through direct methods, such as intangible assets.

By evaluation there is not created value, but it is interpreted the market in order to reach the estimation of a value. Thus, the economic value is determined through a specific process, economic evaluation, which represents an assembly of techniques, procedures and methods based on multidisciplinary, through which an asset or a company as a whole are brought, from the value perspective, to the market level and by this it is ensured their comparability with market value.

The systems of indicators used by banks for evaluating trustworthiness start with financial statements presented by the company requesting credit. Thus, in the calculation of some indicators (solvability, liquidity, profitability etc.) there are some elements the value of which is not necessarily real.

If in the case of debts, liquidities, financial investments the value is highly close or even expresses the real value, in the case of other assets the situation is quite different.

One example is the value of inventory evaluated in accounting either for their entry price, or for their production price. The issue is that these inventories may not be requested by the market, consequently, to have no value or their value to be much smaller. That is why an indicator such as solvability or general liquidity may have abnormally high values and not be able to guarantee the repayment of the loan.

Another issue is represented by non current assets. They are evaluated in financial statements for their purchase price, corrected by depreciation under the form of amortization, but their value may be much bigger or smaller under the present circumstances. Another aspect is the contribution of these assets to profit making. There are some assets that appear in the balance sheet, but neither brings profit, not will bring profit in the future. These assets have no economic value for the company, but they are taken into account in the structure of the indicators calculated by banks.

The present accounting system of Romania promoters the so-called "accrual accounting" that implies the recording of incomes at the moment when the products and services are sold, not when the proceeds are received. Expenses are not acknowledged at the time of their occurrence (in the case of acquisitions), but in the moment of the assets' exit. There emerge differenced between the profits recorded by accounting and the profits actually made. This leads to the denaturizing of the indicators expressing the profitability of the business, since these profits may transform in liquidities at dates subsequent to those mentioned, or maybe never.

In order to avoid such problems and to obtain values as close to reality as possible, there can be used methods specific to economic evaluation, such as the patrimonial ones where financial statements are retreated and corrected for obtaining values closer to reality or methods based on market comparisons where the assets' value is determined according to the value of the similar goods transactional on the market.

A special aspect is represented by the yield values. According to these methods, the value of a business is given by the value plus that the business brings in the future. These methods imply the actualization of future cash flows. Under the circumstances in which banks should be interested more in the payment capacities and future profitability's then in past ones (taken into account in the case of trustworthiness analysis) these methods for diagnosing the business should have a greater importance.

[1] Deaconu A., *Business evaluation, Editura Intelcredo, Deva, 2002, pg. 12*

As a **conclusion**, it is necessary to pay more attention to the analysis of the company's future and it capacity of generating plusvalue in the future. Business evaluation, through the methods and procedures it provides, should represent a more intense concern for banks in the future context of the development of functional market economy. At all that the bank must use judgment when performing ratio analysis.

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Claudiu Tiberiu Albulescu
West University of Timisoara and Poitiers University, France, Romania

EUROPEAN INTEGRATION OF FINANCIAL SUPERVISION FRAMEWORKS: THE ROMANIAN CASE

Abstract: A recent trend in the institutional framework for regulation and supervision at European and *international level is the creation of a Single Supervision Authority for the supervision of the banking sector, insurance sector and capital markets. A lot of arguments highlight the fact that such institutions are necessary, but there are also other valid arguments which show that the banking supervision must be made by central banks. We can not affirm that one of these possible supervision frameworks is more efficient than the other. The decision of the implementation of a unique supervision organism must take into consideration the structure of the financial system and the central bank's tradition in the regulation and supervision of the banking sector. The financial supervision in the European Union member countries differs from case to case. An important number of supervision frameworks present a unified structure and there are various reasons underlying this choice.*
In this paper we will show on the one hand that the institutional regulation and supervision framework in place in Romania reflects the structure of the Romanian financial system and, on the other hand, that this specialized supervision architecture is compatible with the European supervision framework. The implementation of an operational Joint Supervision Committee is the solution to respond to the problems of financial conglomerates. At present, the remodelling of the supervision architecture does not represent a good option for the Romanian financial system.

Key words: *European supervision framework, single supervision authority, central bank, financial conglomerates*

JEL Classification*: E58*, F55, G28

1. Introduction

The regulation and supervision of the financial system represent a pillar for the financial stability. Many specialists consider that the creation of a Single Supervision Authority (SSA) is necessary for the preservation of financial system stability. Such authorities are independent from central banks and their role is the regulation and supervision of all financial sectors, including the banks. The aim of the SSA implementation is the demarcation between the two goals of central banks, price stability and financial stability, and the elimination of the possible trade-off between these objectives. It is considered that a SSA is also specialized in financial conglomerates supervision, a new challenge for the financial stability.

The construction of a unique supervision authority does not represent the best solution for all financial systems. These authorities do not have the necessary means of intervention to guarantee the financial stability and they can be subject to political pressure because they act as governmental agencies or agencies subordinated to the parliament. It seems that the central banks are better placed to regulate and survey the banking sector, enjoying the required independence and credibility.

During the last period, intense debates were conducted regarding the reorganisation of the regulation and supervision framework at European level. In this study we intend to show that the Romanian supervision architecture in place is adequate and the National Bank of Romania (NBR) can not successfully accomplish its financial stability objective without performing the regulation and supervision of the banking sector. *A priori* this framework is efficient to the same extent as the SSA framework. However, a tendency for unifying the supervision in European countries can be observed. The decision for a SSA implementation must take into consideration the characteristics of each national financial system. It is also important to have good cooperation structures between national and European supervision authorities.

The structure of the study is the following: in the second section we present the arguments supporting the preservation of a fundamental role for central banks in banking supervision and the arguments in favour of a SSA. In the next section we describe the European supervision framework and we propose a cooperation strategy between central and national authorities. In the last section of this article we demonstrate that the Romanian supervision framework is compatible with the structure of the financial system and with the European arrangements. For the Romanian financial system, the creation of a Mixed Supervision Committee by the members of the NBR and the members of the authorities specialized in the

supervision of insurance activities and securities, under the NBR coordination, represent, in this moment, a better solution than setting up a SSA.

2. Arguments in favour or against the supervision unification

Like the monetary authority, the supervision authority must be independent from political pressures. In the same time, a supervision authority must be credible and accountable and must perform a transparent activity (Schich and Seitz, 1999; Ribeiro, 2002; Quintyn and Taylor, 2004; Abraham and Taylor, 2000 and Sinclair, 2000).

The supervision authorities must analyze objectively the financial conditions of each financial institution as well as those of the financial system as a whole. The authority must also be credible because its regulations and decisions must be respected. The credibility and transparency of its actions ensure the independence and, on the other hand, an independent supervision authority becomes more credible. The transparency, the accountability, the independence and the credibility characterise successful central banks in their effort to reduce inflation and, at the same time, represent the attributes of an efficient supervision authority.

The arguments for the integration of the supervision function within central banks are presented by the ECB (2001). They are related to the synergy of the information between the supervision function and the central bank's fundamental missions, to the particular emphasis on systemic risk and to the independence and technical expertise of the central bank. The arguments in favour of keeping the banking sector supervision function within the central bank are often stated as arguments against the set up of a SSA. Abraham and Taylor (2000) enumerate some arguments in this respect such as:

- *The objectives of a SSA may be unclear*. One of the strongest arguments advanced against the unification of supervision functions within a SSA is the difficulty to find the equilibrium between the different objectives of the regulation.
- *Diseconomies of scale*. Economies of scale represent an important argument in favour of a Single Supervision Agency, but we have to admit that diseconomies can also occur. A source of inefficiency can appear due to the fact that a single agency is in a monopole position, and the new structure can be more rigid and more bureaucratic.
- *Limited synergies*. Some critics of the unification indicate a reduced gain caused by the unification, namely the economies of scope are probably less significant than the economies of scale.
- *Moral hazard*. Maybe the most alarming argument against the unification is the moral hazard. It is based on the assumption that the public will suppose that all the creditors of the supervised institutions will receive equal protection.

The arguments in favour of the set up of a SSA are as numerous as those militating for integration of the supervision function within the central banks. These arguments comprise a potential conflict between monetary policy objectives and financial stability objectives and the maintenance of a formal role for the central bank in supervision, due to the synergy and circulation of information and the appropriate functioning of the payment system (Gulde and Wolf, 2004).

A list of arguments in favour of the separation of price stability function from the supervision function is also presented by the ECB (2001):

- *The conflict of interests between supervision and monetary policy*. A prudential concern related to the fragility of the banking system can determine the central bank to adopt a more lax monetary policy and not to pay attention to the achievement of the inflation objective.
- *The emergence of financial conglomerates*. This argument has often been analysed during recent debates. During the last years, the closed connections between banks, insurances and capital markets make hard to distinguish between the individual activities of each financial conglomerate.
- *The concentration of power within the central bank*.

Others elements advanced by Briault (2002) are the following: neutralization of the arbitrage; flexibility of regulation; creation of a specialist team and improvement of accountability. The most important argument is the increase of the number of conglomerates, in which different categories of financial institutions, both national and international, are operating. The conglomerates appeared as a result of the increase of international competition and following the development of the merger – acquisition process (Dierick, 2004). Groups such as financial conglomerates have deep impact and represent a threat to financial stability (Tordjman, 2004). Their supervision is difficult in particular when we refer to transnational conglomerates, with high systemic importance, mainly due to their participation to payment systems. Saving conglomerates from bankruptcy involves the materialization of the effect "*too big to fail*".

3. The European supervision framework

There are many issues related to the European regulation and supervision framework which must be clarified. The first question that arises is related to the opportunity to have a single regulation and supervision authority at European level. Secondly, we have to analyse the possibility for the ECB to play this role. Finally, we have to establish what supervision framework we should have in place in order to ensure a better coordination between national and European supervision authorities.

One of the objectives of the Lisbon Strategy is the establishment of a common European financial system (Goodhart, 2004). This author proposes the transfer of fiscal competences in the management of bank crisis and the transfer of banks supervision function at central level. In his opinion, these two functions must not be separated.

The economic literature provides arguments for and against a centralized supervision function. At present, different sectoral authorities are charged with the identification of systemic risk at European level. These authorities have only a coordinating role and they do not dispose of adequate intervention instruments. They constituted together a Joint Forum for the financial conglomerates supervision which recommended the creation of a Mixed Technical Group (MTG), where supervised financial sectors are represented.

The European supervision framework is shortly described by Gulde and Wolf (2004). At European level, the regulation and supervision intervene at three levels: at the first level we have the Ecofin Council, at the second level the regulation committees vote the European Commission's (EC) proposals related to the technical measures for implementation and finally, at the third level, the committees advise the EC about the measures adopted at the second level and promote the implementation of the European Directives and of the convergence in the supervision practices. While the institutional structure includes a second level concerning the financial conglomerates (and, optionally, a third level), the strategy in place focuses on the individual supervision of each sector (Table 1).

Table 1: The framework for Formalized European Co-operation in Banking and Insurance Supervision

	Banking	Insurance	Securities	Conglomerates
Level 2 Regulatory Committees	EBC European Banking Committee	EIC European Insurance Committee (includes Pension Funds)	ESC European Securities Committee	FCC Financial Conglomerates Committee
Level 3: Supervisory Committees	CEBS Committee of European Banking Supervisors	CEIOPS Committee of European Insurance and Occupational Pensions Supervisors	CESR Committee of European Securities Regulators	

Source: Gulde and Wolf (2004)

Another issue intensely discussed is the ECB role in the financial system regulation and supervision. The ECB does not have a statutory responsibility in this field and the supervision institutions act at national level. The ECB main objective is the implementation of the monetary policy and its involvement in the supervision activity could have several implications regarding the independence, transparency and responsibilities of this institution. The loss of the ECB's reputation involves more severe consequences as compared to the loss of the reputation of a national central bank.

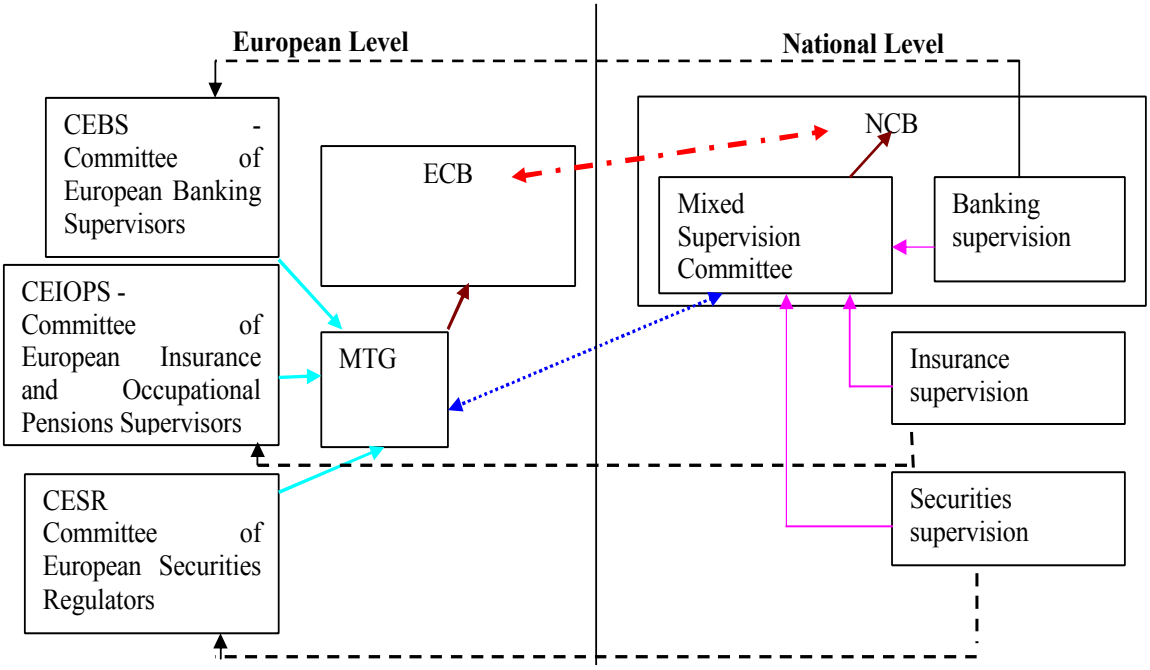
We propose a supervision and collaboration framework, to be implemented at European level (Figure 1).

The difference between the centralized and national supervision framework is the location of the Mixed Supervision Committee inside the national central banks (NCB). This is necessary because the NCB are the only institutions which dispose of the appropriate tools for preventing financial instability. The NCB must coordinate the Committee's actions and must take the corresponding decision as soon as possible. At European (central) level, there is only an informative relation between ECB and MTG because the intervention instruments belong to the NCB.

In our opinion, if, at national level, a SSA replaces the Mixed Supervision Committee and operates outside the NCB, the resulting supervision framework will slow down the decision making process. In the same time the role of the European System of Central Banks (ESCB) will be considerable reduced. In order to have a good coordination and cooperation, the national and central supervision framework must have the same structure.

There are specialists who sustain the creation of a European Financial Service Authority (EFSA). This preoccupation is based on the intermediation and capital market integration trend and could increase the overall transparency of the banking supervision (Eijffinger, 2001). This implies also a modification of the Treaty.

Figure 1: A proposal for the European financial supervision framework



Where: - - - - - Represents the reports prepared by national supervision agencies for the European Committees, which contribute to a better regulation and a detection of each sector's risks;

——— Represents the information collected by the Mixed Supervision Committee from each supervision agency and it is meant to identify the systemic risks, especially the ones caused by the financial conglomerates;

——— Represents the information exchange which allows the regulation harmonization between financial sectors and the identification of the risks suspected to affect the stability of the European financial system;

——— The information transmitted by the MTG and the Mixed Supervision Committee to ECB and NCB about the threat of systemic risks;

..... Mutual information about systemic risks at national and central level (double control);

- · - · - Represents the mutual information flow between ECB and NCB in relation with systemic risk and the implementation of the action plans

We consider that the EFSA implementation would be justified in particular by the tendencies in the structure of national financial systems. Is this new supervision framework more efficient? Without performing a cost-benefit analysis, we can reach the conclusion that a good collaboration between European and national supervision structures can occur when the two frameworks are similar. This means that each member state must implement a SSA and we showed that this does not always recommended. The Mixed Supervision Committees can accomplish an important part of the SSA activity, especially in case of consolidated supervision.

Consequently, in countries where the banking sector prevails and where the central banks have an important supervision experience, a decentralized supervision framework is more appropriate. The NCB must act as an "umbrella" in the supervision activity (the Mixed Committees can be a distinct department within the central banks or the Financial Stability Department). Removing central banks from the bank supervision activity means a rupture between the monetary policy and stability policy at national and European level. The relationship between the ECB and NCB is not a formal one, based only on an information exchange like the EFSA – SSA relation. The SEBC implication in supervision means coordination and actions based on real intervention tools meant to ensure financial systemic stability. Even the specialists which sustain the SSA implementation agree that the supervision practices are more important

that the change of the institutional framework and propose a progressive approach in the supervision framework of financial conglomerates.

We described above the centralized supervision framework and a possible cooperation framework with the national authorities. In respect of the financial supervision of European Union member states, this widely differs from one country to another (Masciandaro, 2004). No less than 10 countries, out of a total of 27, have had implemented an SSA before 2004. These countries are: Austria, Belgium, Denmark, Estonia, Germany, Latvia, Malta, United Kingdom, Sweden and Hungary. Countries such as: Bulgaria, Cyprus, Czech Republic, Greece, Lithuania, Romania and Slovenia dispose of a specialized supervision for each financial sector. The remaining countries have hybrid supervision institutions.

Econometric studies show that the set up of a SSA mainly occurred in countries where the capital market has an important place, the market capitalization reaches a high level, the presence of conglomerates is significant and good governance policies are in place, policies characterized by high quality services and limited political interference in choosing and appointing the governors (Masciandaro, 2004). In addition, an important factor influencing the creation of a SSA is the central banks' poor experience and involvement in the supervision activity. The independence, authority and credibility of the central bank are also important. If a weak involvement of the Central Bank represents a status quo, the authorities do not wish an increased involvement in order to avoid moral hazard and bureaucratic effects (Masciandaro, 2007). This is called central bank fragmentation effect.

The first European countries were a SSA was implemented were the Northern Countries. The unification of the supervision was necessary after the banking crisis in the '80, when central banks failed in applying prudential supervision. Another feature of these countries is the high concentration of the financial system and the presence of financial conglomerates. The fact that the financial industry in Baltic Countries imitates the pattern of Northern Countries, constituted a sufficient reason for the implementation of a SSA in these countries too. Many banking groups from Sweden and Finland activate in Estonia and Latvia. However, a reorganization of the supervision activity was not needed here because the Baltic Countries were confident from the very beginning in the efficiency of unified supervision.

The situation was different in the United Kingdom. The FSA was created in 1997 in particular due to the inefficiency of the nine supervision agencies which performed their activity in this field. By the set up of the FSA, a tripartite cooperation agreement was signed between the Bank of England, the FSA and the Treasury. The model was also adopted by Ireland. Nevertheless, this supervision framework did not prove its efficiency in 2007 when, after the subprime crisis in the United States, the Northern Rock from England was affected. The FSA failed in prudential supervision and the central bank had to intervene in its quality of LOLR.

The HFSA from Hungary was set up in 2000. The main reasons put forward for the reorganization of the supervision framework were the interconnection of activities in the banking sector, insurances and financial investments. At the same time, the idea of a better supervision on consolidated basis was sustained. However, another reason was the lack in legislation which resulted in supervision arbitrage. In 2002, the BaFin was created in Germany as an SSA subordinated to the Ministry of Finance, its activity being financed by the supervised institutions. Bundesbank still has a formal involvement in supervision. In Malta, a SSA was also set up in 2002 (*Malta Financial Services Authority* – MFSA). In this case the supervision authority is completely autonomous and it reports directly to the Parliament. The decision for setting up the MFSA was the result of the reform in the financial system legislation, like in Hungary. In Belgium, the *Banking, Finance and Insurance Commission* (CBFA) was created in 2004 having as main objective to protect the deponents and the insurants. CBFA is also responsible for prudential control.

The most recent unified supervision framework was established in Poland, on the 1st of January 2008, by the set up of the *Polish Financial Supervision Authority* (PFSA). In this case also, the main argument was the presence of financial conglomerates and their importance. Until 2008, the banking supervision was performed by the *Banking Supervision Commission* whose single objective was to guarantee the bank deposits.

We can see that there is a trend related to unified supervision in Europe. But not all of these SSA fulfil the independence and credibility criteria, neither do they have clearly defined objectives for ensuring financial stability. For example, in Germany, the activity of BaFin is financed by the supervised entities, situation that may lead to pressures from these institutions. In Hungary, the legislative framework gave room to interpretations and to the arbitrage phenomenon. In Poland, the supervision activity of the Banking Commission was insufficient.

As Abrams and Taylor (2000) argued, the supervision unification must take into consideration at least the following key elements: prerequisites for effective supervision (independence, credibility, accountability, clear objectives); regulatory framework (presence of financial conglomerates, regulatory arbitrage problems, coordination problems); structure of financial system (dominant banking system; presence of universal banks).

4. A SSA does not represent at present a solution for Romania

None of the above mentioned elements indicates the need to implement a SSA in Romania. The banking sector is dominant and the NBR enjoys the independence and credibility necessary for an efficient supervision. The supervision activity objectives are clearly defined and there is no incompatibility between monetary and supervision policies. The regulatory arbitrage problems are missing because the legislative framework does not allow the possibility of different interpretations. The problems related to financial conglomerates, even if it exists, it can be handled by a mixed supervision committee (but the operation and efficiency of this committee must be real)[1]. The Romanian supervision framework is compatible with the centralized framework and it can thus ensure a corresponding information flow.

NBR is responsible for the regulation and supervision of the banking sector while the insurance and securities regulation and supervision are ensured by the Insurance Supervisory Commission (ISC) respectively the National Securities Commission (NSC). In 2007, the private pension funds began their activity in Romania and the Private Pension System Supervisory Commission (PPSSC) is in charge with the supervision of their activities.

Table 3: The structure of the Romanian financial system

% GDP	*2002*	*2003*	*2004*	*2005*	*2006*
Financial intermediation institutions, among which:					
Credit institutions (1)	31,0	30,8	36,6	44,6	50,6
Insurance companies (2)	1,5	1,8	1,9	2,2	2,5
Investment funds (3)	0,1	0,1	0,2	0,2	0,3
Financial investment companies (4)	1,4	1,4	1,3	1,8	2,3
Other financial firms, of which:					
Bucharest stock-exchange (BSE) (5)	6,1	6,2	13,9	19,5	21,5
RASDAQ Market*	4,0	4,0	3,2	2,9	3,1
(1) Net assets of credit institutions; (2) Total value of net assets; (3) Investment funds assets; (4) Financial investment companies' net assets; (5) Market capitalisation. *) Romanian Association of Securities Dealers Automatic Quotation.					

Source: NBR (2007)

One of the Romanian financial system features is a reduced intermediation degree and the activity of the insurance companies and financial investment companies is limited. The banking sector still remains the most important sector within the financial system.

NBR presents all characteristics necessary for a supervision agency. The Romanian authorities made important efforts to transpose the *acquis communautaire* in the financial field and the NBR's independence is guaranteed by the law. Before the adoption of Law 321/2004 related to NBR statute (the NBR Act), there was no legal provision concerning the central bank's independence, but the NBR was "*de facto*" independent (Călin, 2004). At the Article 3 (1) of the law, it is stipulated: "When carrying out their tasks, the National Bank of Romania and the members of its decision-making bodies shall not seek or take instructions from public authorities or from any other institution or authority".

If the political independence is clearly stipulated, we can not state the same about financial independence. The legislation stipulates that: "the National Bank of Romania shall transfer to the State budget a share of 80 percent of the net revenues left after deducting the following: (a) expenses related to the financial year, including expenses for the provisions established; (b) the loss related to the previous financial years that remained uncovered after applying the provisions". Nothing is mentioned about the cover of

[1] Bichi (2005) considers that the unified supervision model does not represent the single solution for remodeling the supervision arrangement framework in Romania, and, if it necessary to change the supervision institutional schema, elaborate studies must be performed in order to identify the development level of financial conglomerates.

NBR's losses and about the state contribution. The lack of provisions regulating this situation could result in future political pressures menacing NBR independence.

The financial conglomerates in Romania act mainly in the banking sector: Allianz, ING Group, Société Générale, Unicredito, San Paolo, Raiffeisen, National Bank of Greece or Alpha Bank. Some of these financial conglomerates own subsidiaries in Romania and they are supervised by Romanian supervision authorities only in case they represent the major shareholder in a Romanian bank or insurance company.

The NBR undertook some safety precautions to prevent the systemic risk caused by the financial conglomerates. By adopting the European legislation, the NBR has the possibility to appeal to an information exchange with the partner countries supervision authorities. Mutual information refers to foreign subsidiaries. Thereby, the NBR has concluded MoU with the regulation and supervision authorities from: Cyprus, Greece, Italy, Germany, Netherlands, France and Hungary (the origin countries of financial conglomerates active in Romania which are considered partner countries in prudential supervision).

Likewise, the NSC has concluded MoU with similar authorities from partner countries. The ISC – in charge with insurance supervision – has not concluded MoU yet. One of the reasons is the poor development of the insurance market in Romania and a reduced associated systemic risk. The Romanian authorities must show considerable concern for this aspect because the insurance market has an important growth rate and because the most of the financial conglomerates are involved in this activity.

The information exchange between national supervision authorities is also important (we have addressed this issue when we presented a possible European supervision framework). In our opinion, the cooperation between the NBR and the other supervision authorities is not transparent enough, even if a collaboration agreement has been signed. This agreement stipulates: a clear tasks delimitation, professionalism and transparency, cooperation in regulation, efficiency, confidentiality and an ongoing exchange of information.

This national MoU (Protocol) was signed on 10 March 2006 between NBR, NSC and ISC. The PPSSC joined the agreement in 2007. The MoU foresees quarterly Committees meetings between the decision-making bodies of the four authorities: NBR governor, the NSC president, the ISC president and the PPSSC president (or between the members assigned to represent these authorities). Five distinct Committees are stipulated in the protocol: the Financial Stability Committee; the Supervision and Control Committee; the Regulation Committee; the Payment System Committee and the Financial Statistics Committee. Members of all the parties in the Protocol are included in the structure of these technique committees and the presidency is ensured based on a rotation procedure.

As we can see, the collaboration process has a functional disposal. In the event of a financial instability period, the information exchange can be slowed down due to this spread over structure. These separate Committees do not perform their activity within the NBR and their quarterly meetings are not frequent enough. In this case, the information exchange can prove inefficient. There is no stipulation related to the organization of an extraordinary meeting or about the conditions which can lead to such a meeting. We sustain the idea that NBR must be the leading authority in this Protocol because it is the only institution which disposes of the necessary tools to prevent a financial crisis.

At ECOFIN Council recommendations, an additional agreement was concluded in 2007 between the Ministry of Finance, National Bank of Romania, National Securities Commission Insurance Supervisory Commission and the Private Pension System Supervisory Commission for cooperation in the field of financial stability and crisis management and for facilitating the information exchange. Based on this agreement, the National Committee for Financial Stability was set up.

A supplementary supervision, necessary in case of risks caused by financial conglomerates, does not have to negatively impact upon the prudential supervision of each separate activity. The construction of a Mixed Supervision Committee is necessary for detecting systemic risks. In Romania we have a functional architecture of cooperation and five such committees. A reorganization of the financial conglomerates supervision framework is needed in order for the supervision activity to become more operational.

Conclusions

The arguments for and against the maintenance of the regulation and supervision function of the banking sector within the central banks mutually equilibrate themselves, none of the two thesis eliminates the other. However, in case of an economy whose development is ongoing, including the former planned economies experiencing transition nowadays, more factors incline the balance in favour of the integration the banking supervision within the central banks. Many central banks in these countries have been reformed and they enjoy solid guarantees related to independence (sometimes guaranteed by the constitution). Their

governors often have a strong security of their positions, and the central banks have their own financing sources. As Schinasi (2003) noted, the central banks have a natural role in terms of financial stability.

We have to mention that the effective supervision can not be guaranteed through the modification of the regulation structure and the recent trend to set up a SSA between European countries does not always stand for the best solution. Buiter (2007) considers that after the failure to prevent the financial turbulences at the end of 2007, the supervision structure in the United Kingdom proved its limitations, the FSA being inefficient. It is necessary for the central banks to stay involved in this process as they are the bodies which have available the instruments necessary to correct the imbalances.

Through their participation to the ESCB and by the accumulated knowledge and experience, the NCB can gain an advantage in terms of prudential control and systemic risk management. The NCB are both a component of the EU structure and national institutions, fact which can represent an advantage in solving international issues or issues related to the good functioning of the European financial system supervision.

Unlike these institutions, the national supervision authorities which are distinct from the central banks have an exclusive national mandate and have only formal or sometimes informal connections with the Ministry of Finance in the respective country. In case a problem occurs, these agencies are less concerned in systemic aspects and more in the cooperation with the national authorities.

Nevertheless, the choice of a certain supervision regime has an endogenous nature depending on the economy and institutions' structure, on the context but also on the definition given to the financial stability safety nets. Moreover, it is necessary to take into account an average or a longer time horizon.

The regulation and supervision framework in Romania is a sectoral – specialized one. It reflects the structure of a financial system where the banking sector has a significant share. By the set up of mixed supervision committees between the national authorities, the compatibility with the supervision framework, under construction at EU level, is ensured and, at the same time, the decision making process gains an increased efficiency. However, the functional structure of these mixed committees should be revised to have an adequate systemic overview. In addition, taking into consideration the fact that only the NBR possess the instruments required to correct the imbalances, the mixed committee should function under the tutelage of this institution.

We do not exclude the possibility to rethink the Romanian financial supervision in the future. One of the most important elements is the remodelling of the European supervision framework by the creation of a European Authority of Financial Services. Another reason is the failure to cooperate in the supervision of financial conglomerates. The passage to a unified supervision framework could be put into practice by an intermediary stage, similar to that in Netherlands where the Bank of Netherlands, after the merger with the Pension and Insurance Board, in 2004, became responsible for prudential supervision of the entire financial sector. In the meantime, the control and supervision of the compliance with its regulations was attributed to the *Netherlands Authority For the Financial Markets*. The elimination of the NBR from the banking supervision activity does not represent a solution for the present situation and it will not improve the financial supervision framework. Even if a SSA will be implemented in the future, the national bank still has to be sure that the banking institutions fulfil their obligations and responsibilities.

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Ph.D. Liviu C. Andrei
National School of Political Sciences and Public Administration, Romania
Ph.Student Dalina Maria Andrei
Institute of Economic Forecasting" of Bucharest, Romania

THE EUROPEAN UNION BETWEEN THE MONETARY "SNAKE" AND THE COMMON CURRENCY

Abstract*: The European economic integration started in the aftermath of the World War II, but its specific monetary story just since 1971. The European Community here made history by her performing, as real lessons of the monetary topic area, but despite this the whole history of money world-wide is much longer than that. The aspect emphasized and developed in this paper will be, however, the one that the "Monetary Snake"(1971), European Monetary System (EMS/1979) and even the current Euro currency seem to have resulted from a deep monetary crisis world-wide. Not being "euro-skeptical", we conclude that all these could be missed in exchange of a plus of welfare.*

Key words *: monetary history, economic integration, monetary Snake*

JEL Classification *: E42, E50, N14*

Some scholars[1] argue that Europe might be a distinct area, with a particular model of economy and even of existence. Let us debate some aspects of this idea of the early twenty-first century in the text below. Nevertheless, this debate will limit to the monetary aspects, whereas conclusions will though extend to a larger area of ideas.

1. The European view: monetary and integration theory and policy

The European Union (EU) benefits from both its integration process and policies and its specific theory of integration. And here might be mentioned Balassa (1961), with her stage description of the integration development. We'll see below that his author's merits starts even by the 1961 year of her paper's appearance.

In such an order of facts, integration appears as optional (so was for these European countries) as both entirely and stage by stage undertaking, so starting from its incipient free trade area and customs union stages and finishing by its economic and monetary union final one. Then, to be noticed that the monetary problems of the European Community started in early seventies, and her retorts to were, correspondingly: (1) the Monetary "Snake" (1971), (2) the European Monetary System (EMS/1979) and finally (3) the unique European currency (1999 and 2001) -- as also corresponding to three leaders of the European Commission on each of these moments: Pierre Werner, Roy Jenkins and Jacques Delors.

So, in early seventies, previously to the Monetary Snake formula, the Europeans realized their dependence on the American currency and the international monetary system (IMS) settled at the Breton Woods international agreement two and a half decades earlier. The floating exchange rates were the ones engendered by what was happening to the central international basic value, as the American dollar was, at least since 1944. Moreover, the "Snake" proved itself a kind of fiasco, as the result of numerous cases of breaking the agreement by member States.

Then, in 1979 the decision for building the EMS was as ambitious as a sort of a "declaring independence". Despite this, McKinnon (1993) notices the rather unexpected similarity of the EMS (1979) with the so criticized at the time IMS(1944), as seen in the Table 1.

[1] Marin (2006)

Table 1 Comparing the Breton Woods IMS (1944) and the EMS (1979) on their basic construction items

Ord.	Item	Breton Woods IMS (1944)	EMS (1979)
1	Nominal anchor	US$	DM
2	Financial Managing Institution	IMF	EMI*
3	Account currency	SDR	ECU
4	Exchange rates	fixed	fixed
5	Metal (gold) base of currencies	yes	no

* As differently than the IMF case, the EMI was founded later, in 1994, after the Maastricht Treaty (1991) deciding the EMS replacement by the common European currency (the Euro).

Actually, McKinnon (1993) was arguing that the EMS not only was unable to get scientifically superior to the IMS, but it would also follow the latter's path of self destruction. As the ultimate argument for such a forecasting, the American author indicates the gold metal base of the US$ (line 5, in the table), in a unanimous opinion context in which the metal base of money ever was the most appropriate supporting fixed exchange rates. In other words, the EMS missing all metal base for its national currencies exchange rates amongst would get bankrupted under the money market heats forcing the central banks to too much expensive interventions everyday.

The McKinnon's view can be understood in two ways. There can be mentioned that the author was historically wrong. So, the EMS has not ended the same way as its previous IMS had, but it was replaced by the unique currency in the next following and ending stage of integration. Moreover, the American Professor here makes some mistakes, as in details. As for instance, the two international monetary systems were much different size, meaning similarly different in their economic homogeneity degrees. First, the IMS rule was starting in 1944 for a high variety of national economies and economic developments, whereas the Western Europe economies were always much different situation than that. Second, the metal base of currencies is overestimated by the author, even for the 1944 moment and monetary system. See below that the gold standard could not work, but internationally, so its insertion into the IMS-1944 remained rather on the psychological level and was going to work like that, as reduced to a formal commitment of repaying dollars by the American part. Third, the similarity of positions between the US Dollar and the Deutsche Mark, for the two monetary systems, is obvious as nominal anchors, but once more different degrees of their direct involvements in the corresponding market areas. The dollar was supposed to feed a world-wide economic area in the proper sense, whereas its German correspondent for Europe had correspondingly a much more relaxed task, given the same specific European economic context[1].

On the other hand, the McKinnon's demonstration keeps a more profound aiming. This is the theory of the optimum currency area (OCA), which is explained below and needs a really genuine consideration. So that, the EMS hasn't got bankrupted, it could still work today, but its end was imminent in any way. Through replacing the EMS by the European common currency, the European governors actually proven their knowledge and respect for the OCA theory, and that meant taking over the German responsibility, as monetary, for the entire area. In other words, the united Europe preferred a new problematic context to be solved in a new timing inserted, to an old one well known as missing any solution (Andrei 2007a).

The EU looks today much transformed and different than what she used to be in early seventies. Even different than in the EMS time, for which there are to be mentioned the fixed exchange rates here supported without a metal base and the end of the system, as thoroughly controlled, as European specific strengths. All those steps achieved, plus the Euro currency gathered together have made of course a great political success which belong to the two successive centuries.

And which is the new problematic context, as mentioned above, skipping the old American influence upon the European monetary state of seventies and the threat upon the fixed exchange rates missing the metal base of eighties and nineties? The new dark clouds on European monetary union consist at least in the unachieved integration in the real economy terms and in the imperfection of any monetary union in the absence of the corresponding fiscal union, plus the latter's perspective missing.

2. The world-wide context: the Europe's monetary history is just a piece…

Recall the outline of economic integration by stages (steps) of Balassa (1961), but equally that the monetary problems of the European Community were starting later on, in the first years of seventies. That

[1] Let us mention, among other things, that there were working here around currencies like the French Franc and Pound Sterling(Guitton, H & Bramoulé 1987). Vaknin (2000) argues that the Sterling currency area does no longer exist.

was 1971, when the Breton Woods IMS basic terms failed. In practical terms, the FED – as just an executive Institution of the 1944 international agreement – broken the same agreement terms through devaluating the Dollar for three times during the same year and canceling the same currency gold convertibility, apparently "by herself".

But the European integration actually had started just after the last World War and the Americans had done enough help for – see only the "Marshall Plan" and the OECD founding examples. It is true that the European vanity hardly accepts today these events of such a significance. But, the question is: would the history between the Monetary "Snake" and common Euro currency ever take place in the absence of the post IMS crisis? Or, the answer to such a question is not quite easy.

The Breton Woods agreement among States (and very open to all States of the world at that time) built the IMS which since ensured the monetary order world-wide for two and a half decades. This IMS was not the first one. It followed the basic principles of a previous one, which, despite that, had been much different in its structure and had ruled a much different world and world economy apparently for much longer. That was the so called (international) gold standard. The Breton Woods IMS founders have first of all explicitly recognized what the gold standard had been in its qualities and significance. But implicitly there was also recognized that this could not be revived any more.

2.1 The gold standard

2.1.1 Some other history

The European States had monetary systems based and ruled on the gold system since 1470s. So, that was much earlier than what is called the modern international economy. Later on, the USA were following the European way, with a similar monetary structure, plus a specific for frictions between State banks and the Federal Reserve. The first were for gold standard, the latter for the banking system centralizing – and this was for a true "internal war" (Stepczyznski 2002). As for the Asian continent, there was another particular aspect: the State monetary systems also converged to the unique basing standard, in early nineteen century, but this was not gold, but silver. The stage of gold standard, in modern Asian States, came one century later(Davies 1996). The Latin Monetary Union (1867-1926), a pale precedent of the present European Union, was the lonely international organization mentionning the gold standard in her own status.

One more aspect for the old Europe. France temporarily adjusted her monetary system into "bi-metalism" (gold-silver), in which, however, gold was essentially preserving its master rule. But the system succeeded to be a model for other States at the time, and Romania was one of them for a while, at the end of the nineteen century.

Banks and central money making Institutions, supported by States, were now and then interrupting their own currency gold convertibility. That was the case of Napoleon wars and, after 1900, of the First World War. Some authors saw the "death of gold standard" in 1912, but they were wrong. The enough influential at the time "Bank of England"[1] respected once more the gold rule, after 1920.

As for theoretical bases of the gold standard, it is to go back about one century earlier, in 1831, when Karl Marx(1958) was claiming a unique value reference on any market space, as of principle. There is to be undeerstood the author's accusing the multitude of currencies left from early ages, braking the new modern market working, so making it unfunctional. And that was for an essential dissimilarity between the nineteenth century (multiple currencies) and the next one (inflation and currency devaluation-depreciation). But the classic of labour-value theory was far from being a gold standard supporter himself. Besides, the gold standard adversaries were born, even amongst primary theorists. As for instance, David Ricardo had come in earlier than Marx and worked, together with other specialists, on building a project for replacing gold standard by what they were calling a "general price index". This project was never done.

In real terms, the gold standard was out in 1931, when "Bank of England" rejected the gold convertibility of sterling. And the example was followed, in 1933, by the other economic superpowers of the time, France and USA. The gold rule was out eversince, except for the US dollar, in 1944, in a fully different context.

2.1.2 The ruling and economic mechanism

The gold standard was built much more thoroughly than ever thought, in older ages. Only its internationalizing was done later on, plus it is still largely controversial, as theory. Its supporters indicate a short and simple set of functional principles for all. Its adversaries, in their turn, claim that it was (and is) just fiction (Meutey 1984).

[1] A kind of today International Monetary Fund (IMF).

Assuming that the system was working, the State was declaring his currency, as convertible into a metal mass, and itself commited to supporting it. But this, never preventing the free market of gold, so the metal's market price. Any person was, so, free to keep it, sell and buy it on market, and convert it into currency, at the State monetary Institution. Anyone was, on the contrary, purchasing metal on market or from the State, using money.

But the most important aspect come on the State side, as much as he rejected any accounting preocupation for money supply. So, we say today that there was no monetary policy. Also interesting for the today conditions, the unit value of the currency was preserved, at least around the gold market value, irrespective of any State preocupation about. As for an important aspect of the gold standard philosophy was, this way, the one of reflecting the basic economic liberalism, as for the minimal State and free competition concept. The system fallen down later on, in the twentieth century, but the first denying it were also the liberal economists: this was for too much monetary constraint.

Now, let us go back to the system description, now in the international context, where the free market concept was consistent: gold was freely leaving the country space and nobody was stopping it at the boundaries. The metal mass was paying imports and, more rarely, supporting foreign investments. Basing on its consistency about the free market on both domestic and international levels, there can be asserted that the gold standard was as exact as an economic-mathematical model. Its single restriction was that all countries (states) were supposed to support it. And actually, this was also not too much hardwork on this. The principles set of such a rule was as "natural" as simple to implement, and no rule could be missed or added up to. In other words, the rule was universal and States might feel free not to negociate or sign any agreements in such a respect. So, this system was really unique.

Andrei (2000) tries an explanation about what was the gold standard, using two models of settling the market value in macroeconomic systems missing the currency. Big letters nominate utilities on the market, small letters associate to these utilities corresponding quantities for settling basing values and, finally, the $\Leftrightarrow$ sign indicates that every utility and corresponding quantity of its left side have meat the utilities and corresponding quantities of its right side.

(A) $aA \Leftrightarrow bB \Leftrightarrow cC \Leftrightarrow \ldots \Leftrightarrow nN$ the "horizontal" model

(B) $aA \Leftrightarrow nN$ the "vertical" model
$bB \Leftrightarrow nN$
$cC \Leftrightarrow nN$
$\ldots \Leftrightarrow \ldots$
$mM \Leftrightarrow nN$

Both models base on the Leon Walras' theory of settling prices on the market. The two models are not essentially similar, but basically related to each other. The most interesting aspect of this pair models is that a historical approach of them might discover (identify) (A) as the primary barter economy model of all times and (B) as the gold standard, here meaning the last stage of the same barter economy. The historical difference between is essential: (A) is a small (cell) macro system of the ancient times, with a small number of goods, the highest price stability ever achieved and no internal contradiction. On the contrary, (B) extends to the world-wide market of modern times (the XVIII and XIX centuries).

And, as the most important conclusions of these theory: (1) the "engine" of this very long term economic mutation is just the need of eliminating the market confrontation among all utility items, so clearing the way of the unlimited extending of their number; (2) this way, the relationship between the two models might explain something of the well-known price and value stability of the gold standard. In such an explanation context, the gold standard has existed, worked out the modern currency in the aftermath of its artificial selection as market value standard (reference), and even has got able to base the first IMS of the economic history, as explained below.

But let us also approach the essential international achievement of the gold standard. The State trade and external balance of payments was supposed to be in deficit, or conversely. As for the deficit, gold was leaving the domestic area and State monetary reserves. Then, money supply contracted, so did the price and cost systems on the short while. Just on the contrary for exceeding balance of payments: the more the amounts of metal on market and reserves, the higher the money supply, the higher the prices and costs, as consequinces. Interesting to be noticed that the currency unit value stayed untouched by the trade balance

disequilibria, whereas money supply was suffering – and the economic consequences are ever supposed to be different, as starting from these different macroeconomic positions.

Then, the downward pressure on domestic prices was followed by creating competitiveness for the domestic economy on the international market space. But rising the same prices did the opposite, as in an old David Hume's theory (Meutey 1984). Enough for fulfilling premisses of restoring the external balance equilibrium, on both opposite circumstances. This way, the gold standard supporrters argue that this one did enough for achieving the international monetary system requirements. It is true that this international mechanism was working on larger periods of time, than on domestic areas.

2.1.3 Concluding remarks for the gold standard

There is, first, to make the difference between two value concepts: (1) the money exchange rates, which were fixed, and (2) the prices, which were just stable – much more stable (non-inflationary) than they would be in the next following non-gold monetary system. The gold standard was also supposed to create a specific price system world-wide – for all market goods and services. Here there are adversaries who contredict such an idea (Oprescu 1981). There is to be claimed, by supporters, that, through the gold standard the economy itself extended world-wide, as money were.

As summarising, the gold standard was: free market, minimal (liberal) State in the economy, stable prices, fixed exchange rates, free competition capitalism, equilibria of interantional trade flows, as on medium and long-term trend, and an international price system, as world-wide. The gold standard contained, besides the non-monetary policy aspect, the State indifference between the two senses of the external balance of payments disequilibria, and his option for equilibrium only.

Shortly, once more, it might be an international monetary system (IMS), unless controversial, fulfilling the two unanimously accepted requirements: (1) a unique stable value, as basis: (2) an international mechanism for external balance of payments equilibria remaking. The gold standard was a worldwide IMS by both its international price system and the restriction of the rule adopted by all participant States.

2.2 Later on, the Breton-Woods Agreement (1944), another IMS, a different history, but a similar end

A decade time called international monetary disorder**,** after 1931-1933, radically changed the worldwide economic picture, but one thing remained: this was the need of a new international monetary system. The context had, at least, a double new issue: (1) the need for rebuilding the old national economies damaged by the World War II**,** and, here connected (2) the need of a new status for the forthcoming international transfer of capital. In other words, there were the foreign direct investments (FDI) and the famous "Marshall Plan" for the Western Europe to talk about.

Let us have a very brief description of an IMS, under the shape of an international Agreement negotiated near the American capital, in 1944. Actually, the international money standard had the US dollar, instead of gold. As a completion, the American FED was re-applying the gold convertibility rule for the US $, but now this was the lonely currency in the world doing this. The other currencies were denominated into Dollar units firstly and functionally, and only secondly into gold. Officially, there was a new "hybrid" money standard: dollar and gold.

Aware of its incapacity to provide both a worldwide unique stable reference value, the new system provided a managing Institution, which was the International Monetary Fund (IMF). The World Bank legally helped this, and member States of the Agreement were supporting both Institutions. The basing working rule was that member States had free economic policies, except for the exchange rates of their currencies. The exchange rate was fixed, as of principle, as in the old gold standard conditions. So, any State intervention about the exchange rate of the currency was supposed to be discussed with the IMF (Fund), actually with the other member States. In exchange, the Fund was helping States to remake their external balance of payments equilibrium, and not only.

The new IMS lasted for two and a half decades, up to 1971, when, finally, the exchange rates stopped being fixed, as ensured by the IMF and member States. As missing space for thorough analyses, the import thing is that the Breton Woods international agreement has built the second IMS existing, but also ending in the same way as the international gold standard: to floating exchange rates, apparently as the basing symptom of monetary disorder. However, two specific aspects might be there noticed. The one is common to the years 1931 and 1971: the IMS meant cooperation among States and State indifference between the two senses of disequilibrium of the external balance of payments. The IMS is rather incompatible with monetary policy. The non-IMS is, on the contrary, economic confrontation among States and State preference for both equilibrium and plus in the external balance of payments. The non-IMS equally makes room for monetary policy, as well as the other policies are stronger and strongly defend the home economy against (even) the other economies.

The other one was not common, but new in 1971 and ever since: no other IMS was possible to be rebuilt(Corden 1994) and no commonly agreed idea of, except for a restraint area, like Europe.

2.3 The optimum currency area (OCA), instead of IMS

There is a verry problem of the economic thinking, and this is about the IMS idea, more precisely whether the non-existance of IMS would get equivalent to the monetary disorder, as international. It is the idea of currently living in the middle of a monetary disorder for, this time, three and a half decades already, since there is no any gold standard any longer, and the US dollar is continuously declining either. Besides, remaking the IMS (building another IMS) looks as impossible as finding a new standard of value, like the gold metal (1818-1931) or even the "dollar-gold" (1944-1971).

A new image of the international money order was outlined by Robert Mundell (1961) and achieved by other authors, including Ronald McKinnon (1993). The optimum currency area (OCA) theory keeps the old idea of a single basic value of reference, but argues that, within the international market area, this cannot be, but a national currency. Then, there is a money(nominal) anchor, instead of the standard of value or material general-value equivalent. Then, a national currency, versus the rest of national currencies creates assimetry in the international area. The economy issuing the money anchor will be an " anchor economy" herself. The anchor economy or country will let her currency freely cross boundaries, and this will pay for non restricted imports. Actually, such a circumstance will play two roles: (1) feeding the international market area with the money anchor for all basic money functions; (2) building a home market, as price formation basis for the same international market and economy. The economy anchor will moreover money-feed the international area at least through direct investments and credit.

The anchor economy will be, then, as asymmetric as her currency is supposed to be. As opposite to the other economies (countries), there won't be any monetary policy (restrictions), by definition – actually, this idea might prolongate to the circumstance in which the anchor economy practices the weakest monetary policy in the whole area. Plus, this country's external balance of payments will certainly have deficit, as much as it serves the rest of economies. On the other hand, the other countries feel free to exert monetary policies and regulate their external balances of payments, in the interest of their money stability.

The OCA might be an area of stable prices and balance of payments in favour of the participant countries. It also accepts the exchange rates floating, but differently than in the Friedmann's (1953) view. As evaluated by cost-benefit analyses, the OCA might be optimal – when benefits exceed costs for all countries and economy makers in the area.

But the real problems occur when everybody might be happy in the area, except the anchor money and economy. This is the statutory contradiction of the currency freely flowing abroad, so naturally depreciating against the other currencies on which monetary policies are freely exerted. This also is the contradictory position of the country that play an asymmetric international role, without a corresponding return for her and her firms and population, at least on short or medium terms. That was the Breton Woods Agreement, not in favour of the US. That also was the UK's context after the World War I, as preserving the gold standard, as no longer functional. And there is the same theory applying for what happened after 1971, when, actually, the earlier world monetary system broke down into a number of currency areas[1], instead of encountering the simple monetary disorder of 1931. The anchor gets bankrupted, as McKinnon argues[2]. The area will feel forced to search for a new anchor.

2.4. Some "Euro-conclusions"

Europe, in her turn, benefited from several essential particularities. First, she was developing on the area of Deutsche Mark (DM), once the Bretton Woods Agreement's ended working. That was while the rest of the world started working by different monetary areas, but also while two other old European currencies[3] had their own areas outside Europe. Second, Europe had proceeded to a complex integration process since the same end of the last World War. Third, an important moment of this (1979) was the one of the European Monetary System (EMS) and McKinnon (1993) explains the (paradoxical) similarity between the last Bretton Woods IMS (1944) and the EMS (1979) through actually fulfilling the same set of requirements on both sides of international monetary systems. Fourth, also basing on its integration process, the EU preferred the common responsibility for their own money and monetary policy, to the „old fashioned" type of a monetary system in which Germany and Bundesbank were keeping the monetary responsibility for the whole area. Fifth, all these above seem to contredict the assertion of the integration theorists so far: that all steps of integration and the integration itself would be optional for the concerned economies. On the contrary, at least

[1] See the Dollar, Yen, Deutsche Mark, French Franc and Sterling areas (Guitton&Bramoulé 1987).
[2] McKinnon (1993).
[3] the French Franc and Pound Sterling.

the monetary part of the integration appears as compulsory, in given conditions. There are also currency areas in different parts of the globe even not basing on so thorough integration process as in the European case. Sixth, the Euro Currency Area (ECA), as in the same OCA view, does not limit to the twelve EU member countries giving up national currencies for Euro, but includes the rest of prè-in countries.

Then, recall Balassa (1961), plus a long list of authors[1] currently basing a true European „culture" of the XX and XXI centuries. And recall the question asked above: was this monetary integration of the EU region necessary as sinequanon ?

Partly, the answer was just given here above and it is affirmative: the Union was forced to be also monetary. But there is equally another part of the same question asked: let us assume, from the very beginning, an IMS working well and no monetary or other kind of crisis world-wide. Let us assume no regionalising tendency or mainstream. So, what would be the „United Europe" off any of these crisis aspects ? Certainly, it is not easy at all answering this question and everybody might wonder if this really makes sense. We cannot answer this question either, as entirely, but we are able to assert that, instead of a whole pro-European ideology (versus „euro-skepticism"), we would be supposed to have more prosperity world-wide. In Europe, certainly. And we are not euro-skeptics.

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[1] See Viner, Tsoukalis, Thibault de Silguy, Pelkmans and many others.

Dir. Grigore Bâce
National Bank of Romania, Cluj-Napoca, Romania

FUNCTIONS AND OBJECTIVES OF CENTRAL BANK OF ROMANIA

Abstract. *In the paper the author shows the functions and the objectives of National Romanian Bank, taking into account the new duties of Romania EU membership.*

Key words: *functions, objectives, monetary circumstances*

1. Introduction

The National Bank of Romania is a central bank and acts as institution representing the state in order to establish and coordinate monetary and credit policy of the economy. The central bank has a special role in maintaining the stability of the national currency and the trust of the population in banks.

2. Method and Results

Central banks have, in general, the following functions (even if, sometimes, these responsibilities are divided between governmental organisms):[1]

- establishing and introducing the monetary and credit policy;
- issuing coin;
- administration of foreign currency reserves;
- supervision of the financial-banking institutions;
- last borrower;
- acts as state agent and keeps in its records state's Treasury;
- providing funds for the state;
- ensuring the relation with international financial-banking organizations;
- Analyst of the monetary and economic circumstances.

In a technical paper, Daniela Beju differentiates the responsibilities of the central bank. Functions of the central bank are the following:

- issuing coin;
- determining and introducing the monetary policy;
- determining and introducing the foreign currency policy;
- bank of the state;
- Bank of banks.[2]

Among the responsibilities of the central bank, the same author mentions:

- ensuring primary coin;
- regulating, organizing, coordinating and performing the monetary circulation in the economy;
- elaborating and introducing monetary and credit policies in economy;
- shaping the foreign currency policy of the country, determining an adequate foreign currency regime and implementing it;
- Exerting the general control over banking activities and applying the principle of prudential supervision of the banking societies.[3]

Moreover, we note that the National Bank of Romania has special attributions, related to the transition period from centralized economy to market economy. They are:

- ensuring a fair competition between banks;
- Encouraging the development of fair banking practices that would support the development of a healthy private sector.

One of BNR's objectives is that of ***supervising the banking system***.

[1] *L.C. Ionescu – The Banks and the Operations, Economica Publishing, Buharest, 1996, p.71*
[2] *D.Beju – Monetary Politics,House of Science Pub., Cluj-Napoca, 2006, p.84*
[3] *D.Beju – qw., p.84*

The supervision of the payment system is a way of maintaining the trust of the population in the banking system, since not making payments in due time decreases the confidence of the requester it in the institution that engaged in performing the respective operation.[1]

The central bank decides which units may operate as banks and determines the regulations for issuing the functioning authorizations of the banks. It monitories the activity of commercial banks by constantly demanding financial reports and by making controls at their headquarters.

Banks with financial problems are under a special supervision of the central bank. If requested by circumstances, it will provide a 'saving portfolio', so that the population should not lose confidence in the banking system.

A first function of BNR is that of ***performing the monetary and credit policy*** of the state.

In this sense, the central bank controls the level of the monetary mass and interest rate in economy, as part of the general, macro-economic policy of the government. This situation led to debates referring to the independence of the central bank. The central bank usually collaborated with the Ministry of Finances in order to dole the main issues of the monetary and financial policy.

In Romania, the central bank is an organ of the state, and the members of the Administration Council of BNR are named by the Parliament. In the name of the Administration Council, the governor of BNR presents, on an annual basis, to the Parliament of Romania the round-up concerning the monetary and credit situation.

Another function of BNR is the function of ***issuing currency***.

The central bank has the monopoly for issuing currency. In principle, currency is issued according to the economic growth. Issuing currency over the real economic necessities – over-issuing of currency – may lead to inflation; stopping governments of generating an inflationist process by the supplementary issuing of currency, may be another argument for the ensuring the independence of the central bank.

By its issuing function, the central bank has the responsibility of the monetary circulation quality and dimensioning of the monetary and credit mass (by operating the discount tax, operations on the free market, system of minimum compulsory reserves).[2]

Issuing currency is usually guaranteed by the state, being a monopoly of the central bank. Issuing bills and administering the primary currency represents the essence of the public service performed for the community by the central bank.[3]

In order to prevent being counterfeit, money have incorporated a series of specific characteristics, for example the support is made through a special technique and includes several security elements. The central bank also handles the gathering of the used bills in order to destroy them when they are too dirty or deteriorated to be used. These bills are, usually, burnt or minced.

Another role and, at the same time, another function of the central bank is that of ***bank of banks***, acting as a banker of other banks. Central banks demand the other banks to keep at the central bank a part of their deposits as reserves, as deposits without interest (or with a low interest).[4] This is an aspect of the general process of monetary control; rising or lowering the requested level of reserves, the central bank is able to increase or decrease the capacity of the banks to give credits.

With this role, of bank of banks, the central banks opened account for commercial banks, receives deposits from them and is last borrower for them.[5]

According to several specialists in the banking field, this function is related to the previous one and implies the direct involvement of the Central Bank in the activity of commercial banks on several levees:

- the central bank administratively regulates the functioning of the other banks that function only with the approval of the central bank and according to the functioning norm it imposes;
- Central bank regulates and administers the liquid availables of the other banks from the national banking system, availables held in accounts by the central bank.

The central bank ensured the normal unfolding of the payments between commercial banks and, consequently, in economy, both by regulating the circuits of payment instruments and by ensuring the institutional framework of unfolding the monetary transactions and performing certain services in the field of payment documents circulation.[6]

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[1] *idem, p. 120*
[2] *M.Stoica – Banking Management, Economica Publishing, Bucharest, 1999, p.29*
[3] *D.Beju – Qw., p.84*
[4] *D.Beju – Op.cit., p.84*
[5] *D.Beju – Op.cit., p.132*
[6] *V. Dedu – Administation and Banking Auditing, Editura Economica Publishing, Bucharest, 2003, p.27*

The central bank can also hold accounts of the commercial banks used in discounting inter-banking debts.

The function of ***bank (agent) of the state*** implies the fact that BNR should act as state treasurer, bookkeeping the current account of the Treasury of the state. In this account there are reflected the taxes and other payments made in the name of the Treasury of the state.

The central bank of not government's creditor, even if it helps it to identify other loan sources with the economy.

This function results, above all, from the nature of the propriety form of the capital of the central bank, since in most cases this belongs to the state. This function is also connected to the fact that the state gave the monopoly of issuing currency to the central bank, precisely in exchange of the possibility of obtaining resources.[1]

As banker and casher of the state, the central bank book keeps in the account of the state, makes payments and proceeds through it, is able to give down payments and loans to the state under certain circumstances, may act as agent of the state as far as issuing, sale and repurchase of state bonds and other effects through[2] which the estate borrows from the public are concerned.

The most common financing methods are opening credit lines for ensuring the flexibility of current bank administration. This financing method represents a direct borrowing method of Treasury.[3]

The function of ***ensuring funds for the government*** is highlighted when the government borrowed money from the economy and the central bank acts as its agent and consultant. The government borrowed from the national market, offering for sale securities, for example treasury bonds. The central banks, as agent of the state, may act directly, or through other banks, in the process of issuing obligations or other documents, in their sale and repurchase and the payment of the corresponding debts. It also offers counseling for the best security to be sold, the level of the interest to be paid, credit conditions and the time when the sale offer should be made on the market.

The amount of money owed by the government is called ***public debt***. The central bank administers public debts by reimbursing the value of the obligations and other securities when they reach their due time and replaces them with new ones (if necessary). The general reduction of the public debts level is accomplished by the central bank through the purchase of governmental securities from their holders (but using the sums provided by the government).

The function of ***administration of foreign currency reserves*** suggests that BNR should keep the reserves of the country in gold, convertible foreign currency and other reserve assets internationally recognized. The central bank used these reserves when it intervenes on the foreign currency markets in order to control the evolution of the national currency exchange. The foreign currency reserves are also used for ensuring the convertibility of the national currency on the circulating medium market.

The function of ***last borrower***_implies the fact that the central bank should lend money to commercial banks in order to support those banks that, temporarily, have insufficient liquid funds for paying the sums requested by deponents.

This is a temporary assistance. On long term, banks have either to solve their problems with liquidity, or to stop their activity.

The function of ***ensuring the relation with international financial-banking organizations*** shows the important role in international economic and financial cooperation held by BNR. The central bank administers and keeps record of the financial operations of the country with international organisms, such as The International Monetary Fund or The World Bank. BNR participates, in the name of the state, to external discussions and negotiations in financial, monetary and payment issues.

3. Conclusions

An important international financial institution is the Bank of International Settlements from Basel (Switzerland). Initially founded (in 1930) for handling the transfers concerning international debts, BIS became "the central bank of all central banks". Together with the settlement of payments between central banks, BIS also handles issues referring to bank cooperation, agreements concerning the regulations to be used in international financial transactions etc.

The sessions of the group of countries also known as G7 (USA, France, Germany, Italy, Great Britain, Canada and Japan) are very important in international financial cooperation. A broader forum for

[1] *D.Beju – Qw., p.86*
[2] *idem*
[3] *V.Dedu – Op.cit., p.28*

discussing the international financial issue is G10 formed by G7 + Sweden, Belgium, Holland and Switzerland (there are 11 countries, but Switzerland is neutral). On these meetings there usually participate ministers of finances, but the central banks have always a major role in the discusses issue.

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Prof. univ. dr. Nicolae Balteş
"Lucian Blaga" University of Sibiu, Romania

THE ROLE OF CORPORATE GOVERNANCE IN BANK RISK MANAGEMENT

***Abstract**: Banks are exposed to financial, operational, business, and event risks. Corporate governance provides a disciplined structure through which a bank sets its objectives and the means of attaining them, as well as monitoring the performance of those objectives. Effective corporate governance encourages a bank to use its resources more efficiently. Financial risk management is the responsability of several key players in the corporate governance structure. Each key player is accountable for a dimension of risk management. The key players are regulators/lawmakers, supervisors,shareholders, directors, executive managers, internal auditors, external auditors, and the general public.*

***Key words**: Financial risk management, corporate governance, the credit risk, speculative risks.*

The liberalization and the volatility of financial markets, the increasing competition and the diversification expose banks to new risks and challenges, thus causing the need of continuously innovating the ways of managing a certain activity and its risks, with a view to maintain and support competition. The risks that the banks are acing can be divided into four main categories: financial, operational, business and event risks.

The financial risks may cause a loss for the bank if they are not correctly managed. At their turn they are divided into pure risks that include the liquidity risk, the credit risk, the risk of solvency and speculative risks, based on the financial arbitrage, that may cause profits or losses depending on the accuracy of arbitrage.

The operational risks are associated to the organizations and to the functioning of the internal systems of a bank including the computers and other technologies.

The business risks are associated to the background of a bank's activity, namely the macro economical policies and the financial and legal infrastructure.

The event risks include external risks such as political crises or banking crises that, were they real, they could jeopardize the operations of a bank or they could harm the financial status and the degree of capital adequation.

The quality of the bank management and especially the process of risk management, embody the main preoccupations in order to grant the security and stability both of the bank as an entity and of the banking system in general.

Corporate governance in credit institutions

The management of the banking risk implies a partnership in which every factor has a clearly defined responsibility for a certain part of each risk type. (fig 1).

The relationships established among the management of the bank, its Board, share holders and other partners define the corporate governance, referring to the manner in which a credit institution is governed, including the setting of the objectives, and of the risk profile with a view to protect the interests of depositors and other beneficiaries. One credit institution may be said to have corporate governance when it includes key elements such as:

a) A well defined corporate strategy, in which both individual contributions and general successes may be assessed.
b) The establishment and the implementation of clear sets of responsibilities in agreement with the risk profile
c) A strong ability of managing financial risks and appropriate systems of internal control (including internal and external audit positions)
d) Internal regulations, conduct policy, effective systems used for the insurance of conformity, with a view to monitor risk exposure
e) Financial incentives offered by the Board to the management and to the employees, in agreement with the set objectives and the performance
f) The transparency of the information both inside the institution and outside it, towards the public.

FIG 1. Partnership in corporate governance of banks

Financial and Other Risk Management Areas

Key Players and Responsibilities	Balance sheet structure	Income statement structure and profitability	Solvency risk and capital adequacy	Credit risk	Liquidity risk	Market risk	Interest rate risk	Currency risk	Operational risk
Systemic (key players):	**Accountability (dimension of risk for which key player is responsible)**								
Legal and Regulatory Authorities	Set regulatory framework, including risk exposure limits and other risk management parameters, which will optimize risk management in the banking sector								
Supervisory Authorities	Monitor financial viability and effectiveness of risk management. Check compliance with regulation								
Institutional (key players):									
Shareholders	Appoint "flit and proper" boards, management, and auditors								
Board of Directors	Set risk management and other bank policies. Ultimate responsibility for the bank								
Executive Management	Create systems to implement board policies, including risk management, in day-to-day operations								
Audit Committee/ Internal Audit	Test compliance whit board policies and provide assurance regarding corporate governance, control systems and risk management processes								
External Auditors	Express opinion on financial statements and evaluate risk management policies								
Public/Consumer (key players):									
Investors/depositors	Understand responsibility and insist on proper disclosure. Take responsibility for own decisions								
Rating Agencies and Media	Inform the public and emphasize ability to service debt								
Analysts	Analyze risk-based information and advise clients								

The Board – organic structure in charge with risk management

Although each of the key factors presented in figure 1 have clearly defined tasks and responsibilities, according to banking laws, the ultimate responsibility concerning risk management is attributed to the Board and to the bank's management.

The members of the Board, as key factors in risk management, have to have the adequate qualifications and skills in order to be able to efficiently assess all the details pertaining to the activity of the credit institution. The Board of a credit institution has to be strong, independent and actively involved in the bank's business and together with the executive they have to adhere to the high ethic standards, being able to act for the benefit of the institution. Recent studies show that almost 60 % of the banks that went bankrupt, had in their board, members who, either did not have the necessary knowledge in the banking field, or they were uninformed and inactive concerning the supervision of the bank's activity. An abstract of the responsibilities of the Board concerning risk management is present in box no. 2.

BOX 2. THE BOARD'S FINANCIAL RISK MANAGEMENT RESPONSABILITIES

Legal principles in banking laws and regulations leave no room for doubt that the board of directors should be regarded as the primary player in the risk management process. The board's primary responsibilities are to:

- Formulate a clear philosophy for each risk management area.
- Design or approve structures that include clear delegation of authority and responsibility at each level.
- Review and approve policies that clearly quantify acceptable risk, and that specify the quantity and quality of capital required for the safe operation of the bank.
- Ensure that senior management effectively takes the steps necessary to identify, measure, monitor, and control the bank's financial and operational risks.
- Periodically review controls to ensure that they remain appropriate, and make periodic assessment of the long-term capital maintenance program.
- Obtain explanations where positions exceed limits, including reviews of credit granted to directors and other related parties, significant credit exposures, and adequacy of provisions made.
- Ensure that the internal audit function includes a review of adherence to policies and procedures.
- Formally delegate to management the authority to formulate and implement strategies. (The board should forever, critically appraise and ultimately approve the strategic plan.)
- Specify content and frequency of reports.
- Ensure sound staffing and remuneration practices and a positive working and environment.
- Perform an annual evaluation of the performances of the chief executive officer.
- Elect a committee, primarily made up of nonexecutive directors, to determine the remuneration of executive directors.

In our opinion, the most important responsibility of the Board is to make sure that the management has the skills, knowledge, the experience and the professional reasoning required by a solid and responsible management of the bank. The Board sets the directions of activity, monitors and supports the efforts of the management, making sure that there are adequate control systems to be able to identify and solve the problems before these become major ones.

The executive - organic structure in charge with the implementation of risk management policies

The responsibility for banking operations and the implementation of risk management policies is attributed to the bank's executive. The general manager and the managerial team have to lead the daily activity of the bank according to the policies of the Board, to the rules and regulations that must be applied, and they have to be supported by a solid system of internal audit. The management have to offer the needed information to the auditors so that they be able to accomplish their responsibilities and to rapidly and totally meet the demands of the Board. The responsibilities of the management towards financial risk management are summarized in box no.3

The role of the management in identifying, assessing, measuring and managing the risks is presented by the Basel Committee on Banking Supervision. The committee has established that risk management has to be part of the everyday activity of a bank manager to make sure that the systems of risk management are correctly implemented and the procedures are followed entirely. Besides, the management has to make sure that the bank has adequate internal audit systems, including appropriate audit agreements, because the failure of risk management occurs not due to unanticipated or extraordinary risks but rather to an ineffective decision taking process and to a weak audit system.

The audit committee and the internal auditors – a valuable tool for risk identification in a bank

Even if there are contrary opinions concerning the value of the audit committees and of the internal auditors, we think that these have an important contribution in the process of risk management. The mission statement of an audit committee should be that of "improving operational risk management at group level". Thus the objectives of the internal audit activity could be the following:

- to allow the management to identify and manage the risks of the activity

- to deliver an independent assessment
- to assess the effectiveness, the efficiency and the economicality of operations
- to assess the agreement with the rules, regulations, policies and directions of operation
- to assess the credibility of the information communicated by the informational and accountancy systems
- to offer investigative services to the line management

The monitoring and the management of the internal audit is part of the general responsibilities of the audit committee. The responsibilities of the audit committees and those of the internal auditors are summarized in box no 4. Both the Board and the management have to have a tool to help making sure that the policies are followed ad literam and that the risks are properly managed.

BOX 3. FINANCIAL RISK AND MANAGEMENT RESPONSABILITIES

Management's responsibilities with regard to financial risk are to:

- Develop and recommend strategic plans and risk management policies for board approval.
- Implement strategic plans and policies after approval by the board.
- Establish an institutional culture promoting high ethical and integrity standards.
- Ensure development of manuals containing policies, procedures, and standards for the bank's key functions and risks.
- Implement a effective internal control system, including continuous assessment of all material risks that could adversely affect the achievement of the bank's objectives.
- Ensure the implementation of controls that enforce adherence to established risk limits. Ensure immediate reporting of noncompliance to management.
- Ensure that the internal auditors review and assess the adequacy of controls and compliance with limits and procedures.
- Develop and implement management reporting systems that adequately reflect business risks.

BOX 4. THE RESPONSABILITIES OF AUDIT COMMITTEES AND INTERNAL AUDITORS

The responsibilities of audit committees and internal auditors in financial risk management are to:

- review management's adherence to board policies and procedures;
- provide assurance regarding corporate governance, control systems and risk management processes;
- verify the adequacy and accuracy of the information reported to the board by management;
- report periodically to the board regarding adherence to policies and procedures;
- improve communication between the board and management;
- evaluate risk management measures for their appropriateness in relation to exposures;
- test all aspects of risk activities and positions;
- ensure effective management controls over positions, limits, and actions taken when limits are exceeded;
- ensure that managers fully understand the established policies and procedures and have the necessary expertise to implement the;
- assess operations and suggest improvements.

According to a market oriented approach, an audit involves all the methods used and measures taken for a certain business to safely keep its assets and to safely manage its risks. At the same time it involves the assessment of the correctness and the credibility of the information provided by the accountancy system, the promotion of the operational efficiency and the support for the adhesion to the management policies.
The most important duties of an internal auditor are 'providing feed back concerning corporate governance, the control systems and the risk management processes'.

The responsibilities of the external auditors concerning risk management

The main objective of an external audit is that of allowing the auditor to express, in an audit report, their opinion concerning the correctness of the financial reports made by the credit institution. The traditional approach of an external audit, according to the requirements of the International Audit Standards include, in general, an evaluation and an analysis of the internal control systems. As the activity of the external auditor is an extra protection for the banking service consumer, we think that the passage form an audit mainly of the balance to an assessment of the inherent risks in the banking industry, is important. When such an approach is taken by all the auditors in the financial institutions, the risk management process will be significantly enlarged and all the users of banking services will beneficiate from it. The responsibilities of the external auditors are summarized in box no 5.

BOX 5. FINANCIAL RISK MANAGEMENT RESPONSABILITIES OF EXTERNAL AUDITORS

External auditors have the responsibility to:

- evaluate risk inherent in the banks they are auditing;
- analyze and evaluate information presented to them to ensure that such information makes sense;
- understand the essence of transactions and financial engineering (structures) used by the client bank;
- review management's adherence to board policies and procedures;
- review the information supplied to the board, shareholders, and regulators;
- review adherence to statutory requirements;
- report to the board, shareholders, and regulators on the fair presentation of information submitted to them.

In our opinion the job of financial auditor has to become important as part of the process of banking supervision. The letters to the management and the long form reports provided by auditors may give the Board and the management a valuable insight into various aspects of the operations made by the credit institution. This is important especially when the external auditors find facts that could jeopardize the stability of the institution or even that of the whole banking system.

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Professor Ioan Bătrâncea
Sorin Borlea
Victor Ardelean
Andrei Morcviciov
" Babeş – Bolyai"University of Cluj Napoca, Romania
Associate Professor Aurel Bejenaru
"Dimitrie Cantemir" University of Targu Mureş, Romania

LEVERAGE FINANCING VERSUS SELF FINANCING

Abstract. In the paper the authors present the modalities of financing the company taking into account two different ways, the owner's capital and the borrowing capital.

Key words: optimal structure, debt, capital, degree of financing

1. INTRODUCTION

An *optimal capital structure* depends on several factors. If a company finances its activities through credits, the creditors expect that the invested sum and the corresponding interest should be paid back according to the loan contract. The impossibility of the company to pay back the due sums leads to suing.

The financing of a business through *credit* is cheaper then through capital. This is caused by the fact that:

1. The creditors require a smaller part of the profit then shareholders do. The investments financed through credit imply a lower risk then investments financed by the shareholders since they wish to receive dividends, which have to reach at least the level of the interest given by the bank to the deponents. But, at the same time, self financing is safer as far as the risk assumed by the company is concerned.
2. A profitable business generated a leverage cost lower then the cost of shareholders' equity, since gross profit is reduced by the tax on profit, which represents a deductible expense from a financial point of view.
3. The cost of attracting new credits is usually lower then those for issuing new shares.

In our opinion, there are several positive aspects resulting from the financing of a company through leverage. However, companies tend to avoid high external financing levels because of the high financial risk. This can be explained by the fact that interest has to be paid to the financial creditors irrespective of the cash flow level. If the company has difficulties with its operational activity, it will surely have problems with paying its obligations towards its non financial creditors, shareholders, financial creditors etc.

The basic idea of the financial leverage is the following: if the company obtains a big profit, shareholders claim as dividends the profit remaining after the reimbursement of the crediting cost. If the profit is low, creditors have to be paid and shareholders can not claim dividends.

The impossibility of the company of paying the interest as determined by the credit contract may generate its *financial incapacity* and, therefore, this situation is a constant pressure on the company, determining it to adopt financial decisions under the pressure of time, in order to fulfill its legal obligations towards creditors. These decisions may not coincide with the interests of the company's owners.

The starting idea is that any capital has its price, so that solutions have to be hierarchized according to this price, but also with the risks implied by it.[1]

At a first glance, the most convenient solution for any company would be self financing by using amortization and profit capitalization, since, these own sources may apparently be engaged free, unlike the external ones that bear a cost. In fact, self financing also has its price. This represents the unaccomplished profit sue to the substraction from other placements of the sources engaged in self financing.[2]

This means that self financing is convenient only if the valorification degree of capital in the own company is higher then that offered by other placements or if one cannot attract foreign, cheap sources.[3]

[1] *C. Tulai, Public Finance, Science Publishing House, Cluj-napoca, 2003, p. 81*
[2] *Idem*
[3] *Idem*

The self financing capacity depends on its forms and the own sources engaged. If we look at self financing from the point of view of its objective, then we notice two forms:[1]

- Self financing of maintaining or replacement that allows the unfolding of the activity through the replacement of the depreciated assets. It is ensured basing on amortization and provisions (reserves for covering the depreciation of certain assets like inventory, debt securities, participations etc.)
- Self financing of development, for increasing the patrimonial assets through investments of economic growth. This is accomplished basing on the net profit for capitalization.

2. METHOD AND RESULTS

In the case of a company evaluated on the stock market, a part of the net profit is directed to dividend payment. What is left after this repartition servs for the development through self-financing.

In relation to the resources engaged, self financing may be:

- Net, accomplished basing on net profit;
- Gross, accomplished basing on net profit, amortization and
- Non exigible provisions[2]

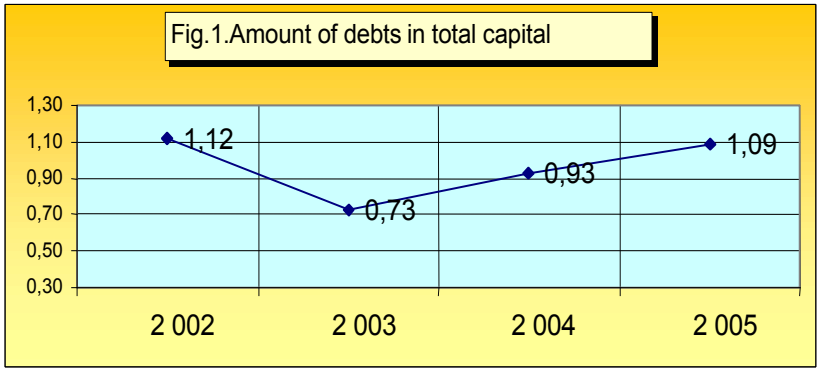
This meand that the maximum possibility of self financing (Gross cash flow) is given by the sum of the three sources.[3]

In order to evaluate the external debt service, a company has to calculate the leverage degree or the amount of debts in total capitals:

LD = Debts / Total capital

Table 1 Debt evolution in comparison with shareholders' equity evolution with SC ABC SA

Indicator	2 002	2 003	2 004	2 005
Total debt (DT)	97 217 073	89 964 477	139 336 362	159 570 651
Shareholders' equity (C_{pr}):	86 545 935	123 204 887	150 607 746	146 207 167
Amount of debts in total capital	1,12	0,73	0,93	1,09



From this graphic representation, as presented in the previous paragraphs, there can be drawn the conclusion that, on intermediary and long term, SC ABC SA can no longer request bank loand. The only way was self financing through profit or increase of share capital.

The closer the indicator is to 1, the higher the external financing of the company's operations is, as compared to self financing.

Another measure of evaluation *the structure of the capital* is represented by the degree of external financing (GFE), determined as a report between total liabilities and total assets and shows the degree of financing assets with debts:

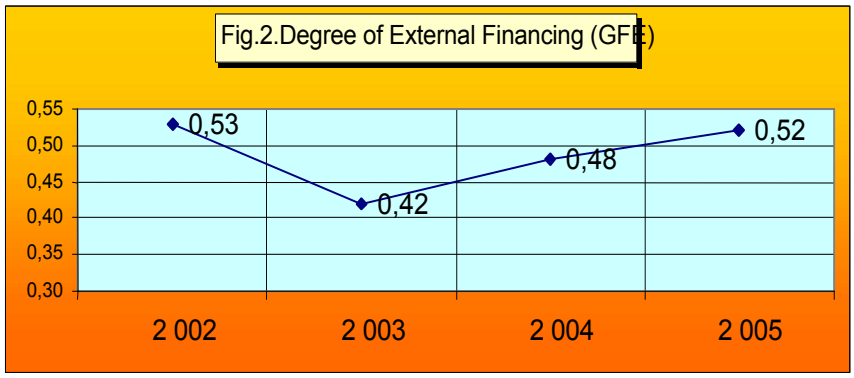
GFE = Debts/ Assets

[1] *Idem*
[2] *Idem*
[3] *P. Guyomarch- Dictionaire de l'entreprise, Haiter, Paris, 1993, in C.Tulai – Qw., p.81*

Table 2 Evolution of the external financing of assets with SC ABC SA

Indicator	2 002	2 003	2 004	2 005
Total debt (DT)	97 217 073	89 964 477	139 336 362	159 570 651
Total assets	183 763 008	213 169 364	289 944 108	305 777 818
Degree of external financing (GFE)	0,53	0,42	0,48	0,52

DEGREE OF EXTERNAL FINANCING



From the graphic representation above, we may notice a decrease of the external financing during 2002-2003 from 53% to 42%, followed by an increase up to 52% in 2005.

3. CONCLUSIONS

In practice, there is a tendency of companies from certain industries to use more financing through leverage then self financing. It depends on the difference existing in the structure of capital within these industries. So:

- industries basing more on research and development of new products and technologies (foe example pharmaceutical companies) tend to have a lower degree of financing assets through leverage then companies that do not rely on research – development;
- industries that require technologizations (for example shoe manufacturers) tend to have a lower level of these indicators.

It is interesting to notice the level of the indicators corresponding to leverage within different industries. For example, in power industry there is a higher level of this indicator then in beverage industry. There is a variation even within the same industry. The question rising is the following: why some industries tend towards a higher leverage degree then other industries? A possible answer would be that these depends on the role of the financial leverage, on risk and on the tax on income level.

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Dir. Grigore Bâce
National Bank of Romania, Cluj-Napoca, Romania

BENEFICIARIES OF FINANCIAL MEDIATION MECHANISMS

Abstract. *In the paper the author shows the modalities of financing the companies and the population taking into account different sources of capital.*

Key words: *primary debts, owners' equity, financial sources*

1. Introduction

The study of loans has highlighted many sides of credit relationships.

There resulted that the credit flows in economy is often inter-correlated, sometimes even overlapped, with capital and cash circuits. It is time to attempt a clarification by more accurately shaping the credit flow.

There also resulted the lively interest for the optimization of the placements that all participants to the crediting process have, participants that are aware of the interest level and thoroughly negotiate crediting conditions. We can ask ourselves: which is the framework of market relationships and which are the interested participants?

In order to answer to these questions, we will use the interpretation and presentation made by Gurley and Shaw[1], who, relating to modern theories (newkeyneism and modern monetarism); create an acceptable, instructive and contemporary vision.

According to this interpretation, there are three great categories of participants functioning in the economy (called last agents or expense units), which are appreciated according to the result of their budget:

- *surplus units*, which save (and look for a placement for these savings; these units are, in fact, *families*;
- *Deficit units* with development expenses higher then their accumulations or savings. These are generally called *non financial companies*;
- *Units with alternative situations*, respectively sometimes surplus, sometimes deficit, situation in which we find *the administration* and *the exterior* (this latter one represents the intervention of external economic agents on the internal market).

It is obvious that it starts from the evaluation of the generally accepted equation: savings = investments, which expresses the orientation of the general economic flow and shows the essential fact that in economy there are two poles: final borrower and last borrower, participants mostly to the process of redistributing capital in economy, among which there are many circuits going on.

2. Method and Results

A first circuit is represented by the *primary debts*.

On the other hand, within this circuit, non financial companies issue shares and obligations that they sell to the families, thus attracting the necessary additional capital.

Non financial companies also use intermediary and long term credits for the same purpose.

Families appear to be more and more interested in buying such financial assets[2] that bring interest and dividends. They obtain these assets wither by subscription, to by the access to the capital market, stock exchange.

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[1] *Gurley şi Shaw - Money in a Theory of Finance, 1960, reproduced after C.Basno, N.Dardac, C.Floricel – Monedă, credit, bănci, Didactică şi Pedagogică RA Publishing, Bucharest, 2003, p.144*

[2] *the financial assets* are the value documents that bring incomes in interests and dividends (shares, obligations, receivables but also trade effects). We can differentiate *real assets* (production and consume goods) and, important here, *liquid assets* (available deposits, treasury bonds, petty cash bonds). Liquid assets are charcterized by the fact that their use is not conditioned by a due time and liquidation/transaction costs and have a certai, fixed yiled, defined according to their nominal value.

It should be noticed that families for not engage all their economies in this stage, paying also attention to liquidated assets.

We have to stress the fact that this short term financing, also called direct financing, does not require financial intermediaries.

Financial intermediaries have a special role in the case of *secondary debt*.

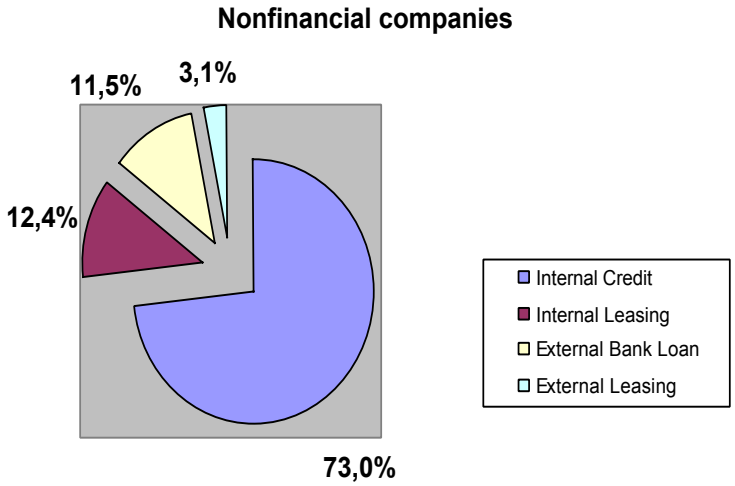
The main beneficiaries of non governmental credits are: non financial companies and population.

The main financial intermediaries are: trade banks, mortgage credit cooperatives, mortgage saving and crediting banks.

External credits are insignificant in the crediting process for the population. In the graphics below there are presented the percents held by different institution in the crediting of non financial companies and population at the end of 2006.

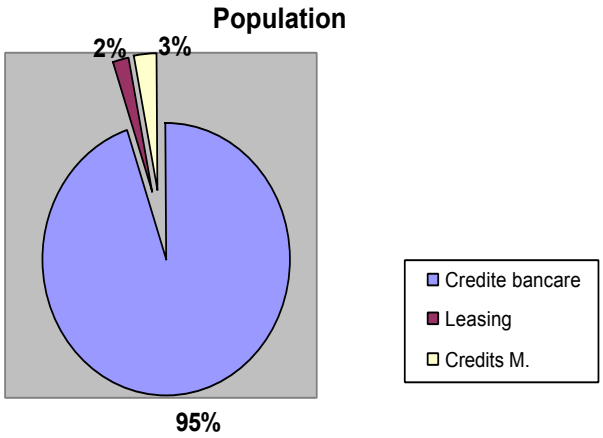
Non financial companies

- internal credit
- internal leasing
- external bank loan
- external leasing



Population

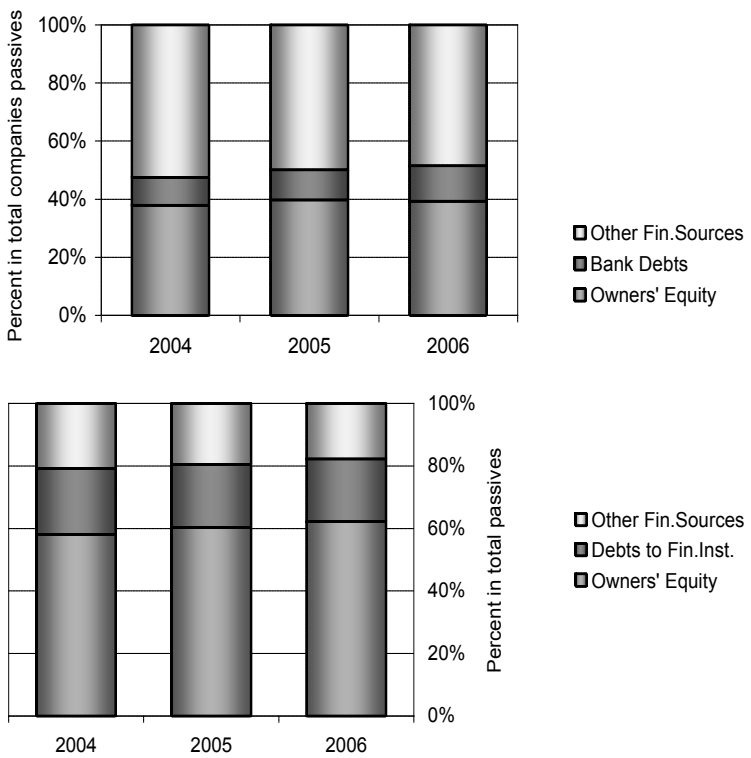
- bank loans
- leasing
- credits with mortgage and consumer credit societies



Graphic 1

Source: BNR, ALB, ASLR

Even if banking financing has the first place in crediting the Romanian companies, the financing level is inferior to that in the euro zone:



Graphic 2 – Percent in companies' Liabilities and Owners' Equity

From the analysis performed during 2004-2006 on their structure of net financing presented below,

Table 1 Financial structure **- % -**

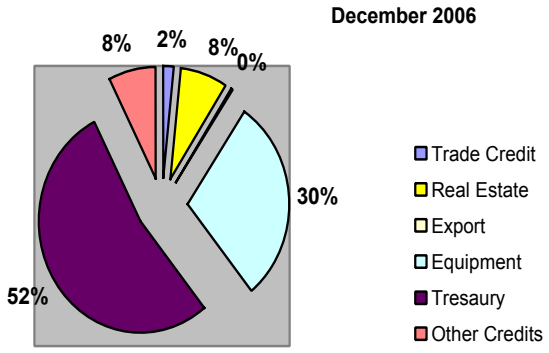
Category / Financing type	Non financial companies	Small business	Corporations 1	Corporations 2	Corporations 3	Corporations 4
Shareholders equity	47	40	32	96	47	59
Debts – total, out of which	46	57	69	3	42	26
-trade debts	39	46	20	4	26	24
- internal bank loans	10	12	0	-1	19	3
- external debts	3	1	18	-1	11	5
- arrears	-6	-2	31	1	-14	-7
Other liabilities	7	3	-1	1	11	15

- financial institutions provide less then 10% of the financing necessary of the companies;
- Big companies are financed more from own funds then smaller companies. The similar situation abroad is determined by the much bigger profits obtained by the big companies allowing them to provide more for development
- Big companies are less financed with bank loans then smaller companies, analogous situation aboard determined by the higher cost of credits as compared to the costs of issuing shares or bonds.

The internal bank loan increased its percent in the financing of small businesses and, analyzing the evolution of the internal bank loan, there can be noticed that this increased its percent in the financing of small businesses at the end of 2006. The main characteristics of this evolution are:

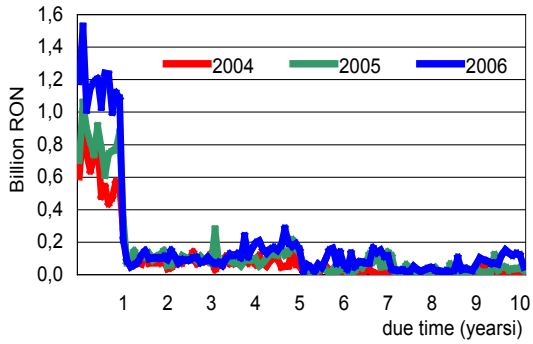
- increase by 35% in 2006;
- 62% from total credit is for companies, the rest is for the population;
- the percent of the credit in the balance sheet is 9.3%, while for small businesses is 19.7%;

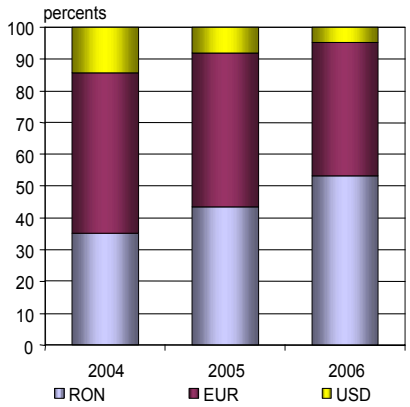
- 13% of the small businesses have internal credits;
- 86% have no bank loans.



Graphic 3

Internal bank loan is majority as short term and in national currency during 2004-2006.





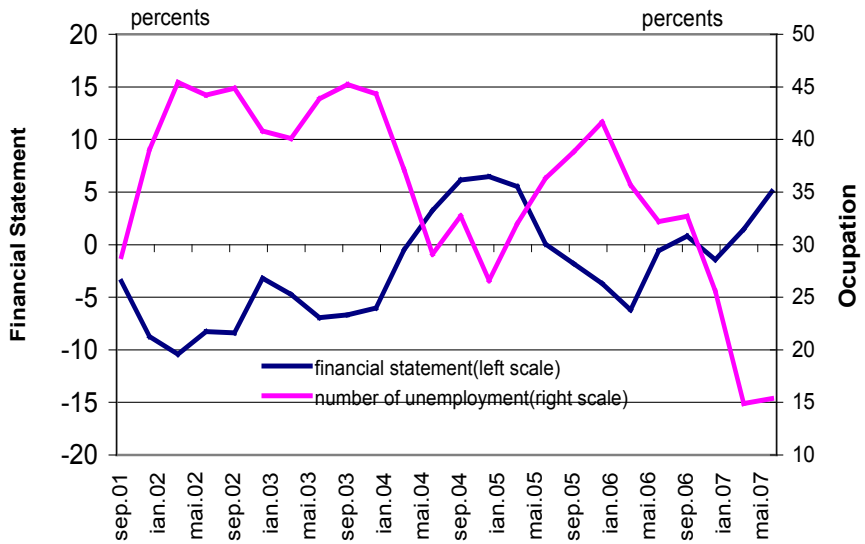
Due time (years)

Graphic 4

As far as the population's request for credits is concerned, we may notice a significant potential that can be valued, determined by:

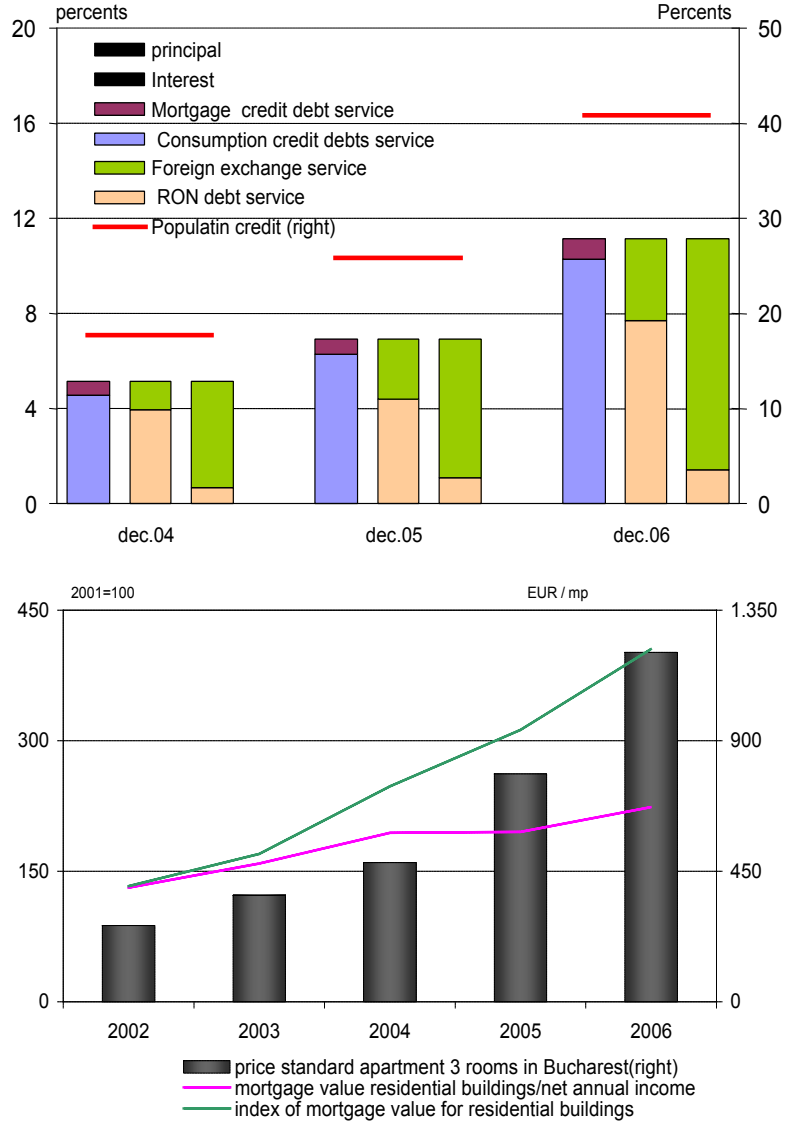
- the still low endowment with long term use goods;
- The marginal trend towards consumption is over the average.

The financial standing and unemployment during September 2001 – March 2007 is presented below:



Graphic 5

Even if the reasons mentioned above create the premises of the ascending evolution of population credits, there are concerns regarding the offer determined by the increase of the population debts service from 5.6% in 2004 to approx. 28% in 2006 and, on the other hand, caused by the very fast increase of real estate prices, which, for example in the case of apartments, has a spectacular evolution. Thus, if in 2002, the average price for sum for an apartment in Bucharest was 80-110 euro; in 2006 it was 1100-1200 euro.



Graphic 6

3. Conclusions

As a result of the analysis of the beneficiaries of financial mediation, there can be drawn the following conclusions:

- small businesses and households are the most exposed to the shocks of monetary policy;
- These two categories are mostly affected by bank specific shocks.

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Professor Maria Bătrâncea
"Bogdan Vodă" University, Romania
Larissa Bătrâncea
"Babeş – Bolyai" University of Cluj Napoca, Romania
Victor Ardelean
"Babeş – Bolyai" University of Cluj Napoca, Romania
Cătălin Dâmbean
"Dimitrie Cantemir" University of Targu Mureş, Romania
Andrei Moscviciov
"Babeş – Bolyai" University of Cluj Napoca, Romania

FINANCIAL STRUCTURE RATIOS

Abstract*. In the paper the authors show the modalities of analyses of the financial position of the company, using the financial structure ratios.*

Key words*: leverage, financial structure, debt, sales stability*

1. INTRODUCTION

The leverage capacity of a company expresses its possibilities of receiving securized credits. Their reimbursement, including the payment of interests, should not create unbearable financial difficulties.

So who is interested in determining the leverage capacity?

- First of all, the company itself, which, wishing to borrow money for financing a project has to evaluate both its available securities, as well as the positive future financial, flows, so that the reimbursement of the credits and interest payment should be made without problems.
- Second, the creditor or the bank, since granting credits, the bank assumes certain risks (of non reimbursement, un-payment of the interests, intangibility, devaluation of the currency) and, therefore, it is interested to be familiar with the economic-financial standing of the future client, in order to decide if it accepts the credit request or denies it.

That is why the decision concerning the financial structure has to be an optimal decision, in other words, to determine such a report between credit financing and own resource financing, so that the financing costs should be as low as possible. This financial decision depends on many factors, among which: the objectives of economic growth of the company, foreseen profitability level and the risk that the company agrees to assume, but also third parties (shareholders, banks and other creditors), state as well as the economic circumstances. The banking practice shows that the amount of credit should not be over 60% of the financing sources.

The decision regarding the financial structure (financing method) is influenced by a complex of factors:[1] ***sales stability; competitive structure; assets structure; operational leverage;[2]growth rate; profitability; taxes; control; market context; business risk degree; financial flexibility.***

The optimization of the financial structure, respectively that of financing proportion can be accomplished through several methods:[3] **Modigliani and Miller theory (mm),** respectively **the modern theory.**

The optimum financial structure[4] is that combination between shareholders' equity and borrowed capital that leads to the maximization of the market share price, or that structure that ensures *equilibrium*

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[1] *See, P.Halpern and oth. – Managerial Finances, Economica Publishing, Bucharest, 1998, p.655-659*

[2] *If fixed costs represent a high amount of the total costs of the company, it is said that this has a high effect of operational leverage*

[3] *At the basis of financial optimization lies, among others, the classic theory that shows that debt indicator (D/Cp = D) may be correlated as proportion of the debt in total capital (shareholders' equity + debts). This theory sustains that both shareholders and creditors are afraid of a too high leverage*

[4] *Modern theory of capital structure begins in 1958, when Fr. Modigliani and M Miller demonstrated, starting from a highly restrictive set of hypothesis, that, due to the deuctible character, from a fiscal point of view, of the interest corresponding to the borrowed capital, the market value of a company continuously increases while the respective company uses more borrowed capital, and that is why the value will be maxim when financing is made almost*

between *operational profit* and *risk*, so that it should maximize the company's value. The optimum capital structure can be determined from theoretical point of view, but, in practice, it can not be accurately estimated, reason why it is measured with the help goes the financial lever (D_t/C_{pt}).

The analysis of the company's trustworthiness[1] is made by determining its **leverage capacity**. For this task is in charge, first, the debtor and, second, the creditor, which, granting the loan, assumes certain risks.

The leverage capacity expresses the possibility of the company of engaging credits that should be guaranteed and the payment of the corresponding interests and due reimbursement of the loan do not create economic-financial difficulties.

2. METHOD AND RESULTS

The system of indicators of evaluating *the leverage capacity* are determined by reporting total debt (DT) to the liability of the balance sheet (TP), or shareholders' equity (C_{pr}).

$$K_{îg} = \frac{DT}{TP} \le \frac{2}{3} \qquad K_{îg} = \frac{DT}{C_{pr}} \le 2, \text{ so}$$

$$CÎG = \frac{\text{Total debt}}{\text{Total liability}} \le \frac{2}{3}; \qquad CÎG = \frac{\text{Total debt}}{\text{Shareholders' equity}} \le 2$$

Table 1 **The evolution of global leverage of resources with SC XYZ SA**

Indicator	2 002	2 003	2 004	2 005
Total debt (DT)	97 217 073	89 964 477	139 336 362	159 570 651
Total balance sheet liability (TP)	183 763 008	213 169 364	289 944 108	305 777 818
Global leverage coefficient ($K_{îg}$)	0,53	0,42	0,48	0,52

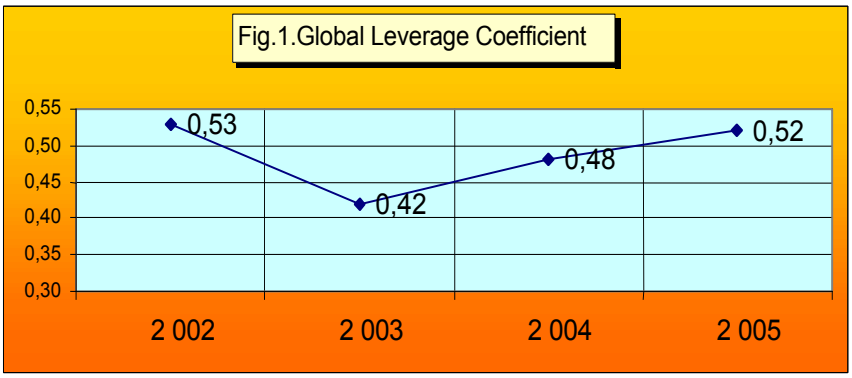


Table 2 **The evolution of global leverage of shareholders equity with SC XYZ SA**

Indicator	2 002	2 003	2 004	2 005
Total debt (DT)	97 217 073	89 964 477	139 336 362	159 570 651
Shareholders equity (C_{pr}):	86 545 935	123 204 887	150 607 746	146 207 167
Global leverage coefficient ($K_{îg}$)	1,12	0,73	0,93	1,09

From the two representations above there results that global leverage decreased during 2002-2003 and increased during 2003-2005.

b) the due time leverage coefficient ($K_{ît}$), determined through the reporting of due time (intermediary and long term –DTML) debts to permanent capital (CP), shareholders' equity (C_{pr}) and the self financing capacity (CAF = net profit + amortization – dividends – participation of employees to profit).

entirelythrough borrowed capital. The hypothesis are: a) there are no broker costs; b) there are no taxes on personal income; c) the profit from operational activities is not influenced by the use of borrowed capital etc. (see P. Halpern – Qw, p. 699)

[1] *The company's trustworthiness bears two forms: a) financial trustworthiness expresses the trust inspired by a legal entity with which certain economic-financial operations are determined, especially based on credit; b) commercial trustworthiness that stresses the capacity of a company of paying the obligations it is going to assume by signing a contract and following the stipulations of the respective document. The indicators characterizing the trustworthiness of a company are financial ratios (liquidity, solvability etc.)*

$$K_{\hat{i}t} = \frac{DTML}{CP} \leq \frac{1}{2}$$

$$K_{\hat{i}t} = \frac{DTML}{C_{pr}} \leq 1$$

$$K_{\hat{i}t} = \frac{DTML}{CAF} \leq 4$$

$$RDF^{1} = \frac{\text{Long term financial debt}}{\text{Permanent capital}} \leq 1/2$$

$$C\hat{I}T = \frac{\text{Due debts}}{\text{Permanent capital}} \leq \frac{1}{2}; \quad C\hat{I}T = \frac{\text{Due debts}}{\text{Shareholders' equity}} \leq 1$$

$$RAF = \frac{\text{Debts} > 1\text{ an}}{\text{Permanent capital}} \leq 1$$

Table 3 **The evolution of due time leverage with SC XYZ SA**

Indicator	2 002	2 003	2 004	2 005
Due debts (intermediary and long term–DTML)	29 730 177	28 603 328	33 712 286	29 594 985
Permanent capital (CP)	116 276 112	151 808 215	184 320 032	175 802 152
Due leverage coefficient ($K_{\hat{i}t}$)	0,26	0,19	0,18	0,17

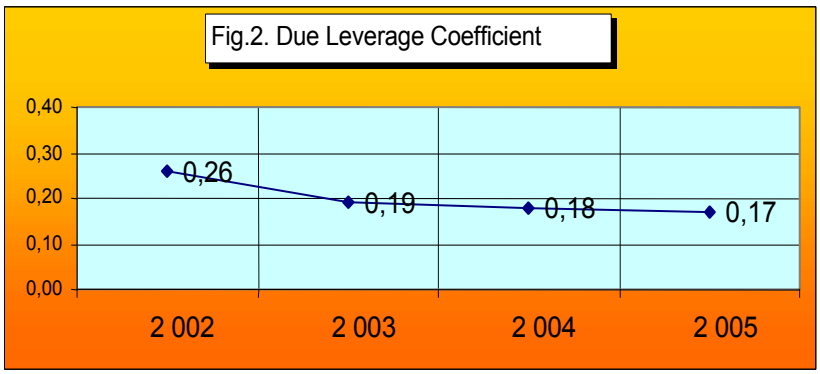
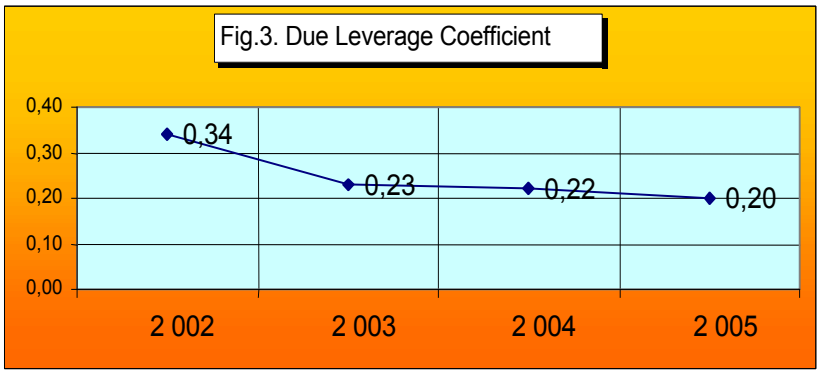


Table 4 **Evolution of due leverage according to shareholders' equity with SC XYZ SA**

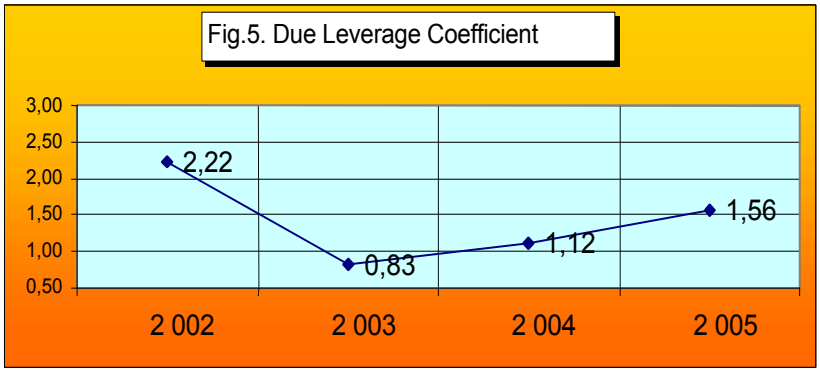
Indicator	2 002	2 003	2 004	2 005
Due debts (intermediary and long term–DTML)	29 730 177	28 603 328	33 712 286	29 594 985
Shareholders' equity (C_{pr}):	86 545 935	123 204 887	150 607 746	146 207 167
Due leverage coefficient ($K_{\hat{i}t}$)	0,34	0,23	0,22	0,20



[1] *I.E.Nistor – Enterprise Finance, House of Science Publishing, Cluj-Napoca, 2004, defines this indicator through financial debt ratio (RDF)*

Table1 5 **Evolution of due leverage according to self financing capacity with SC XYZ SA**

Indicator	2 002	2 003	2 004	2 005
Due debts (intermediary and long term–DTML)	29 730 177	28 603 328	33 712 286	29 594 985
Self financing capacity (CAF)	13 383 951	34 284 540	30 191 651	18 975 448
Due leverage coefficient (K_{it})	2,22	0,83	1,12	1,56



3. CONCLUSIONS

After all the graphic representations above, we may notice that, in dynamics, due leverage shows a decreasing tendency, excepting the last drawing that resembles in evolution to global leverage.

If the company reaches the maximum values of the above mentioned indicators, it means that it has a saturated leverage capacity and can not receive credits any more.[1] It takes as little as one indicator to be surpassed for the crediting operation to fail.

The financial result (±) that the company obtains as a result of using the credit as capital is called leverage effect (E_i). The leverage degree of the company (level of internediary and long term credits) depends on the correlation between economic profitability (R_e) and interest rate (R_d):

If $R_e > R_d \Rightarrow E_i$ positive and $R_f > R_e$

If $R_e < R_d \Rightarrow E_i$ positive and $R_f < R_e$

If $R_e = R_d \Rightarrow E_i = 0$ and $R_f > R_e$

The short term leverage policy is based on the decision of the company referring to the choice of the report between total debts and shareholders' equity.

The values of the indicators presented above express the real situation at a certain given moment, without taking into account the fact that, according to different circumstances, they can not be modified.

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[1] *M.Toma, P.Brezeanu – Finance and Finance Administration, Economica Publishing, Bucharest, 1996., p.17; H.Cristea and others.- Enterprise Finance, Mirton Publishing, Timişoara, 1999, p.190*

PhD senior Lecturer Marcela Bengescu
Lecturer, PhD student, Mihaela Dumitru
University of Piteşti, Romania

TYPES OF COMMERCIAL CONTRACTS AND THEIR IMPACT ON ACCOUNTING

Abstract: *Within the present paper we shall analyze the relation between the nature of the contract and the management of the economic entity, by taking as an example the case of contracts that contain payments in advance, the case of concession contracts, the case of contracts that include withholding of warranties for good execution. The nature of the contract between the buyer and the seller is influenced by: the range of contracted products, the responsibility of the contracting parties, the risk involved and the means of payment.*
All these elements convey a large variety of forms of contracts with influences upon the company's taxation and accounting.

Key words: *contract, advance payments, concessions, rent, warranties for good execution.*

JEL Classification: *M, M4, M41*

Preliminaries

The nature of the contract between the buyer and the seller is influenced by: the range of contracted products, the responsibility of the contracting parties, the risk involved and the means of payment.All these elements convey a large variety of forms of contracts. Within the present paper we shall analyze the relation between the nature of the contract and the management of the economic entity.

Advance Payment

Advance payments represent the partial or whole payment of the value of goods and services, made before the date of delivery or before the service is performed.

The fiscal code states through art. 134^2 letter b) that the maturity of the tax occurs when the advance payment is received, for payments in advance that are made before the date when the generating factor occurs.

Advance payments received for imports and value added tax correspoding to the import, as well as any advance payments received for operations which are exempted or are not taxable, are an exception to the previous statement.

The contents of art. 155 (1) of the Fiscal Code impl that the taxable person has the obligation of issuing an ivoice to each beneficiary, for the amount of advance payments received in relation to a delivery of goods or of services, as late as the 15th working day of the month following that in which the advance payments were received, with the exception of the case in which the invoice has already been issued.

By joining the aforementioned provisions we come to the conclusion that the supplier recognizes the debt to the state budget at the moment the advance payment is received and can issue the invoice at a date earlier than the receipt of the payment..

In our opinion, the date at which the advance invoice is issued should coincide with the date when the advance is received. In this way, the payer of the advance payment can benefit from the right to deduct the value added tax at the moment when the person receiving the advance payment collects VAT. Also, by introducing this rule, cases in which collecting the tax was delayed depending on the date the invoice is issued, can be avoided.

Taking into account the coincidence between the date when the payment is received and the date when the invoice is issued, the optimal succession of operations, as well as the fiscal and accounting analysis is outlined as follows:

Explanation	Accounting records and the effects on patrimonial elements

For the supplier

Issue of advance invoice	Clients		Client creditors		Collected VAT	
	X RON			X RON		X RON

Issue of advance invoice	Monetary Assets		Clients	
	X RON			X RON

Summary of effects	Liquid assets increase, simultaneously with the increase of trade debts and fiscal liabilities

For the buyer

Receiving the invoice	Suppliers -debtors		Deductible VAT		Suppliers	
	X RON		X RON			X RON

Payment	Suppliers		Monetary Assets	
	X RON			X RON

Summary of effects	Receivables from suppliers increase, fiscal receivables increase and liquid assets decrease

Observations: The analysis was based on a contract whose objective is the delivery of inventories. In case the buyer is going to classify the goods that are going to be purchased as fxed assets, instead of the receivables account he is going to use accordingly the unfinished fixed assets accounts: « Advance Payments for Fixed Assets ».

Concessions versus renting

The concession appears based on a contract in which one party, called the conceder, transfers, in exchange for a payment, to another party, called the concessionaire, for a predeterminded period, the right to benefit from the use of a certain good or from the execution ofa service.

According to the dispositions of paragrapf 76. (2) of O.M.F.P. no. 1752/2005, the concessions received are reflected as intangible fixed assets when the concession contract establishes a predetermined period of time and value for the concession.

The amortization of the concession is going to be registered throughout the period of its use, established according to the contract.

In case the contract states the payment of a rent, and not an amortizable value, the entity reveiving the concession reflects the expense regarding the rent, without recognizing an intangible fixed asset. Subsequently, the contractual clauses influence the way the right to use a certain good or service is reflected in accounting.

If the contract contains the notions of : “amortizable value” and “period of amortization” the concessionaire recognizes an intangible asset, simultaneously with a long term debt. Monthly or quarterly payments diminish long term debts, and the value of the concession is transfered periodically in the expense accounts through amortization.

In the second case, if the payments are called “rents” and the contract does not state an amortizable value, the concessionaire will only recognize the expenses involving rents..

The Fiscal Code: According to art. 134^1 letter b), in case of concession operations, the generating factor regarding value added tax occurs on the date specified in the contract for the payment.

The accounting analysis, in the case of recognizing an intangible asset:

Explanation	The effects generated in the balance sheet and the results account	
Recognizing an intangible fixed asset for the entire amortizable value	Concessions, licenses, trade marks, similar rights and assets	Other loans and assimilated debts
	X RON	X RON
Invoice for the retrieval of the price of the concession, in case the operation is taxable	Other loans and assimilated debts	Deductible VAT / Fixed asset suppliers
	X RON	X RON / X RON
Payment	Fixe asset suppliers	Monetary assets
	X RON	X RON
The amortization of the concession	Operational expenses regarding the amortization of fixed assets	The amortization of concessions, licenses, trade marks, similar rights and assets
	X RON	X RON
Upon the expiration of the contract the amortized fixed asset is removed from accounting	The amortization of concessions, licenses, trade marks, similar rights and assets	Concessions, licenses, trade marks, similar rights and assets
	X RON	X RON
Summary of the effects	**Effects on the balance sheet:** it modifies the value of the intangible fxed assets, long term debts and monetary liquidities. **Effects on the profit and loss account**: the recognition of operational expenses regarding the amortization of fixed assets. **Fiscal effects:** the deductible VAT increases proportionate with the value of matured installments, the profit tax decreases.	

The accounting analysis, in case the concession contract states the payment of a rent and not an amortizable value:

Explanation	The effects generated in the balance sheet, in the results account and in the special accounts.		
Recording the contingent debts in the special accounts	DEBIT 8036 Royalties, leases, rents and other assimilated debts		Total rents
Receiving the invoice regarding the rent, when the operation is taxable:	Deductible VAT	Expenses with royalties, leases and rents	Suppliers
	X RON	X RON	X RON

Payment of the rent	Suppliers	Monetary assets
	X RON	X RON
Diminishing the contingent debts	CREDIT 8036 Royalties, leases, rents and other assimilated debts	Rent paid
Summary of effects	The short term liabilities and the liquidities are modified in **the balance sheet**. Expenses regarding royalties, leases, rents and other assimilated debts are recognized in **the profit and loss account.** Contingent debts are generated in **the special accounts;** these are dimiished as the rents are paid.	

Note: According to art. 141 (2) letter e) of the Fiscal Code, concessioning and lending of fixed goods are exempted from VAT for domestic operations, with the exception of: accomodation operations that take place within the hotel sector or within sectors with a similar function, including the renting of camping spaces; renting spaces and locations for the parking of automobiles, renting machinery and machines that are permanently fixed in fixed assets; renting of safes.

Any taxable person may choose to be taxed for the operations stated by alin. (2) letter e), with the condition of notifying the taxation.

Amounts withheld as warranty

Within contracts regarding the execution of construction assembly works, as well as those for the delivery and installation of technological lines, the usual practice is for the beneficiary to withhold from payment a certain percentage of the contract price.

The amount withheld stays with the beneficiary as warranty, throughout the warranty period, i.e. the time interval in which the constructor or the seller of the machinery has the obligation to remedy any hidden flaws that occur after the delivery of the service, on his own expense.

The respective amount is returned to the supplier when the warranty period expires, if the eventual flaws have been remedied under the conditions imposed by the beneficiary. Sometimes, the beneficiary requests a bank warranty letter which is payable on demand in case the flaws in quality have not been remedied.

We now outline the case of contracts with amounts withheld as good execution warranties. Therefore, we will start with the example of a construction assembly work, with the total value of 10.000 RON, plus VAT 19%. The good execution warranty is 20% of the total value of the contract.

Accounting analysis:

Explanantion	Effects generated in the balance sheet, in the results account and in the special accounts.		
Invoice	Clients	Income from services performed	Collected VAT
	11.900 RON	10.000 RON	1.900 RON

Version I – warranty involving withholding from the value of the services

Receiving the payment, minus 20%	Monetary Assets	Clients
	9.520 RON	9.520 RON
Creating provision for the warranty	Operational expenses regarding provisions	Provisions for warranties
	2.380 RON	2,380 RON

Effects	The warranty is reflected in the debit side of the Clients account, by maintaining the receivable at the level of the amount of the warranty.

Version II – bank warranty letter

Opening the warranty letter

Other fixed receivables	Monetary assets
2.380 RON	2.380 RON

Receiving the value of the service

Monetary assets	Clients
11.900 RON	11.900 RON

Creating a provision for the warranty

Operational expenditure regarding provisions	Provisions for warranties awareded to clients
2.380 RON	2.380 RON

According to the Methodological Norms for applying art. 22 letter b) of the Fiscal Code, the provisions for warranties are created quarterly only for goods delivered and services performed throughout the respective trimester for which warranties are awarded in the future, at the level stated in the concluded contracts or at the level of the warranty percentages stated in the service fee.

For construction works that require warranties for good execution, according to the provisions of the concluded contracts, such provisions are created quarterly, within the limit stated in the contract , with the condition of integrally reflecting the value of the work performed and confirmed by the beneficiary based on the work progress status as an income.

Recording the provisions created for good execution warranties is performed as the expenses with the remedies are paid or upon the expiry date of the warranty included in the contract.

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Prof. Univ. Dr. Bogdan Ioan
„ Lucian Blaga" University Sibiu

"BUSINESS GLOBALIZATION AND INTERNATIONALIZATION OF ORGANIZATIONS - THEIR MAJOR IMPACT WITHIN THE MANAGEMENT OF ROMANIAN ORGANIZATIONS"

Abstract: *Business globalization and the internationalization of companies are two of the essential components of change – irreversible phenomena, which continuously amplify and diversify their ways of manifestation. Their structural effects have profound implications in the management of organizations. "Those who do not change will face unpleasant surprises', the renowned scholar Peter Drucker used to say.*

The consequences of failing to adapt the management to the rate of change are obvious on a day-to-day basis. Affected by such phenomena are particularly the companies whose attempts to adept are not systematic, cohesive, and scientifically approached.

Business globalization results from the narrowing of internal markets and the attractive effect of specific aspects of the global market insufficiently considered until the present moment. These aspects ensure competing positions for all the elements in the market, as well as new advantages on all level, such as markets of resources, of technologies, and top management of knowledge.

The internationalization of the companies and, more specifically, their emergence on the global market, is not only a purpose per se, but also has reactive and proactive motivations that must be carefully valued, the decision for their revaluation being one of the most fundamental, advantageous, as well as one of the riskiest options – depending on the level of scientific background. This decision involves the adaptation of the mission of the company, new strategies, new information management systems (taking into account the distances, the impact of multiculturalism, etc.), new organizational structures, new models for the optimization of decisions, the adaptation of the methodological system of management, adaptation of all functions of management and all functions of the organization – thus, of the management in general. This is the object of this paper.

Therefore the globalization must be addressed as a **characteristic and dominant phenomenon of the contemporary world,** because the local, national and regional issues **radiate** and form this phenomenon that enforces a **change in the perception and general philosophy on existence and development,** in all fields of human activity.

All these mutations are generated by **objective causes**, which if are not taken into consideration, expose companies to risks whose effects are yet **incommensurable**. Below you can find just a couple of those causes:

- **Globalization of science and technology,** as a result of the freedom of knowledge transfer. Within knowledge the secret is no longer important, but the rapidness they are converted to a competitive advantage.
- **Globalization of the identification and the use** of resources in general**;**
- **Globalization of marketing activity,** with extend to a global level**.**
- **The creation of a global financial system,** through internationalization of banking activity, financial world-wide institutions, free circulation of capital, liberalization and stimulation of foreign investments;
- **Globalization of the communication infrastructure,** which facilitates communications and transactions in real time, facilitating the economic and financial flows, in an ground-breaking rhythm.
- **A more profound impact of the activity of world-wide organizations** (for example the World Trade Organization)
- **Effect of the increase tendencies of the regional economic integration** (as an example the UE extension)
- **Deepening of international labor division and deepening** of interdependencies between national economies, etc.

The globalization of economic life is significantly reflected by the evolution of worldwide trade, by the global character of the market strategies - **which take into account the market globalization** - by the creation of a global economy built on transnational interdependencies, in all **fields of activity**: production, trade, services, finance etc., carried out in a new business environment, **more complex and more dynamic, challenging** for more performing initiatives, achieved through free trade and in a intercultural and multicultural context.

These mutations are already **reflected** in the **increase of international trade**, which outgoes in a significant rhythm, the industrial production and the gross internal product (GIP) (the international trade has grown over 80 times more in the last 50 years, while the industrial production has only grown 10 times more, and the GIP over 9 times), **which means** that a great portion of the production is achieved through imports, this **magnifying the global exchanges and deepening the international labor division.**

The mentioned evolutions **have not balanced, but have accentuated** the power of Western Europe, USA and Japan which together hold **approximately 60% of the worldwide trade** (approximately 38%, 15% and 7%). They get great advantages because of these evolutions that would have to be taken into consideration by other countries and companies, **first of all as a challenge**, for the weight increase of the internationalized production, starting from the fact **that in the mentioned areas and countries the gross internal product weight (GIP) of this type of activity is very high and has accelerated increase tendencies**. In the same manner should be treated the international serviced that are offered.

The conclusions draw attention on the fact that **although internal factors are the most important**, the performance of the national economy and companies is **contingent** more and more on the **performance of the participation in the worldwide circuit of material and intangible values**, in the development and utilization of **knowledge**.

International business, in this vision, **need a certain managing way**, an **international management**, which is the **management of international business;** it appears within relations between states, between non-governmental organizations and between national enterprises with **different cultures.** The main mutations that have to take place within companies' management are mainly the **following ones:**

- **Restructuring** of the entire provision activity and adjustment of managing equipment;
- **Appropriate** organization of the market activity, which implies the creation of appropriate structures for production and distribution of products and services, in a new perspective;
- **Restructuring of the communication activity,** especially within market research and within promotion of businesses on the international market;
- **Adapting** of products and services to the new markets and demands;
- **Restructuring** of the entire activity within **business negotiation** which takes place in a different environment
- **Improvement and adapting** of the decision system to the new conditions and demands;
- **Restructuring of the entire business contracting activity,** for the same reasons;
- **Selection and combining,** in accordance with other criteria, of the managing methods and techniques

Taken separately or as a whole, these **mutations have direct and profound effects within the management of organizations**, which is easily apprehended, thus **imposing a new vision** over their future, over international trade, over object conception and operationalization, over their subsystems and management functions, **aspects that I will come back to within my talk.**

All these and many more, **are motivations to accelerate the internationalization process of the organization**, and are grouped into **two major segments**:

- **Reactive motivations,** those that represent the answer to the demands and problems; they are certain and actual and have appeared within the organization, like competition (local, national and regional, as well as general, which forces the organization to be in a permanent quest for new markets, otherwise remaining with open production capacities, and per ensemble discontinuing its development), access to resources, to technologies, to effective management;
- **Proactive motivations,** those that are the result of development strategies, especially the strategies for the creation and better use of competitive advantage, strategies to strengthen its position on the market, promotion strategies etc.

The internationalization of the organization, in this context, **imposes great modifications within all management subsystems** (information, organizational, decision, methodological), within all **management functions** (provision, organization, coordination, training and control) and also within **all functions of the organization** (research-development, production, commercial and marketing, financial and human resource); all these functions are to be addressed especially from the point of view of the demands resulted from the economy, the organization and the management based on knowledge.

The internationalization process of the organization can not take place by chance, as a necessity generally accepted, but in a **scientific manner**, **on the basis of a new mission and strategy**, which imply **the following steps**:

- **Determine, using an analysis -** SWOT analysis **-** the potential of participation to the international economic business.
- **Establish the ways** of participating to international business that bring advantages to the organization and that can be fulfilled.
- **Choose the types of strategies** for the entrance and maintenance on international markets
- **Internationalization of the organization** in a multicultural and international context.

Determination of potential

The organization's potential to participate to the international businesses, is mainly given by the following components:

- **The available production capacities** and their performance in comparison with the demands imposed by international activities;
- **Technical and qualitative level of products** that can be manufactured and offered;
- **The possibilities of technological cooperation for** renewal, diversification and modernization of products;
- **Financial capacity** to invest in auxiliary costs and activities implied by the international activity (market research, training of specialized people, supplementary logistics etc), which can be recovered in time.
- P**rofessional capacity** of the stuff and of the specialized people the company can bring, in order to do market research and to promote its business, especially on long or average term, and the adjustment of the offer by standardization, selective adjustment or differentiation.

Therefore, **the decision to emerge on the international** market is a complex and responsible one and its substantiation starts with this diagnostic analysis for the determination of its own potential.

Establishment of the ways to participate to international business

Romanian companies can emerge on the international market through all methods by which a business can be promoted; **these are in a permanent diversification**.

The best know methods of commercial international businesses **are**:

- **Export of goods and services**, which refers to their selling on the international market, with advantages and disadvantages, that need to be well known and managed;
- **Import** of raw materials, tools, installations, modernization products etc, and the re-exportation of all these, after their processing, with higher prices and profits; this is a more competitive method.
- **Selling of the usage right of a technology, or** selling of technological knowledge, by which the goods can be reproduced, identically or more even better and can be sold on international markets, this being seen as a more advanced export of intelligence method.
- **Movement of production,** the technology transfer abroad, in order to manufacture and sell the products and services there; this is seen as a more complex international trade method, which implies better results and higher efforts for the company, but also a more solid position on the international market.
- **Creation of production and sale departments abroad** (branches, subsidiaries, joint-ventures etc), this being seen as a more solid presence of the company on that market, and has to prepared as such. The accomplishment is done through direct investments which have to rely on a long-term option, rigorously substantiated. We're talking about new entities created abroad, either as structures of the main company

(branches, offices etc), or as autonomous legal persons (subsidiary) with a long-term institutionalized base, which are performing commercial operations (import-export) , but also manufacturing;

- **International trade with commercial services,** the so-called invisible trade (transport services, insurance, tourism etc) which renders more valuable the technical, material and national foundation;
- **Combined exterior trade operations (re-exportation, pair-off commercial operations etc)** that aim the international techniques of revaluating the exchange opportunities and the profit increase;
- **Strategic alliances** for manufacturing and selling on international markets, which is the most modern and performant method for the valuation of your assets on international markets. They are based on long-term relations, materialized into proper common strategies and may exist as associations, corporations, joint ventures etc). They all have a main wide-spreading objective, such as the creation of new objectives and turnkey deliveries, by means of institutionalized cooperation.

Going back to the materialization of advantages and disadvantages of all methods presented, we would like to give the below examples:

- **Direct export has the following advantages: high profit** acquired by avoiding the establishment of specialized structures, experience in marketing, flexible adaptation to the market, promoting the brand etc. it also has its limits such as higher commercialization expenses that can be covered by a certain export volume, higher risks caused by the unknown, the need of certain specialized structures, which require some costs (compartments, export directions, agencies abroad, relations, logistics, expenses with administering of sales etc;)
- **Indirect export**: manufacturer – mail-order house – external client, therefore the manufacturer transfer to the mail-order house the commercialization activity, this having certain implications, such as the loss of some advantages, but also the avoidance of certain disadvantages, both easily perceptible.
- **Export through a commission agent:** manufacturer – intermediary – external client, with the same mentions in regards to advantages and disadvantages.
- **Exterior trade companies,** characterized by high specialization in marketing, negotiations, promotion, contracting, execution, the relationship being the following: manufacturer- exterior trade company –external client. Those companies are built by different principles: by trades, by geographical areas; by mixed principles, etc.

Of course depending on their potential and opportunities, **companies may use these methods and modalities** to emerge on international markets **individually or collectively, simultaneously or combined**, depending on the performance and abilities of the staff or of the specialists. Each method has of course its **advantages and disadvantages**, and the success of their combination is the amplification of advantages and the compression of disadvantages.

Internationalization strategies of organizations

Depending on market researches, on general strategies, on opportunities, **organizations can use a large variety of internationalization strategies.** We present below some of these strategies and their **main** characteristics and demands.

The global strategy

This is the organization's general strategy adapted to the demands of its internalization. It represents a general option for long-term development and naturally has to foresee the development trends, the strategic objectives for development, the necessary resources and the main methods used to accomplish its goals.

Active development strategy

This is a strategy through which organizations try to actively intervene to influence or to shape some environmental elements, to counteract the competition, resorting to offensive, even aggressive actions.

Passive development strategy

This is a strategy through which organizations adapt to the modifications that occur in the business environment, inclusively at a technical or technological level.

Innovative development strategy

This is a strategy recommended by specialists, within the context of change and of the organization's orientation towards the client, the context of an economy, organization and a management based on knowledge. They say that innovation has to be transformed "from a gleam of ideas" into a continuous

production of ideas and innovations. It is as well a means of building and turning operational the active development strategy, presented above. The innovation doesn't limit to the technical and technological side of the organization, but aims all domains of activity within the organization. (Research-development; Manufacturing; Sale; Financing; Usage of modern management methods and techniques etc). It essentially refers to the rapid incorporation of the results of scientific research within the manufacturing and sale activities, through accentuation of the influence of the qualitative factors of development.

Extensive and intensive – extensive strategies

For a long period of time organizations have chosen within competition the extensive modality, in order to conquer the markets, through amplification of the product and services offer, for an improvement of their situation on internal and external markets.

As the degree of saturation on the market started to increase and the competition accentuated, as the results of the technical and scientific progress grew and diversified, the intensive and intensive – extensive strategies gained ground, and development and diversification mingle with specialization.

Concentration strategies

They have been formulated to create a highly specialized offer with a high modernity coefficient, accomplished through a high degree of resource processing, along with the extension of activity in new sectors, which assure a diversity of users and markets and access to competitive technologies.

Organic Growth Strategies

They aim the growth mechanism by division and regrouping, thus creating new units, that value more the earned experience, oriented towards new users and more competitive markets.

Vertical Integration Strategy

It has been formulated to facilitate the integration of organizations into new domains of activity, both upstream and downstream of the traditional object of activity, following mainly accentuation of the specialization of these new integrated structures.

Market Strategy

It is a strategy specialized on the general problems on the market, and has importance within the context of change and of the organization's orientation towards the client. The strategy aims mainly the optimization in the relation organization-market, starting with the assumption that these can influence each other in a convenient manner. It is a general market strategy, that integrates the other know strategies: price strategy, distribution strategy etc.

Differentiation strategy

It has been created to differentiate the market segments, in order to treat them selectively and to satisfy them better.

Undifferentiated strategy

The strategy starts from the premises that the organization addresses to the entire market, trying to reach its objectives without rendering valuable its dissimilarity. It tries to impose itself through other methods: sale methods, price levels, promotion and distribution systems etc. It is specific especially to monopolies, which impose themselves through novelty of products and services.

Skimming strategy

It is chosen by companies which follow mainly a profit on short-term. During this time they chose products with a short life cycle, accessible markets, limited investments, usually small ones, and distribute its product in a large geographical area. It is mainly suited for consumer goods.

Penetrating strategy

It is a strategy necessary for markets that are difficult cu penetrate, that are profitable on a long term, that imply important investments. It is recommended with products that have a long manufacturing cycle, with equipments with a high degree of standardization. It is a sophisticated strategy, based on cost- benefit analysis, on complex market researches, on technological supremacies, on selling of high value products, which most of the times are strategic products.

Damping strategies

They are conquering strategies through prices; when they establish the final price, it is below the cost level and this is usually non-loyal competition. They aim is a quick cash-flow, or a long term control of the market. Markets are therefore accessible only through price.

Operating strategies

They aim the markets that are relatively not consolidated, with high prices whose access involves a progressive investment in time, and are suitable for long life cycle products; they pursue a long-term profit.

Strategies specific to multinational organizations

The strategies **reflect the international and global orientation of these organizations and have a complex typology**.

a) **Strategy of the source subsidiary,** which is the source of resources or services, and has as a main strategic objective the capitalization of the advantage of the lower cost;
b) **Strategy of the subsidiary with functional autonomy**, which refers to a subsidiary with the same object of activity as the main company, but autonomous, which is controlled by the main company only by property relations, by technological supply. The subsidiary pursues to promote the object of activity of the main company, on international markets. Joint ventures can be created, and they can function together on the external market.
c) **Complex integration strategies,** that aim not only the internationalization of manufacturing but of the other activities and functions of the main company (research and development, financial, human resources management etc)
d) **Technical and financial strategies,** that have as a strategic objective the promotion of technical advantages and financial opportunities
e) **Global strategy** aim the new multinational organizations, which have a global vision over the market and over competition; they have a global activity in business, their activities are based on high technology, they get added value from many countries and locate their activity through informatics technologies. Other characteristics: international centralization of capital; structuring in strong international holding groups, which tend to dominate sectors of the business activity; global integration of manufacturing;
f) **Strategic alliances**- when the main organization is a multinational company and can be at the same time, competitor in some activities and partner in other activities (for example, within research and development)

Internationalization strategies of small and medium-sized organizations

It is said that small and medium-sized organizations don't harmonize well with the strategies of multinational companies, as they have certain characteristics: size, small capital, simple and incomplete structures etc. Still they have high chances of internationalization, especially those that have a great experience in their activity; those in the manufacturing industry; those that have a technological advantage (licenses, brands etc). **Here are the strategies that suit them:**

a) **Niche strategy,** where they have the supremacy **(**licenses, innovations etc)
b) **Concentration strategy** where they can use their internal performance on the international market.
c) **Differentiation strategy** where they can serve the users better than the big organizations
d) **Mixed strategy**, combined strategies, global approach, at the small and medium-sized organizations, especially from a technological and informational point of view (for example if they don't know that since January 1, 2007 the "most-favored-nation" clause is no longer available, they will have a big surprise, therefore they first need knowledge strategies)

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The essential element in the elaboration of strategies remains the competitive potential of the organization, which depends on **the dimension and quality of resources** it has available, the so-called "**critical mass**", which can be technical, commercial or of research, which is the minimum dimension required to participate with changes in a competition. Organizations that **can not reach this** level have a low competitive capacity and often **approach markets of a secondary interest**, or get involved in different activities by outsourcing production or sub-contracting etc in order to find **customers who have been neglected by the other competitors.** In the practice of exporting companies we often find the **association strategy** to reach the critical mass. For this they create **common informational groups** on the external markets, associations (for transport and flow of business papers) and even ad-hoc alliances in order to **win political credibility and to negotiate from a common platform** with the authorities, for the purpose of diminishing some commercial restrictions etc.

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Considering the complex and dynamic conditions in which international commercial activities take place, strategies have to **permanently be compared** with the evolutions and the objectively outlined perspectives and when the conclusions require, they must be reorganized and reoriented on time. Also it is

essential that for these types of situations, companies have **reserve strategies;** therefore they must be flexible from this point of view.

Internationalization of the organization in an intercultural and multicultural context

We are referring to the implications within management, of the emergence of organizations on international markets, **in a cultural diversity**, in an environment where one can find different national and enterprise cultures, **which have developed in time**, under the impact of culture and business environment where they appeared and grew. We're also referring to the **impact over managers, as bearers of the enterprise and national culture**, of the other cultures they or their teams encounter on the international markets.

Not taking into consideration this impact within the management of the organization is now **one of the major risks in business,** which visibly accentuates in the future.

On the other hand, the internationalization of the organization **depends on its dominant mentality** and on the mentality of its managers.

The relations between organizations and state, and between the organizations and other states and other organizations assumes the **interference and interaction between different cultures**. Their organizational culture comes into contact with the culture of other entities therefore their management is done in an environment characterized by cultural diversity.

When business is done on a global extent the culture must be taken into consideration on many levels:

- **Global level, when** we take into consideration the differences between regional cultures for example the Occident, the Orient;
- **International level,** when we take into consideration the difference between national cultures (American management, Japanese management);
- **Corporate level,** when we take into consideration the cultural difference organizations meet on the market;
- **Organization's level,** when we take into consideration the cultural difference between the organizations it confronts with on the market

Taking into account that many times culture is confounded with civilization, we remind you about the opinion of the Romanian inter-war specialist, Anton Dimitriu, who made a delimitation, of great use, without any retort even today, which is this: **'the civilization represents all material works of the collectivity, and the culture represent all spiritual works"**. Selma Legendof, an authority in this domain, defines **culture** as **what remains once you have forgotten what you've learnt, and the civilization** as the particular type of society, which makes it distinct of the other ones, the culture being formed of ideas, customs produced by a certain society.

Irrespective of approach, one can draw a conclusion over culture as being a collective intellectual phenomenon, a means of existence of a group, community or nation and has the following characteristics.

- **Acquired character** (it is not inherited, but it is learned by knowledge and experience);
- **Collective character**, not being specific to individuals but to a collectivity**;**
- **Symbolic character,** being in people's minds and is manifested together with them;
- **Structural character,** therefore it is an integrated universe, with a specific structure;
- **Persistent character;** it is transmitted from one generation to the other, through knowledge and experience;
- **Dynamic character,** it changes even though there objections;

Culture is influenced by many categories of factors, which define the cultural domains (national, industrial, functional, professional, etc);

The functional and professional domains are combined and a distinct social category emerges – the experts; they represent a specific superior culture and they will be the human species of the widest interest in the future.

Culture as a whole, has to be **approached in a systemic manner**, and has the following subsystems.

- **Symbols:** images, objectives, with distinct significations;
- **Standards of behavior,** interpersonal relations inclusively**;**
- **Rituals, collective activities,** which are not mandatory, but the success comes from fulfilling them**.**

- **Cultural practices,** practical sum of what was shown above**;**
- **Values,** the essence of what was shown above**.**

The concept of **organizational culture,** although it has a great importance in management these days and it is not disputed, has a pretty short history, and became of interest only beginning with the **7th decade of the last century,** being brought into attention by the fact that the **Nippon companies** have a better origin in their culture.

A major contribution to the rapid spread of the landing of organizational culture was brought by **T. Peters and R. Waterman,** through their best seller ,, In Search of Excellence", where they illustrated in many examples the **correlation between the characteristic of organizational culture and the performances of some of the most competitive organizations in the worlds**.

It is acknowledged that **at a country's level**, we may define **four categories of cultures**: national, economic, on economic activity branches, organizational. Two of them have a major importance in management: the **national culture**, a defining element for a nation, which marks intensively the evolutions of each country, and the **organizational culture,** a component and a major determinant of the state, functionality and performances of every organization, no matter of its nature. They influence each other, but are under the influence of the other two.

The organizational culture is a decisive condition within the success of organizations on the global market. It is a great chance for their internationalization, through assimilation, innovation and creation, through the capitalization of cultural difference and of similitudes, through a new, attractive and performant behavior.

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Putting into practice these mutations and demands, companies become different, from many points of view. These "points of view" have to be carefully chosen and with professionalism, following elaborate studies of compared management and specialized literature, written especially after 2000, with reference to the organization of the future, management of the future, strategic management, the economy, organization and management based on knowledge etc. There are more than 70 titles on the list we have created. But we must not neglect Pater Druker's opinion according to which:

,, **One must not search for an ideal organization, but must create one based on purposes, people and cultures. We need an organization that can be reconfigured, that can continuously go from one strategy to the other".**

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We close our essay by synthetizing the main ideas.

The reason of our essay lays in the reality that the society of the twenty first century irreversibly evolves towards the globalization and internationalization of organizations, as a result of the fact that on one hand, **internal markets become too small**, and on the other hand, **global markets** leave room for all competitors and **advantages for all of us.** It is natural for the management of organizations, especially of economic ones, **to adapt to these realities**, as fully and as fast as possible.

Before these perspectives, we consider **it's useless to bring any arguments to emphasize** that these mutations can be scientifically managed, only through a **Management of international Business,** which is systemic and integrated in a performant General Management. This being said, we no longer insist on this matter.

We insist on emphasizing the need that **each management segment**, like the Management of International Business, has to be defined and accomplished starting from the General management and making the necessary adjustments. We believe that this is the only scientific approach, which observes the treating of management as a system, with all its subsystems, as a **whole**.

Any management segment has to have as foundation, the object of general management, its general components and the components of organizational management, the functions of general management and the functions of the organization; all these have to be then individualized to a certain management segment and eventually completed with conceptual innovative particular elements, that General Management doesn't have.

We consider that the modernization of the management of Romanian organizations and its adjustment to all major phenomena of contemporary world has to be made only in the above manner; otherwise it will miss its purpose and finality.

This is the reason we have chosen to **approach** the Management of International Business, with consistency and firmness, from the perspective of business globalization and internationalization of organizations, from the point of view of **the improvement of the object of general management** (Management Science. Scientific Management, Management Processes, Management Relations, Principles of management and Management as an economic, synthetic discipline), **improvement of the components of organizational management** (Information System, Organizational System, Decision System, Methodological System), **improvement of management functions** (Provision, Organization, Coordination, Training and Control, Audit, Evaluation – taking into account the new functions derived from knowledge-based management), **improvement of all functions of the organization** (Research-Development, Manufacturing, Commercial and marketing, Financial-Accounting and human resources - **taking into account the new requirements derived from the knowledge-based economy, organization and management**)

Business globalization and internationalization of organizations are realities of the contemporary world and we consider that the approach of the issues we made reference to, will be useful to everybody with its general part, and to students, MA students, Ph.D. students, with its detailed elements, for their degree dissertations, and not last to specialists from economics, who are the first and the most interested in the management implications of these profound contemporary phenomena that are continuously changing.

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Lect. univ. drd. Vasile Brătian
„Lucian Blaga" University of Sibiu, Romania

MODERN INDICATORS OF THE COMPANY VALUE SPECIFIC TO COMPANIES QUOTED ON THE MARKET – SIGNALLING VALUE CREATION TO INTEREST HOLDERS

Abstract: *The primary aim of contemporary financial research resides in substantiating the company's financial value, in anticipating its determining elements, while this value, which is ascertained based on the investors' anticipation, shall then be compared to the observed value (company market capitalisation).*
The current realities with regard to the investor's behaviour and the signals guiding investors on the capital market have determined the contemporary private finances to adapt to a reality characterised by informational asymmetry.
The main issue on the present operational level is to find the necessary tools capable of measuring value and guiding the management decision in accordance to the new priorities.
On international level, the major consultancy offices rival in establishing templates and indicators that determine the company's created value. This undertaking materialises each year into tops of major groups and companies published by the specific media (Fortune – in the USA, L`Expansion – in France).

Key words*: creation of value, signal of value, interest holder, performance.*

JEL Classification*: G12*

1. Introduction

In the following, we set out to reflect on modern indicators that quantify and synthesise the performance of a company listed on the capital market, as well as an interpretation of these indicators as value signals.

Besides the market indicators (multiples) of quoted companies, the specific literature points out the so-called modern analysis indicators of business potential that rely on the *creation of value* principle. This concept is used in the Anglo-Saxon literature in order to substantiate a new integrated approach on the company's activity, namely management based on *value creation.* The creation of value is the target of excelling companies holding synthetic values regarding the entirety of activity.

Considering that the major aim of the companies, especially the ones quotes on the stock market, resides in maximising their global value on the market (the paradigm of private finances), while this aim can be achieved only by creating value.

The creation of value may be regarded from several perspectives: the shareholders', the creditors', the employees', the suppliers', and so on.

In the following, we shall focus our attention on modern indicators that communicate the creation of value to shareholders.

The main indicators acknowledged by worldwide renowned consultancy companies and considered as a signal of value creation for the interest holders within companies are the following:

1. ***Economic Value Added (EVA)***
2. ***Market Value Added (MVA)***
3. ***Cash Flow Return on Investment (CFROI)***
4. ***Total Shareholder Return (TSR)***

Nevertheless, this list is not exhaustive, the specific literature refers to other indicators used for a more modernist approach regarding the prediction of the companies' value.

2. Modern Indicators Signalling Company Value

Economic Value Added (EVA)[1]

This indicator is based on the core idea that a company does not have a real profit unless it surpasses the cost of employed capital.

[1] *The owner of this registered trade mark is the Stern Stewart Office*

In this context, the concept of EVA signals to the shareholder that economic profit or EVA will not be achieved unless the operational net profit of a certain period is higher than the cost of the capital invested in the company during the respective period.

The advantage of this approach resides in the fact that the existence of EVA over a certain period allows shareholders to be additionally remunerated by dividends or extended programs of the company's stock redemption having as source a part of the surplus of created value.

On the one hand, measuring EVA signals to shareholders an appropriate environment for appraising management performances from the perspective of economic profit or various investment projects within the company. On the other hand, managers may now envisage whether their current activity generates value or, on the contrary, destroys the shareholders' wealth.

The specific literature points out three possibilities of measuring the EVA indicator, namely:

1. *EVA = net operation earnings – cost of invested capital*[1]*;*
2. *EVA = invested capitals x (return rate of invested capitals – cost of invested capitals*[2]*);*
3. *EVA = turnover – operational expenses – cost of invested capitals*[13]

The first approach indicates that determining the EVA value implies calculating first the cost of the company's invested capitals. This procedure means taking into consideration both the expenses generated by payments of bank interests, bonds, loan lease, and the cost of the equity, which is known as opportunity cost and involves a different accounting management. In this context, we can assume that the effective equity cost is rendered by the profits, which shareholders may achieve with similar investments in other securities with the amounts used by shareholders to form the company's share capital.

The second approach treats the economic value added as residual earning. Nevertheless, this approach regarding the indicator changes the calculation formula, but not its result.

NB: the first two methods of calculating the EVA indicator have a drawback by referring to the operational profit, whose significance is limited in appreciating the company's performance. Moreover, the specific literature indicates that, in the absence of a standard procedure, 160 accounting adjustments have to be made in order to obtain the real value of EVA.

The third approach used to determine EVA implies integrating the operating expenses into a sole monetary indicator to evaluate the company's performance.

In conclusion, it is not achieving a positive EVA over short or yearly periods that is of importance to shareholders, but keeping a constant or even rising value of the economic profit. The company's value will not grow unless the EVA level achieved by the company over a certain period of time exceeds the shareholders' expectations with regard to this indicator level. It may be pointed out that there is a relation between the company's value and the signals sent by this indicator to investors.

Market Value Added (MVA)

This indicator measures the market value added as a difference between the current market value of the company (market capitalisation or observed value) and the invested capitals of the company at their true value.

According to its definition, we may ascertain that this indicator's purpose is similar to EVA, namely to serve the informational interests of the investors, thus allowing them to determine the way managers govern the entrusted capital.

In this sense, a positive MVA signals to investors the creation of wealth for shareholders by the size of the capitals invested by them, while a negative MAV signals that managers do not create value, on the contrary, they destroy value due to poor management, including the value existing at the time of the investment.

This indicator is being calculated as follows:

MVA = company's market value – capital invested by shareholders;

or

[1] *A cost expressed in absolute measure.*

[2] *This cost is determined as a moderate average of the loaned capital costs and the company's capital, considering the company's financing structure.*

MVA = (market value of the company's capitals + market value of debts) –
- (accounting value of the company's capitals + accounting value of debts)[1];

It seems that, in practise, maximising this indicator triggers the growth of the company's market value. Nevertheless, there are instances when maximization of the market value added leads to the reduction of the company's value, as a consequence of strategic investment projects with an internal rate of return (IRR) inferior to the cost of capital or a negative net present value (NPV).

Despite the simple calculation method of this indicator, prior reprocessing of accounting data is necessary. In this concern, the Stern Stewart Office, as the promoter this indicator, suggests some corrections among which the most relevant refer to the company's capital composition: the shared capital value is adjusted by adding the rights issue value, capitalising the research-development expenses and distributing these to the pertaining financial practice, affixing loans and non-assigned benefits to shareholders, not adding the depreciation of goodwill, if its corresponding value has already been taken into account.

Cash Flow Return on Investment (CFROI)

This indicator represents the internal rate of return of cash flows generated by the company's activity and is considered as the main competitor of EVA on international level.

CFROI is superior to EVA because it is determined based on future cash-flows, it includes the adjustment to inflation and is a relative measure that allows the company's results to be compared over different periods of time, as well as different companies to be compared to each other. Even so, in practise, CFROI is calculated by using historical and not estimated cash-flows.

This indicator is determined in a similar method as the internal rate of return of the investment, taking into account four variables:

1. *Net capital invested in current assets.* This value is determined by adjusting the gross value of non-current assets and circulating assets with the depreciations caused by the inflation affiliated to assets and with the depreciation caused by the FIFO inventory evaluation method.
2. *Gross cash-flow*. This is calculated by adjusting the net profit with the depreciation of tangible assets, expenses with interests, restoration expenses, etc., as well as with the depreciation or appreciation caused by inflation.
3. *Economic life duration of current assets*. This duration expressed in years, is calculated based on the gross value of depreciable assets and on the amortisation expenses.
4. *Residual value of current assets*. This is value expressed in current terms and it is generally considered as part of the initially invested capital.

After establishing the above variables, CFROI can be calculated as the IRR that determines the current value of gross cash-flow and residual value to equal the gross value of the invested capital.

Essentially, an internal rate of return like CFROI, superior to the cost of capital, signals to investors that the company's manager handles the assets correspondingly, while an IRR below the cost of capital indicates to investors (mostly to shareholders) a poor investment policy in the company, which will have future repercussions on their wealth.

According to this method, the value of the company is influenced by the current net cash-flows, as well as by the earnings generated by new investments employed with an IRR equivalent to an estimated future CFROI.

Total Shareholder Return (TSR)

The acquisition of a financial asset like share values is an act of capital investment into a company. Essentially, this is a capital transfer towards an entrepreneur who is expected to render an investment yield according to the risk implied by this capital investment.

The modern financial theory has defined a complex management goal of movable values, namely the optimisation of return and risk correlation in placing the financial capitals.

Such an approach is imperiously necessary considering the increased volatility of movable values (e.g. variations of market rates, synonym to the sensibility notion) in relation with the phenomena of financial and economic variations, underlining the direct link between their return and risks. In other words, a higher return is strictly connected to a higher risk and vice versa.

[1] *The base assumption is: debt market value = the accounting value of debts.*

- The yield of a financial asset like shares is determined by two components, namely the dividend and the increase of the market value as compared to the moment of its acquisition on the capital market. The yield is determined by the following formula:

Share yield, hereafter indicated as R = $\left(\frac{\sum_{t=1}^{n} d_t}{p_0} + \frac{p_n - p_0}{p_0}\right) \cdot 100$;

whereas:

p_t, p_0 represent the trend of the share during year t, respectively the trend of the share on acquisition

$\frac{\sum_{t=1}^{n} d_t}{p_0}$ = global yield of the dividend;

$\frac{p_n - p_0}{p_0}$ = yield of capital gain of a share.

The above-calculated yield refers to the entire period during which the movable has been held. To compare it to the interest rates found in economy, its annualisation is necessary as follows:

$$(1 + r_{a(nom)})^n = 1 + R \Rightarrow r_{a(nom)} = \sqrt[n]{1+R} - 1$$

whereas: $r_{a(nom)}$ = annual nominal rate of share yield;

R = rate over the entire period during which the share is held.

NB:

Over a one year's period, the share yield is presented in the following form:

share rate of return (1) = $\frac{d_1 + p_1 - p_0}{p_0} \cdot 100$.

To calculate the yield of a share in real terms implies taking into account the inflation rate according to the Fisher effect, therefore:

$$\frac{1 + r_{anom}}{1 + r_i} = 1 + r_{real} \Rightarrow r_{real} = r_{anom} - r_i + r_{real} \cdot r_i;$$

whereas: r_{real} = real rate; r_i = inflation rate.

In terms of investments, the object of interest is the expected yield, hereafter designated as: E(r).

For its determination, the estimation of future cash-flows, which will be sent out by the issuing company, are taken into account.

In practise, it is common to appeal to a statistic extrapolation of previous yields. As a working hypothesis, it is important to acknowledge that future tendencies will relatively maintain the same parameters.

→ the best measurement of future yields is the average of yields previously recorded, thus:

$$\bar{r} = \frac{r_1 + r_2 + r_3 + r_4 + \ldots + r_n}{n} = \frac{1}{n}\sum_{i=1}^{n} r_i = E(r);$$

whereas: $r_1, r_2, r_3, \ldots, r_n$ represent the yields that have been effectively recorded previously;

i = 1,2,3,…,n represents the month, year, semester, etc. during which these rates have been recorded.

As indicated previously, for an investor, the share yield must be correlated with the risk of the respective investment. In this sense, it is necessary bare in mind that the risk of an investment represents the probability of a yield deviation from the expected average due to anticipated and not foreseen variations of the determining financial-economic phenomena.

- **Risk may be defined as follows:**
- **The sacrifice of an immediate advantage for future advantages;**
- **The sacrifice of an immediate expenditure for future expenditures;**

- **The loss of a definite and immediate advantage via the acquisition of a real asset for a supposedly superior advantage, but which holds a high degree of uncertainty rendered by the investment in shares;**
- **The uncertainty of a value of a financial good, which will be recorded on a future date.**

In the financial theory, risk measurement applies the normality hypothesis, which has often proven as realistic.

The distribution of deviations of effectively recorded yields as compared to their average (the observation is made based on a sufficiently large sample) is symmetrical and pursues the normal law of distribution.

With this hypothesis, the most representative risk measurement is - *dispersion* - and *root mean square average*.

Dispersion **(σ^2) represents the root mean square average of effectively recorded yields as compared to the average yield:**

$$\sigma^2 = \frac{(r_1 - \bar{r})^2 + (r_2 - \bar{r})^2 + ... + (r_n - \bar{r})^2}{n-1} = \frac{1}{n-1} \cdot \sum_{i=1}^{n} (r_i - \bar{r})^2;$$

NB: when dispersion is calculated based on a sample of yields effectively recorded in the past, the total of dispersion squares is divided to *n-1*, in order to correct what statistics professionals indicate as *loss of a degree of freedom*.

root mean square average **(σ) is the square root of dispersion:** $\sigma = \sqrt{\frac{1}{1-n} \cdot \sum_{i=1}^{n} (r_i - \bar{r})^2}$ **;**

The symmetry of deviations of yields effectively recorded previously, as compared to the average yields, triggers the probability of recording positive deviations to equal to that of negative deviations recordings (50%).

Dispersion is actually a measure of the total of deviations from the average.

Concluding, subsequent to the calculation of share yields effectively recorded in the past and of average yields, as well as the calculation of dispersion and of average square deviations, it may be asserted that the share will have an expected yield equal to the average $\pm$ the average square deviation.

This indicator, in aggregated form, signals to the investor the expectancy of that investment return into the company's share, and, moreover, the affiliated risk.

The daily preoccupation of capital market investors regarding the shares of a company is to foresee the increase or decrease tendencies of the general market index. These tendencies are related to the evolution of the market value of each financial security held by investors.

The working hypothesis assumes that an increasing market index implies that the majority of securities have an ascending evolution.

This relation between the yield, which is rendered by a movable value and the capital market yield measured by the general market index, is formalised within the concept of the financial market model.

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Prof. univ. dr. Sorin Burnete
"Lucian Blaga" University of Sibiu, Romania

CENTRAL BANK INDEPENDENCE AND MACROECONOMIC PERFORMANCE IN CENTRAL AND EASTERN EUROPE

Abstract. *Financial reform in transition economies largely relied on neo-liberal principles. Firstly, at the authority level, this vision translated into a shift of emphasis from governments toward central banks. Commercial banks were released from under the rigid state control but remained under the surveillance of the central bank, which is nevertheless not supposed to intervene between banks and their customers but to act according to market principles. Secondly, the reform in the financial sector has been guided by a totally different outlook than the one that had prevailed beforehand. The basic idea is that emphasis must be placed on the proper functioning of the system (its ability to turn resources to good account) rather than mere accumulation. Thirdly, the general belief during the 1990s was that developing the financial sector would boost economic growth. Perhaps it is high time we asked ourselves to which extent this is true…i.e. to which extent economic growth in CEE countries during the 1990s was due to the financial sector. Obviously, the transition process has been facilitated by a host of other economic and political factors. It is therefore hard to determine the exact contribution of the financial sector.*

That's what this paper deals with.

Keywords: *taxation system, market deregulation, macro-stabilization, monetary policy, foreign exchange markets, bank intermediation, central bank independence*

JEL Classification*: F-4*

Chief characteristics of the central-planned systems

In the classic socialist economy, the financial system had three essential features that differentiated it from the capitalist system: (1) the system of taxation was *implicit* and *non-codified*: on the one hand, surplus money of enterprises was collected by the state by means of centrally-fixed prices (not by fiscal instruments); on the other hand, the population's money holdings were restricted by means of a rigid control of wages exercised by enterprises. (2) The monetary system was *passive*: there wasn't a market for money. Supply of money was unlimited: enterprises encountered no constraints in taking out loans, which were restricted neither by interest rates nor by fixed credit lines. Demand for money by enterprises was indeterminate. The result: blocked cash accounts simply build up until they are expropriated or the government gives the enterprise permission to buy something. (3) The internal inconvertibility of money was much more restrictive than inconvertibility into foreign exchange. It resulted from the existence of two parallel monetary circuits: the enterprises' deposits with the state bank (which were virtually blocked) and the population's money holdings (which could be spent freely for goods and services, if these could be found in the shops).

Reform shocks

The reform process began with a number of radical measures. Domestically, the most important was undoubtedly price liberalization*;* this shocking step (the greater the distortion, the more severe the shock) brought transparency of prices and costs. At the same time, the opening of the home capital market allowed the bank credit to fulfill its essential function of supporting financially economic activity: free access to credits for ill-performing firms is henceforth restricted. As concerns commercial banks, they are released from under the rigid state control but remain under the surveillance of the central bank. Internationally, current account liberalization implied removal of restrictions and barriers from import-export transactions. Of course, foreign trade liberalization had to go hand in hand with home market deregulation, including: the removal of state control over prices (as shown above), exchange-rate unification, i.e. the use of a unique exchange-rate in all commercial transactions, and last but not least, capital account liberalization, involving removal of restrictions and barriers from capital inflows and outflows.

External liberalization also produced shocks. One major shock (which occurred after the dismantling of the COMECON in early 1990s)**,** was the so-called 'terms of trade shock". This was partly due to the COMECON's distorted and inefficient trading relations. Trade flows had been distorted for two main reasons: (1) intra-COMECON relations were artificially oversized whilst trade relations with third parts were

artificially undersized; (2) invoice prices deviated a great deal from world prices. As a consequence, the dismantling of the COMECON, coupled with the tough contact with world prices triggered a true terms of trade shock. The situation was worsened by the removal of import barriers, mainly non-tariff restrictions such as: domestic subsidies; public-procurement policies; state participation in commercial activities; foreign exchange controls etc.

The shift from the old highly regulated system to the new one, which is based on a higher degree of frontier permeability, involves certain costs and risks all CEE countries (without exception) fully bore.

Macro stabilization

Macro stabilization is aimed to assure the normal functioning of the system following liberalization shocks. As previously shown, there are two types of shocks transition economies had to cope with: a domestic shock and an alien shock. One of the most powerful shocks was triggered by the removal of controls over internal prices. Price liberalization usually generates an inflationary push. If it is also backed by an increased access to bank loans (which usually comes after the opening of the capital market), an internal price shock occurs.

Because these shocks may negatively influence the economy (most seriously the living standard), keeping inflation under control is critical for the reform success. Some CEE countries managed to fulfill this target, others didn't. Stabilizing the economy (by implementing anti-inflationary programs) was, without a doubt, a clear priority in any reform program for the transition countries. It involved, among other things: dealing with money overhang (rapid money creation under generalized price controls and declining productivity); eliminating fiscal disequilibrium (monetization of the fiscal deficit); the creation of an efficient and effective tax system, the reorganization of the foreign-exchange markets."

Reorganization of foreign exchange markets

The reform programs of all CEE countries included, as a major objective, the reorganization of foreign exchange markets, implying: currency convertibility and implementation of a new exchange rate regime. The type of exchange rate regime selected was dependent on certain factors such as: the economic conditions of the transition process; the micro and macro economic policies adopted; others. After 1989, currency convertibility issue in CEE countries was, besides a major objective of economic policy, a multiple symbol for individuals (it meant the restoration of the liberty to travel), for businesses (it meant the reintegration in the world economy), and of course, for the Western partners, for which it meant the reopening of Eastern markets to international trade and investment.

The CEE countries opted for radical reforms of their foreign exchange markets. The radical reforms of foreign exchange markets started almost simultaneously in all CEE countries, by taking a variety of forms: fixed or semi-fixed exchange-rates, adopted by Poland (1990) and former Czechoslovakia (1991); semi-fixed (also known as crawling peg) exchange-rate regimes, adopted by Hungary and Poland (after the fixed regime proved unsuccessful, in an attempt to keep export competitiveness from falling); floating exchange-rates (clean or managed), adopted by Bulgaria and Romania, constrained by the lack of sufficient hard currency reserves. They opted for a managed floating regime.

The development of financial markets and institutions

Although one cannot speak of a consensus among scholars, there is, undoubtedly, a relationship between the financial sector development and economic growth. More precisely, a strong financial sector is an important prerequisite for future economic growth. Furthermore, the functioning of a financial system, capable of turning resources to good account, seems to be more important than mobilizing savings for investment. From this point of view, it is largely believed that planned economies suffered not from a too small but from a too large accumulation. Besides, the fact that accumulation was focused on a certain type of inappropriate physical capital aggravated their situation.

The economic reform in the CEE countries largely relied on the belief that developing the financial sector would boost general economic growth. However, as yet significant correlations between financial sector development and economic growth are hardly visible. Economic performance in certain CEE countries is the outcome of a multitude of factors that acted both domestically and internationally. The transition process in CEE countries was facilitated by a bunch of economic policy measures such as price liberalization, foreign trade liberalization, capital market liberalization, macroeconomic stabilization, enterprises restructuring, privatization etc. The process was also facilitated by a number of exogenous factors such as FDI inflows and economic assistance from the IMF and the World Bank.

Shortcomings of the banking activity in CEE countries

In their attempt to create viable market-oriented banking systems, all CEE countries had to overcome two major problems affecting the soundness of banks' balance sheets: the bad loans. These could be divided into two main categories: ancient bad loans (inherited) and new bad loans (after 1990). The second type of

bad loans (the new ones) was due to a combination of factors, from among which one could mention: a certain lack of experience in the line of commercial loaning; extending credit to enterprises with shaky financial standing and uncertain future; granting loans under imprudent or fraudulent conditions; a weak regulation and surveillance system.

Specialists identified three primary weaknesses of the banking systems in the CEE countries: (1) a low level of bank intermediation; in the acceding countries of central and eastern Europe, the level of financial intermediation amounts to only one-third of the euro area average and is lower than in emerging market economies with comparable income levels. (2) Mobilized funds exceed offered funds; banks in the CEE countries manage to mobilize more funds than they are willing to lend domestically; the surplus is invested abroad. The banking sector in the CEE countries is thus a net capital exporter towards a group of capital-importing countries. (3) Low profitability is due to the average efficiency of the banking capital in the CEE countries, which is below the level of EU banks because: first, the losses of the whole banking system that occurred in many CEE countries in the second half of the 1990s (especially in the Czech Republic and Romania); second, from a purely technical point of view, the banks in the CEE countries have a higher capital ratio (own capital / total liabilities) as compared to the banks in the EU. This is intended to create the impression of a higher solvency, aimed to attract more deposits, given the riskier background in which they operate. Third, these banks have a higher share of low-risk (and less profitable) assets in total banking assets; deposits at EU banks are an example of this type of assets.

Central bank independence and macroeconomic performance in transition economies

The political independence of the central bank relates to its ability to choose autonomously objectives and to make decisions on monetary policy. The most significant constraint regarding the use of monetary policy instruments is related to financing the public deficit. There are provisions in Treaty of Maastricht explicitly prohibiting the ECB from participating in the primary market for public debt as well as any type of credit facility 'in favor of Community institutions or bodies governed by public law, or public undertakings of member states'. With a few exceptions, CEE countries' central banks are following the same rule.

To reach this goal, an important condition must be met: the term of office of central bankers must be sufficiently long; it must exceed the maximum term of office in the central government. For example, the Executive Committee of the ECB is appointed for an eight-year period of time. The term of office in transition countries varies between five and eight years.

Most central banks (including those from CEE countries) set as their primary objective, price stability that is they will pursue a single policy objective instead of plurality of objectives. By doing this, the possibility for central governments to interfere with demand for short-term objectives aiming at short-term output before election period is eliminated. Article 14 of the Treaty of Maastricht obliges EU member states to ensure that the statutes of their national banks are compatible with the provisions of the Treaty. This tendency is revealed by the legislative amendments to the central banks' charters in transition economies such as Hungary (1996), the Czech Republic (1995), Poland (1997), Bulgaria (1997) Romania (1998) and others.

Central banks have traditionally acted as lenders of last resort. In this capacity, they also fulfilled the task of commercial banks' supervision. The basic argument is that if the central bank is lending to credit institutions, it should be responsible for the commercial banks' supervision. The rationale for this is that by delegating to the central bank a supervisory and regulatory role, it can assess accurately the solvency of eventual borrowers, thereby defending its own interests. In transition economies, this particular aspect is all the more important, especially in countries where the banking sector is massively state-controlled. In order to forestall a liquidity crisis, governments in these countries will keep state banks from going bankrupt. Only, in this way banks will keep on accumulating bad loans and their creditworthiness will be seriously eroded. A typical case occurred in Romania in the mid 1990s: two major state-own banks, the Foreign Trade Bank and the Agriculture Bank, which had been used as "milk-cows" for years were eventually declared bankrupt. Other transition countries also experienced such interference during the banking crisis (Poland and the Baltic States in the early 1990s, Bulgaria in 1997).

Real convergence – a precondition for joining the Eurosystem

Despite their visible and undeniable progress, the accomplishment of real convergence poses some challenges and risks to new member-countries, in terms of external competitiveness and current account sustainability: (1) countries might be confronted with strong pressure to align their wage and price levels too quickly with those of the EU. (2) An inappropriate mix of loose fiscal policy and tight monetary policy could trigger a strong, albeit temporary, appreciation of the currency. (3) Although capital inflows are generally expected to contribute to real convergence – for example, through imported technology and management

skills – they might imply some destabilizing effects, especially if the scale and nature of capital flows were to change substantially from the current pattern where net FDI inflows have essentially covered the current account deficits in many countries, Romania included. On the other hand, capital flows largely in excess of the countries' absorption capacity could lead to overheating and more accentuated output volatility

In most new member-countries, the process toward real convergence has been accompanied by sizeable current account deficits. However, these levels aren't considered as worrying. Perhaps, the case of Latvia is the most illustrating in this respect. In a new paper, Carsten Valgreen, the chief economist of Danske Bank, highlights the cases of Iceland and Latvia. Each has embraced financial globalisation in its own way: Iceland has a free-floating currency; Latvia has pegged its currency to the euro. Iceland's banks are homegrown; Latvia's largely foreign-owned. But both countries have racked up enormous current-account deficits, running at a remarkable 25-30% of GDP. And both have escaped the kind of currency crisis that a vigilant bond market would traditionally have imposed.[1]

Up to now, empirical findings have suggested that despite the global economic slowdown, most of the acceding countries do not face major competitiveness problems and, at the same time, have witnessed sustained rates of export growth over the past few years and, in many cases, have enlarged their market shares in the EU. However, the degree of real income convergence with the euro area, i.e. the catching-up of the per capita income levels, has remained limited for the new member-countries as a whole. On average, GDP per capita in the new member-countries is, in terms of purchasing power parity, about half of that of the euro area. The figure is even lower (about one quarter) when current exchange rates are taken into account.

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lect. Emilia Campeanu
lect. Andreea Stoian
lect Attila Gyorgy
assist. Emilian Miricescu
Academy of Economic Studies Bucharest, Romania

INVESTIGATING THE DETERMINANTS OF ROMANIAN FISCAL POLICY[1]

Abstract: *Determinants of fiscal policy are important to model the fiscal policy in order to identify the control variables in the economic, politic, and institutional fields. Therefore, this paper aims in investigating Romanian fiscal policy determinants based on fiscal reaction function. The evidence of the estimations, based on tax smoothing model, reveals that Romanian fiscal stance reacts to high public debt by an increase of primary surplus with at least 0.02%. The reaction is not instantaneous, it is delayed by 1 or 2 lags, which it is considered as being acceptable, taking into account the quarterly data used.*

Key words*: Fiscal policy, budgetary policy, fiscal imbalance, public debt, sustainability*

JEL Classification*: E61, E62*

1. Introduction

At the European level, fiscal policy became more and more important because it ensures budget revenue and the redistribution to different type of beneficiary according to the political objectives. As a major instrument, fiscal policy absorb the cyclically economic fluctuations and conduct to the long term fiscal and economic stability taking into the consideration the risk factors represented by rising longevity, falling fertility rates and the retirement of the baby boom generation. Also, by fiscal and monetary policy a European Union country may achieve the convergence criteria to Economic and Monetary Union (EMU) in order to ensure the economic integration. During the process to EMU integration, the EU countries focus in fiscal and structural policy by applying important fiscal, financial and labour markets reforms. When a country became EMU members it can stabilize output by pursue monetary and exchange rate policies. As a result, ''It is widely recognized that given the loss of national monetary policy in EMU, budgetary policy needs to play a more significant role in smoothening the impact of country-specific shocks on real output''[2]. In this context of continuous challenges for fiscal policy, we find it useful to analyze the fiscal policy in Romania, who joint European Union in January 2007, in order to identify its determinants. If we know the fiscal policy determinants, or some of them, we can used it's as a control variables in order to model the fiscal policy or to guide fiscal policy to it right stance.

The study is structured as follow. After a brief presentation of the Romanian fiscal policy (Section II) we investigate the literature on fiscal policy determinants (Section III). Section IV highlights the results of the empirical tests to investigate the fiscal determinants in Romania. Section V discusses the policy implications of these findings.

2. Romanian fiscal policy

Analyzing fiscal policy during 1990-2007 and the forecasts for 2008-2050 we find that the fiscal policy are designed to support the real convergence and the long term sustainability by: (i) maintaining the budgetary deficit at a prudent level, financed by no inflationary methods; (ii) enlarging the tax base with a view to consolidate public revenues by improving collection rates; (iii) simplify the tax system; (iv) increasing public expenditure efficiency especially for education, research and development, healthcare, and transportation (v) controlling the growth rate of the wage bill budgetary; (vi) implementing the public policies according to their importance; (vii) improving decentralization and financial autonomy for the local authorities by increasing their ability to manage the own revenue from local taxes; (viii) improving transparency and effective public funds utilization; (ix) reducing the special funds and off-budget funds by

[1]In this study, we use fiscal policy in order to assign fiscal and budgetary policy.
[2]European Commission, Public Finance in EMU—2001. European Economy 3, Luxembourg, pp. 59.

including them in public budgets in order to ensure efficient utilization. [1] An extended presentation of fiscal and budgetary policy objectives during 1990-2050 is included in table 1.

Table 1 **Romanian fiscal and budgetary policy objectives during 1990-2007 and projections for 2008-2050**

Periods	Major fiscal and budgetary policy objectives
1990-1995	Important fiscal reforms were implemented in order to ensure the compatibility of tax system with the market economy. The fiscal reforms conduct to the improvement of fiscal legislation (value added tax, income tax, profit tax, social contributions, excise) and was generated by the need to reduce tax burden and fiscal evasion. Al so was taken important measures in order to implement global income tax.
1996-2000	Objectives to improve budget performance: - improve revenue collection and reduce tax evasion by simplifying the tax system and by lowering the tax burden (the reduction of the profit tax from 38 percent to 25 percent (5 percent on exports), the introduction of a uniform VAT rate of 19 percent); - increase budgetary decentralization; - stimulate the private sector's propensity to saving and investment by lowering direct taxation compared to indirect one; - avoid budget fragmentation and dispersed responsibilities by reducing the number of special funds; - expenditures reforms in order to restructure mining and energy sectors, loss- and arrear-making industries, agriculture, banking sector and, to ensure social protection for the laid-off employees after restructuring. In 1999, fiscal and budgetary policy was tightened and reduced the consolidated general government deficit to it target limit, by important cuts in the value and share of government consumption, and by avoid, in the same time, the crowding out of non-government sector. These two goals were set in fiscal policy for the next years in order to stabilize output and budget balance.
2001-2005	Fiscal and budgetary policy supports the economic growth, unemployment reduction, disinflation and balance of payments sustainability. In order to ensure these economic program objectives, were conducted several measures regarding: - diversity of the fiscal measures taken by granting tax incentives to small- and medium-sized companies, simplification of the taxation system for micro-companies (introduce 1.5 percent taxation regime on quarterly incomes; increase gradually profit tax applicable to export activities and excise duty; reduction of some duty tax, of social security contributions paid by both employees and employers, of fee incorporated in the electricity price, of VAT on some goods and services, of off-budget transactions; elimination of revenues with special destination included in the state budget); - controlling the budget expenditure by decentralization (transfer of some categories of expenditures to local budgets); -sustaining the infrastructure development; -implementing social protection measures (pension realignment stages; raise the economy-wide gross minimum wage and the child benefit); -introducing the flat income tax to encourage investments, new employment opportunities and reduction of workers in the informal economy and the burden associated to the tax administration.
2006-2007	Objectives fixed for this period focused on external sustainability, disinflation process and fiscal consolidation in order to performance the EU commitments. The fiscal and budgetary measures taken to ensure these objectives are: - maintaining a low and prudent level of the budget deficit; - strengthening revenue collection; -reducing fiscal burden in the area of social security with a view to reduce labour costs (the 1.5 percentage point cut in social insurance contributions);

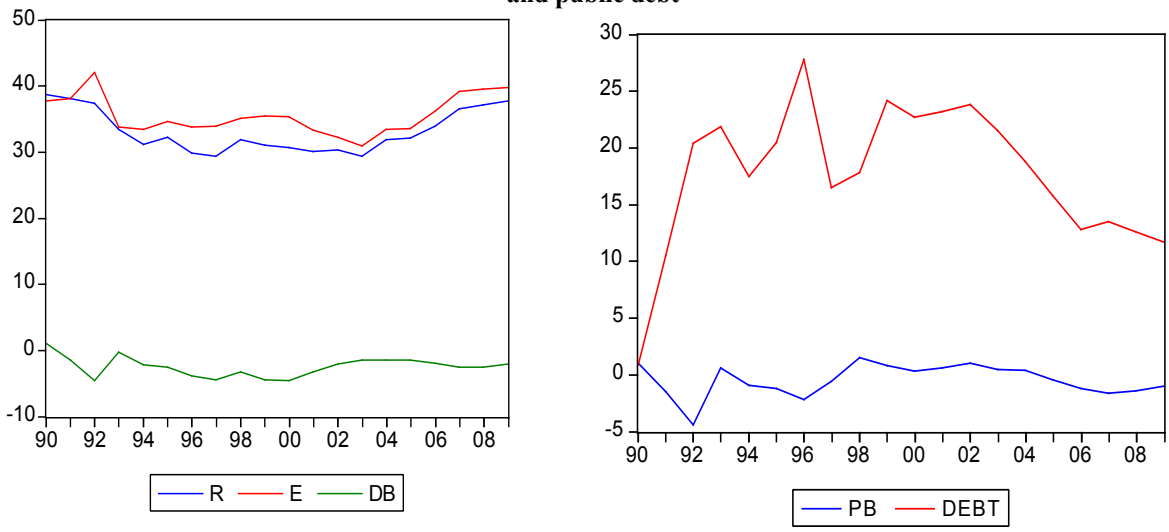
[1]These fiscal objectives are presented in Government Programmes, Convergence Programme, Macroeconomic Reports on state budget, European Commission (2006, 2007).

	-broadening tax base; - improving revenue collection; - promoting efficiency of the public expenditure; - improving transparency and effective public funds utilization; - creating the conditions for a better prioritization of the public policies.
2008-2050[1]	The disinflation process, the reduction of external imbalances and limitation of structural budget deficits will conduct to long term sustainability of public finances, sustainable economic growth and real convergence. The fiscal and budgetary policy framework are: -maintaining a conservative fiscal stance; -promoting cautious wage policies; -ensuring structural reforms in education, health and pension areas; -ensuring a stimulating and non-discriminatory environment, while focusing on measures to consolidate the simplicity, transparency and predictability of the tax policy ; -encouraging the labour market developments by reductions of social security contribution rates who will diminish the economic players' propensity of maintaining their activities in the grey economy; -reducing the structural gaps identified in infrastructure, sanitation, education and R&D areas by continuing and deepening the structural reform for these domains in order to deliver improved public services; - keeping the indebtedness rate within sustainable limits and ensuring the necessary sources for financing the budget deficits at a minimal cost and by assuming a reasonable risk level; - continuing public administration reform; -increasing the expenditure flexibility and the consolidation of the three year budgeting by introducing the program budgeting. Budget expenditure will grow an average with 0.9 percent points of GDP until 2050, which is the result of the age related expenditure increasing. The age related expenditure determines the 42% of the total expenditure growth. According to this threat, will be necessary drastic improvements for the efficient manner of public funds spending, mostly by setting clear priorities. The demographic evolution (fertility and mortality rates) and the labour market participation are major determinants of public finances sustainability.

The fiscal and budgetary policy objectives can be showed by analyzing the profile of consolidated general government revenues (R), expenditures (E), budget balance (DB), primary balance (PB) and public debt expressed in percentage points of GDP over 1990-2009 (figure 1) [2]. The dynamic of fiscal variables can be explained by the business cycles and by the technical procedures that affects revenue and expenditure such as: (i) *for revenue*: due times of taxes (budgetary revenues increase two or three days before due time); the size of companies (small companies pay quarterly or biannually taxes); the turn over of companies (companies with small turn over are excepted from several taxes, for example VAT); the wage gave to employees (the taxes are applied to wages diminished with un-taxed amounts); means of payment use to pay taxes (cash payments are more rapid than electronic payments); number of fees (if public services are offered for fees, not for free, the revenues increase); facilities offered by administration for some companies (state aids or tax echeloning); (ii) for expenditure: frequency of financing public institutions (expenditures are made according to financing limits established by ministries and local authorities); date of budget approval (in case of approving budgets after 1st of January, the investments are paralyzed and expenditures strictly limited); quarterly repartition for expenditures (oblige public authorities to program their payments in accordance with the quarterly repartitions, blocking in this way many payments in the first part of the year); administrative limits (normative acts can establish maximal limits or even interdictions for certain expenditure categories).

[1]The objectives of fiscal and budgetary for period 2008-2050 reflect the Romanian Government priorities as presented in Convergence program 2006-2009, European Commission (2006, 2007).
[2]Note: the variables series are constructed using data from EUROSTAT, EBRD, IMF, Convergence program 2006-2009.

Figure 1 **Consolidated general government revenues, expenditures, budget balance, primary balance and public debt**



3. Review of selected literature

The importance of fiscal and budgetary generated an important scientific debate regarding the determinants, effects on economic variables, incidence on public debt sustainability, fiscal adjustments to ensure macroeconomic stabilization, fiscal sustainability on medium and long run.

The purpose of our study is to investigate the determinants of fiscal and budgetary policy in Romania, so we will focus only to this issue. A growing literature on fiscal policy has explained its determinants using different methodologies and variables. The estimation methods are:

(i) fiscal reaction function (Morande and Schimdt-Hebbel, 1991; Vavouras, 1999; Staehr, 2008; Giuliodori and Beetsma, 2008);
(ii) Global Fiscal Model (Botman and Kumar, 2006; Hauner, Leigh and Skaarup, 2007);
(iii) Feasible Generalized Least Square and Extreme Bounds Analysis (Berger and Holler, 2007);
(iv) two-stage least squares method (Diokno, 2007);
(v) weighted least squares (de Haan and Sturm, 1997);
(vi) multicointegration tests (Leachman, Bester, Rosas and Lange, 2004).

The fiscal policy determinants are identified by using different dependent variables such as:

(i) government debt (Botman and Kumar, 2006; de Haan and Sturm, 1997);
(ii) fiscal revenue (Botman and Kumar, 2006);
(iii) real spending and revenue (Leachman, Bester, Rosas and Lange, 2004; Botman and Kumar, 2006; Berger and Holler, 2007; Staehr, 2008);
(iv) direct taxes, indirect taxes and social security contributions (Vavouras, 1999);
(v) tax gap (Cournède and Gonand, 2006);
(vi) primary budget surplus (Andrés and Doménech, 2006);
(vii) cyclically adjusted primary budget balance (Golinelli and Momigliano, 2006; Giuliodori and Beetsma, 2008).

As Tujula and Wolswijk (2004) observed, the independent variables can be classify as:

(i) *budgetary variables*:
   a. change of public debt (% of GDP) or lagged public debt (Roubini and Sachs, 1989; Hallerberg and von Hagen, 1997). The growth of public debt stock conduc to the increasing of interest spending which will generate budget deficit and will accumulate more and more debt.
   b. lagged budget deficit (Bohn, 1998; Bohn, 2005; Bohn, 2006; De Mello, 2005; Greiner, Koeller and Semmler, 2005; Kirchgaessner and Prohl, 2006).

(ii) *macroeconomic variables*:
   a. real GDP growth, unemployment, or *output gap* (Roubini şi Sachs, 1989; Hallerberg şi von Hagen, 1997; Bohn, 1998; Bohn, 2005; Bohn, 2006; Mayes şi Viren, 2000; Viren, 2000; Granados, 2003; de Mello, 2005; Schneider şi Zapal, 2005; Kirchgaessner and Prohl, 2006). These variables are used to identify the fiscal reaction on business cycle.
   b. interest rate on short and long run and real interest rate (Hallerberg and von Hagen, 1997; Volkerink and de Haan, 2001; Galli and Padovano, 2005; Greiner, Koeller and Semmler, 2005,

Berger and Holler, 2007). The growth of interest rate conduct to increase of government expenditure which al so generate more budget deficit.

c. inflation rate (Granados, 2003; Woo, 2003; de Mello, 2005; Kirchgaessner and Prohl, 2006).
d. social welfare (Woo, 2003). It is used as an indicator of social welfare GDP per capita, social polarization (Woo, 2003).

(iii) *microeconomic variables*: studies that investigate the incidence of financial asset price on budget deficit. Example, Eschenbach and Schuknecht (2002) identify the mechanism chanel of financial market dinamics on deficit, such as taxes on capital use and substitution effects on consumption.

(iv) political variables:

a. electoral cycle.
b. structure of state government (Roubini and Sachs, 1989; Hallerberg and von Hagen, 1997; Volkerink and da Haan, 2000; Perotti and Kontopoulos, 2002; Granados, 2003; Woo, 2003; Berger and Holler, 2007).
c. political relations between the federal and the state level; voting results at the state and federal level; the party composition of state governments (pre- and post-change); bailouts of certain state governments during the 1990s (Berger and Holler, 2007)

(v) *particular variables*: studies that investigate fiscal determinants in a country not a group of countries find specific variables for OECD and EU. So Galli and Padovano (2005) had demonstrated that age population had a negative influence on the budget deficit in Italy.

(vi) *dummy variables*: fiscal determinants in the politic, economic and social fields affect budget deficit and can not be quantify with quantitative indicators (such as occurrence of common oil price hikes, possible effects of German unification (Berger and Holler, 2007).

Determinants of fiscal and budgetary policy are in the economic, politic and institutional field. Roubini and Sachs (1989) study the fiscal factors for OECD countries during 1961-1985 and find evidence on the transitory policy actions in order to increase government spending during an economic slowdown. Marshall and Schmidt-Hebbel (1989) presented a complex model of the effects of foreign and domestic economic variables on the deficit from those of policy-controlled variables using like determinants variables each category of revenue and expenditures. In 1991, they used the model to identify the macroeconomic effects of fiscal deficits in Chile, in 1974-1988, by the relationship between real tax revenue and real output, inflation rate and real exchange rate.

De Haan and Sturm (1997) investigated the cross country differences in debt accumulation in 21 OECD countries during 1982-1992 using the power dispersion index definite by Roubini and Sachs (1989) and Edin and Ohlsson (1991). They explained the fiscal policy variations by expressing the indebtness ratio as a function of lagged public debt (%GDP), unemployment change, debt servicing cost change, and political variables (political index and orientation). Also, Woo (2003) conducted a panel study for 57 countries over the period 1970-1990 and determined three type of structural deficits determinants: (i) political instability, political institutions and government fragmentation (political factors); (ii) income inequality and ethnic divisions (social polarization); (iii) budgetary procedures and rules, bureaucracy and democracy (institutional factors).

Staehr (2008) use a panel dataset, for 1995-2005 and for two sub-periods, 1995–2000 and 2001–2005, to compare fiscal policies across the existing and future members of the EMU. The fiscal determinants are identified using fiscal reaction functions for budget balance, budget expenditures and revenue.

Another way to identify the fiscal determinants is multicointegration tests of government real spending and revenues and the relationship between fiscal institutions and budgeting performance used by Leachman, Bester, Rosas and Lange (2004) for Belgium, Canada, Denmark, Finland, France, Great Britain, Greece, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United States over the period 1960-1998. The sustainability is ensured in Finland, Norway, Switzerland and the U.K. who has strong and transparent institutions. Belgium, Canada, Denmark, France, Greece, Italy, the Netherlands, Portugal, Spain, Sweden and US has not a sustainable fiscal policy and accumulated important deficit and debt which could not be sustain regardless the economic variables.

Kattai and Lewis (2005) studied the fiscal policy in Central and Eastern EU members in 1996-2003 using a monetary policy methodology regarding the government constraint to minimize a loss function between output stabilization and budget deficit. Using this methodology they establish the necessary political conditions to pursue on long run stabilization of deficits or of output. As a result, stabilization is taken place in Poland, Latvia and Estonia. There is no evidence for the Czech Republic, Lithuania, Slovakia and Slovenia, suggesting that fiscal policy was being used for other objectives.

Other determinants of fiscal balances was defined by Eslava (2006) as opportunistic behavior of

policymakers, heterogeneous fiscal preferences of voters or politicians, and budget institutions.

Berger and Holler (2007) set German fiscal determinants for 1975-2004 such as economic factors (business cycle, structural budget balance), politic factors (election, party structure, voting results, political relations between federal and state level). They demonstrate that if economic determinants are prevalent then improvement of fiscal performance could be achieved by lowering spending or by non-fiscal policy. In case that political factors dominate, then will be necessary a change in political framework

The fiscal reform (tax revenue from labor income, corporate income, and personal income in GDP, the ratios of government debt and government spending to GDP) and the privatization of pension system are other fiscal determinants for debt accumulation identified with IMF's Global Fiscal Model used by Botman and Kumar (2006).

The present concern at the European level is generated by the risk factors that will influence the fiscal sustainability on long rung. These risks (rising longevity, falling fertility rates, and the retirement of the baby boom generation) were investigated by Hauner, Leigh and Skaarup (2007) by using two primary gap indicators and by indicating fiscal adjustments needed to ensure fiscal sustainability in G7 countries.

The study of fiscal factors were conducted using not only ex-post data and real data reflecting the fiscal plans role in fiscal sustainability (Golinelli and Momigliano, 2006; Giuliodori and Beetsma, 2008).

4. Fiscal and budgetary determinants: evidence for Romania[1]

Fiscal determinants can be identified by estimating fiscal reaction function. This methodology has became used to a large extent in those cases when classical tests (e.g. unit root test) fail due to some issues affecting time series (structural breaks, lack of data etc.).

The fiscal reaction function can be estimated by regressing primary balance on the public debt, while controlling for other determinants of fiscal stance (see equation 1):

$$p_t = \alpha + \beta \cdot b_t + \delta \cdot Z_t + \varepsilon_t \qquad (1)$$

Where:

p_t = primary balance (surplus/deficit) as ratio to GDP at moment t;

b_t = public debt as ratio to GDP at moment t;

Z_t = set for control variables at moment t;

Most of the studies analyzing sustainability based on fiscal reaction function rely upon Barro's work (1979) on tax smoothing model which implies that the determinants (Z_t) of fiscal stance could be business cycles (*YVAR*) and temporary government spending (*GVAR*), but also, there are taken into account several others explanatory variables. In that sense, Bohn (2005) uses squared debt and time trend in order to improve the main model expressed in equation above. De Mello (2005) estimates equation (1) by making use of lagged primary balance, indebtness and inflation and also allowing for institutional variables which took into account the impact of different acts of law within fiscal field. Greiner, Koeller and Semmler (2005), besides *YVAR* as explanatory variable for primary balance work with social surplus ratio, long term interest rate and lagged debt to GDP ratio. Kirchgaessner and Prohl (2006) added to the main model as explanatory variables the expected inflation and temporary fluctuations of government military expenditures.

According to the results presented in the table above, equation (1) has two alternatives which are different only by the number of lags for public debt. Both models reveal the fact that our estimations are consistent with previous literature. In that sense, de Mello (2005) and Kirchgaessner and Prohl (2006) found that between indebtness and primary balance exists a positive relationship by the same amount. In Romania's case, growing public debt by 1 percentage point goes to an increase of primary surplus by 0.02, respectively 0.03 percentage points. Moreover, using lagged debt ratios as explanatory variables means that fiscal stance does not react instantaneous to shocks on public debt, but with a delay of 1 or 2 lags. Generally, the theory states that the response of primary surplus on higher debt should be immediate, but there are authors who consider otherwise by reason of interest payments which occur at later moments (Greiner, Koeller and Semmler, 2005). In Romania's case, we believe that a delay of one or to quarters is acceptable. Consequently, based on our estimations Romanian fiscal policy reacts to high public debt, even if this reaction has some delays.

In the case of Romania, we shall estimate equation (1), based on quarterly data as ratio to GDP, spanned on 1991-2005 and by using OLS. The results are presented in the table 2:

Table 2 **Fiscal reaction function**

[1]This section is based on the result of the study of Stoian, Campeanu and Roman (2007) presented at the International Conference Macroeconomic Analysis and International Finance organized by University of Crete, Rethymno, Greece.

1991-2005 Dependent variable: primary balance (surplus/deficit)		
Explanatory variables*	**Main model (1) 58 obs.**	**Main model (2) 58 obs.**
Debt (-1)		0.03 (0.00) [3.86]
Debt (-2)	0.02 (0.01) [2.33]	
YVAR	0.07 (0.02) [3.48]	0.06 (0.01) [3.04]
Primary (-2)	0.48 (0.08) [5.67]	0.54 (0.08) [6.32]
Intercept	-9.98 (2.71) [-3.68]	-9.19 (2.450 [-3.74]
R-squared	0.46	0.49
F-stat	15.67	17.58
P –value	0.00	0.00
Breusch-Godfrey Serial Correlation Test (F-stat) 12 lags	0.41	0.57
ARCH LM Test (F-stat) 12 lags	0.50	0.30
Jarque-Bera	2.03	3.06

Source: data available from National Bank of Romania and Ministry of Public Finance
Standard errors in ( ) and t-statistic in [ ]
Newey-West HAC incorporated
Phillips-Perron unit root test (3 lags): Debt -3.80 YVAR -7.70 Primary -6.26
Critical values for PP: -3.54 (1%) -2.91 (5%) -2.59 (10%)
YVAR estimated by using Hodrick-Prescot filter based on GDP quarterly data January 1990 prices. YVAR estimated as potential GDP to effective GDP ratio.
*We took into consideration more explanatory variables (inflation, variations of government consumption, variation of final consumption and of primary expenditures) but their influence was not statistical significant.

5. Conclusions

Fiscal policy can be used to ensure long term fiscal and economic stability taking into the consideration the risk factors represented by rising longevity, falling fertility rates and the retirement of the baby boom generation. In the context of continuous challenges for fiscal policy, we find it useful to analyze the fiscal policy in Romania, in order to identify its determinants. Therefore, we proceed on testing Romanian fiscal policy determinants by estimating fiscal reaction function based on quarterly data as ratio to GDP, spanned on 1991-2005. Using lagged debt ratios as explanatory variables, we found that stance does not react instantaneous to shocks on public debt, but with a delay of 1 or 2 lags, which can be considered as being acceptable having in mind the quarterly data. So, the lagged primary balance and public debt, and business cycles can be used as control variables in order to model fiscal policy in Romania.

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prep. drd. asoc. Diana Marieta Cindea
„Lucian Blaga" University of Sibiu, Romania

PERSPECTIVES ON THE REPORT BETWEEN THE TAX RATE AND THE REVENUES CASHED IN FOR THE STATE BUDGET IN ROMANIA

Abstract: *The present paper only aims to analyze the Romanian taxation system by using the Laffer curve and by control of the relations set in this model between the tax rate and the revenues level, but without attempting to determine the tax optimum, which would be anyway difficult to determine due to the multitude of influencing factors and to the fact that the state cannot be aware of the current tax rate position compared with the optimal tax rate.*

When analyzing the taxation level in Romania one cannot bar the maximum decision moment in 2004 when the tax rate shifted to a standard taxation rate of 16% as of January the 1st 2005, a moment that equaled a tax relaxation.

The objectives of the tax system enforced in 2005 are: business expansion, development of direct investment, remission of underground economy weighing, a sustainable economic development, unemployment remission, enhancement of peoples savings, of the investment.

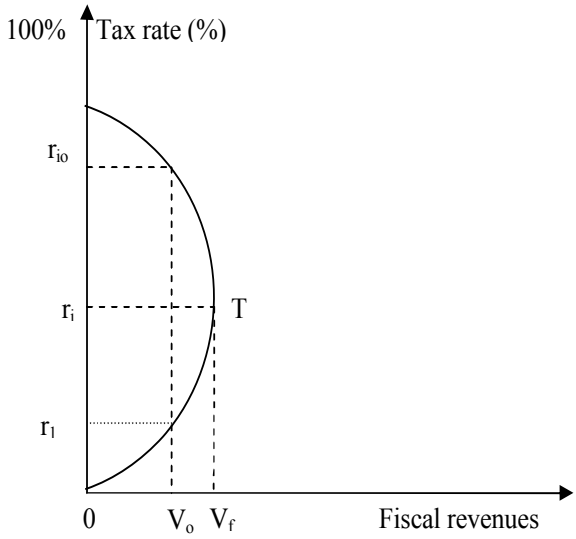
In the end the paper analyses to what extent these objectives considered for the enforcing of the standard tax rate were carried out.

Key words*: public finances, Laffer curve, fiscal revenues, tax rate, fiscal pressure, tax regime*

JEL Classification: *H21*

The connection between the tax level and the fiscal revenues was studied and demonstrated by use of the Laffer curve that is known to belong to Arthur B. Laffer even though he denies it and states that the roots of this curve must be looked for in the 14th century as it is mentioned in one of Ibn Khaldun's works. One can note a similar approach of this connection between the revenues and the tax rate at John Maynard Keynes.

The graphic chart of the correlation between the tax rate and the fiscal revenues for the state budget based on the Laffer curve is:



Laffer showed by this graphic chart that a progressive increase in the tax rate (r_f) generates an increase of the fiscal revenues (V_f) but in a more and more decreasing manner, meaning the marginal tax rate is increasing. It's common sense that for a 0% tax rate the state cashes nothing, as well as for a 100% tax rate; the situation is the same due to the fact that, given the situation, the tax payers will either lack working incentive or they will avoid tax payment. Somewhere in between those two extremes there is the optimum tax rate (r_i) that leads to the maximization of the fiscal revenues. Likewise, an increase of the tax rate leads to the increase of the fiscal revenues but only up to a certain level, a level that is called the optimal taxation

level. Provided the current tax rate exceeds the optimal level then the effect of the fiscal revenues is reversed to a fiscal revenues reduction.

Keyner approaches the same theory using instead two opposite principles: the mathematic principle and the economic principle. According to the mathematic principle things are easy an apparently logic: the decrease of the tax rate leads to the decrease of the fiscal revenues. The same applies to the increase as well. The economic principle admits the positive impact of the tax reduction on work, production and unemployment causing thus economic development and, implicitly, the increase of the fiscal revenues[1]. Though acting in opposing ways, the two principles become fairly logic when treated separately. Things get complicated when the effects of the two principles meet.

The reality is different: the optimal tax rate cannot easily be determined because the state doesn't know the position of the current tax rate compared to the optimal tax rate (r_i). Provided the current tax rate is positioned at the left of the optimal tax rate (r_i) then the state may proceed to its increasing because this causes an increase in the fiscal revenues until it reaches the optimum point. But if the current tax rate is positioned at the right of the optimal tax rate (r_i) and the state decides on an increase then the fiscal revenues will drop. But this is exactly what is difficult to determine: where is the current tax rate positioned to the optimal one? One can notice on the chart that the same fiscal revenues level(Vo) may be obtained in a certain period by using a $r_{i0} < r_i$ tax rate, but also by using a $r_1 > r_i$ tax rate, and this makes it difficult to position the current tax rate. This optimal point of the curve also varies from one economy to another.

1. Limits and disputes on the Laffer curve

According to the Laffer curve the volume of the mandatory contributions is first of all an increasing function of the tax rate pressure up to a certain point *T* which is the maximum point, and after that it becomes a decreasing function of this rate.

The Laffer curve is merely a formal representation that does not allow the determination of the optimal taxation level after which tax pressure would be excessive. This optimal level varies from one country to another, but it's a proven fact along the history, especially in USA, that if a high tax pressure in a country increases some more it generates the tax payers aversion. This aversion may express itself as a production diminution, as a remission of the investment, savings, work incentives. This coincides with the attempts to avoid mandatory tax contributions by evasion and tax fraud. The inflation level is also influenced by the increase in the fiscal pressure due to the fact that the increase in the tax costs for legal persons will be returned by their inclusion in the production costs causing a product price increase. Therefore we deals with the cost inflation.

A different debate against the Laffer curve refers to the fact that this curve is a static representation shaping an economy with a constant production capacity under the influence of two different tax duties. But the dynamic economic reality, the economic increase, is a relatively general phenomenon displayed even when the tax regime remains the same, and thus the fiscal revenues level tends to increase anyway. Thus, according to the previous idea, this increase of the fiscal revenues afferent to different tax regimes is based on the economic growth as well, not just on the remission of the fiscal pressure.

Some economists even debate one of the premises of the Laffer curve that apparently seemed obvious: everybody agrees that at a 0% tax rate the state cashes nothing. We also agreed that at a 100% tax rate the fiscal revenues are null. Still, the latter premise is debated by use of the example of the communist countries that actually applied a 100% tax rate and, even if the system was inefficient, people still continued to work[2].

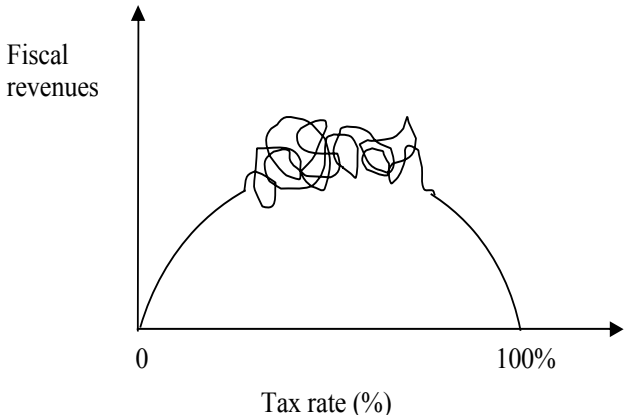
Martin Gardner is one of the main critiques of the Laffer curve. He is the author of the so called Neo-Laffer curve[3].

This curve of Martin Gardner graphically displays all the critiques brought forward to the Laffer curve. The author keeps the extremes, meaning the 0% tax rate and the 100% tax rate when the fiscal revenues are null. For the rest of it, in between these two pints we do not find the perfect, extended Laffer parable, but the overview economic reality of a country. Gardner wants to highlight exactly the impossibility to set the optimal tax rate that he doesn't even mention. In this tangled middle of the curve appear all the influencing factors of the economic growth, factors that oppose the simple Laffer curve model that, according to Gardner, shouldn't be considered a serious model because it doesn't have the possibility to assess the optimal tax rate, it can't even assess the position of the current tax rate to the optimal tax rate.

2. Taxation analysis for 1990 - 2007 in Romania by use of the Laffer curve

[1] www.heritage.org – the Laffer Curve, Past, Present and Future
[2] Tatiana Manole – Local Public Finances, Fundația Viitorului Publishing House, Chișinău 2000, page 60
[3] www.heritage.com

This paper doesn't aim to establish whether the Laffer curve is viable or not, neither to establish whether the implied references are functional. It only aims to realize a taxation analysis for Romania by use of this curve and control of the connections set in this model between the tax rate and the fiscal revenues. It is absurd to attempt to establish a fiscal optimum considering the multitude of the influencing factors, factors that are not only economical but also psychological, behavioral, relational, that act at the level of every individual seen as a member of an organization, of a company, as actor of the economic reality.



When analyzing the taxation level in Romania one cannot bar the maximum decision moment in 2004 when the tax rate shifted to a standard taxation rate of 16% as of January the 1st 2005, a moment that equaled a tax relaxation.

So let's view the Romanian taxation system prior to January 2005, meaning between 1990 and 2004. The fiscal system of 1990 – 2004 was a progressive one with differential taxation rates for the taxes applied to natural persons as shown in Table 1.

Table 1: differential tax rates for natural persons

Wage income (ROL mil)	Tax rate (%)
0-28	18%
28-69.6	23%
>156	40%

Data source: extract from law 571/2003

One may notice (Table 1) that the wage income tax may reach 40%. The corporate tax applied for the corporate revenue was 25%. The interest tax was 1%, the dividend tax was 5%, and the small businesses paid a 1.5% income tax.

This fiscal system was considered by the International Monetary Fund a positive one that doesn't generate macro-economical unbalances, "the 2004 budget policies will sustain the inflation decreasing objectives and the deficit limitation of the external current account, generating conditions for the forward increasing of the private sector investment".

Let's see the level of the fiscal revenues cashed in for the state budget during the period the progressive taxation system was applied, as well as the inflation, unemployment and GIP level presented in Tables 2 and 3. We also consider it important to present the level of the fiscal pressure for this period in order to be able to compare it then to the level of the fiscal pressure in the period when the standard tax rate was introduced, and, in the end, to set the Laffer curve for Romania.

The general tax rate, or the rate of the fiscal pressure, was calculated by use of the formulae:

$$\text{Rate of the fiscal pressure} = \frac{\text{Production and import tax} + \text{Current income and patrimony tax}}{\text{GIP}} x100$$

Table 2

Year	Fiscal revenues	Inflation rate	Unemployment rate	GIP
1990	lipsă date	5,1%	lipsă date	857,9 mld ROL
1991	1291,8 mld ROL	170,2%	lipsă date	2203,9 mld ROL
1992	3654,4 mld ROL	210,4%	lipsă date	6029,2 mld ROL
1993	8318,8 mld ROL	256,1%	lipsă date	20035,7 mld ROL
1994	8318,8 mld ROL	136,7%	lipsă date	49773,2 mld ROL
1995	12454,5 mld ROL	32,3%	lipsă date	72135,5 mld ROL
1996	17523 mld ROL	38,8%	6,7%	108919,6 mld ROL
1997	40051 mld ROL	154,8%	6%	252925,7 mld ROL
1998	60677,9 mld ROL	59,1%	lipsă date	371193,8 mld ROL
1999	85019 mld ROL	45,8%	lipsă date	545730,2 mld ROL
2000	11439,4 mil RON	45,7%	lipsă date	80377,3 mil RON
2001	13727,7 mil RON	34,5%	lipsă date	116768,7 mil RON
2002	16775,3 mil RON	22,5%	8,4%	151475,1 mil RON
2003	23602,3 mil RON	15,3%	7%	197 564 mil RON
2004	30252,7 mil RON	11,9%	8%	246468,8 mil RON

Data source: www.insse.ro

Table 3Rate of the fiscal pressure (%)

1990	1991	1992	1993	1994	1995	1996	1997
26,9	24,9	23,4	21,9	20,4	20,7	19,4	19,5

1998	1999	2000	2001	2002	2003	2004
19	21,6	21,4	23	17,9	17,4	18,1

Data source: www.insse.ro

One may notice in Table 2 that the fiscal revenues and the GIP were increasing in the period 1990 – 2004, the early period is characterized by tremendous inflationist trends, the inflation rate exceeding 250% in 2003. The maximum fiscal pressure level is 26.9% in 1990 after which the tax rate tends to decrease. Anyway, in this period as well the taxation level is inferior in Romania compared to the one in the developed countries as shown in Table 4.

Table 4:The taxation level in some developed countries in 1992 (%)

Country	Great Britain	France	Germany	USA	Denmark	Japan
Taxation level	35,9	41,3	38,1	28,1	47,1	30,8

Source: Manolescu Gheorghe – "Budget. Economical and Financial Approach', The Economical Publishing House, Bucharest 1997

Comparing the data in Table 3 to the ones in Table 4 we may state that Romania has a characteristic medium taxation level. According to the statements made by the National Bank of Romania in 1996 in the "Annual Report" - "the decreasing tendency registered for the taxation level in Romania during the previous years was not caused by the legal facilities but by the accentuated financial discipline that hindered tax collecting for the state".

The fiscal pressure has a huge economic importance due to the fact that it indicates the extent at which the people's nominal income is adjusted by taxation and, at the same time, it shows the extent at which the state budget obtains its revenue by taxation.

The fiscal pressure is an economic concept or reality very important both for the tax payers and for the state, and thus its level has a huge national importance and, in order to get the aimed affects, one must find an optimal taxation level that is compliant with the state economical policies.

Starting with January the 1st 2005 was introduced the 16% standard taxation rate applied to natural person's income and to the corporate revenue. The main changes brought to the fiscal system compared to the previous one are: basically the 16% standard taxation rate, a 19% VAT, the dividends held by natural persons have a 16% tax rate, the income tax for small businesses is 3%, the interest tax is 16%, etc.

The fiscal system enforced in 2005 set the objectives: business expansion, growth of direct investment, remission of the underground economy weighing, a sustainable economic growth, unemployment remission, increase in people's savings, investment growth. The idea was that once the economic agents will have more money as a result of tax reduction, will consider the idea of producing extra, of hiring more people, will invest more in their business, will reduce illegal labor, and all these will result in a sustainable economic growth, meaning the GIP growth rate will exceed the inflation rate. One can notice that only the sizing of the national offer was considered, but what happened to the aggregate offer? Fiscal reduction causes the increase in peoples' available income that will initially lead to an increase in consumption, in product demand, but according to the economical theory, this demand increase will cause inflationist pressure.

We will analyze next to what extent the tax rate influences the fiscal revenues from the Laffer curve perspective, drawing at the time a graphic representation of the curve for 1990 – 2006 in the following charts.

Table 5

Year	Fiscal revenue	Inflation rate	Unemployment rate	GIP mil RON	Fiscal pressure rate
2005	34531,2 milRON	9%	7,2%	288047,8	12%
2006	40486,6 mil RON	6,65%	5,2%	342418	11.8%

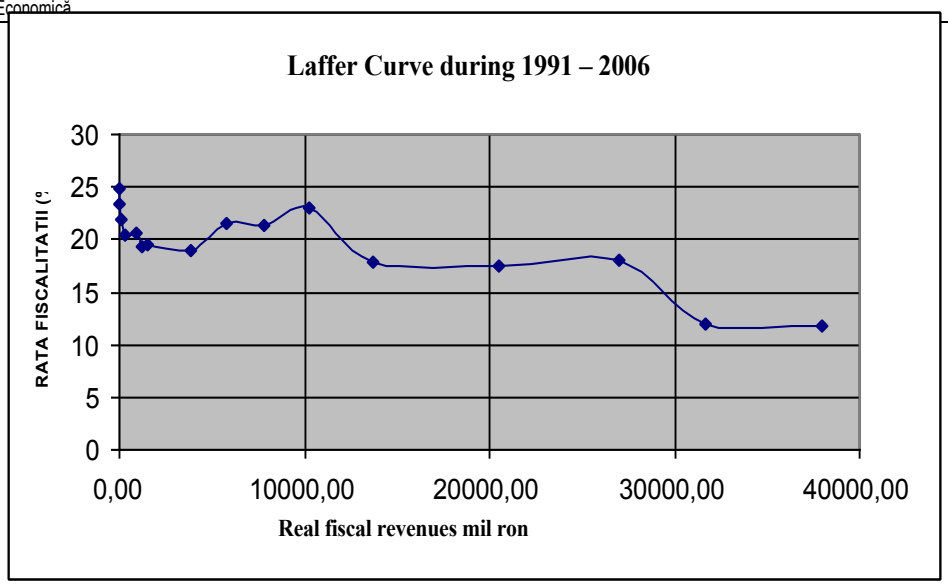
Data source: www.insse.ro

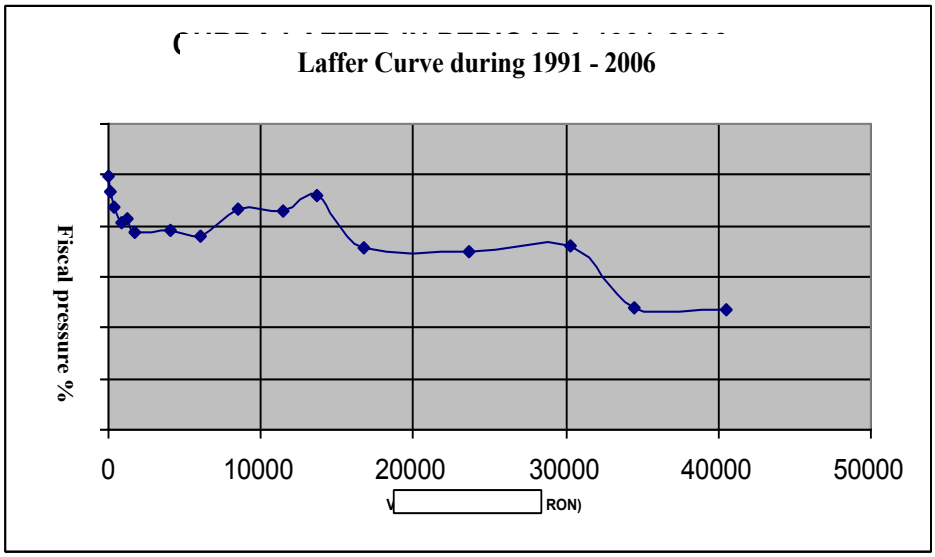
Table 6

Year	Fiscal revenue(mil RON)	Inflation rate (%)	Price rate	Real fiscal revenue
1991	47,94	24,9	2,702	17,74
1992	129,18	23,4	3,104	41,62
1993	365,44	21,9	3,561	102,62
1994	831,88	20,4	2,367	351,45
1995	1245,45	20,7	1,323	941,38
1996	1752,3	19,4	1,388	1262,46
1997	4005,1	19,5	2,548	1571,86
1998	6067,79	19	1,591	3813,82
1999	8501,9	21,6	1,458	5831,21
2000	11439,4	21,4	1,457	7851,34
2001	13727,7	23	1,345	10206,47
2002	16775,3	17,9	1,225	13694,12
2003	23602,3	17,4	1,153	20470,34
2004	30252,7	18,1	1,119	27035,48
2005	34531,2	12	1,09	31680,00
2006	40486,6	11,8	1,065	38015,59

One may notice that both the fiscal revenues and the real fiscal revenues ($\frac{\text{nominal fiscal revenues}}{\text{Ip}}$) keep on growing. If we analyze the situation in 1991 – 1992 in a comparative manner we will notice that a 6% or 1.5 percent reduction of the taxation rate caused a nominal increase in the fiscal revenues of about 170% and a real 135% increase. This rule applies until 1998 when the fiscal revenues reach RON 6067.79 mill compared to RON 47.94 mil in 1991 based on a 19% tax rate reduction, meaning 5.9 percent compared to 1991. Thus, until 1998 the basic idea of the Laffer theory is applied, but one may notice that in 1998 the tax rate grows to 21.6% but the fiscal revenues do not decrease and continue to grow. The same happens in 2001 when the tax rate is 23% and the fiscal revenues reach RON 13727.7 mil.

Fiscal revenues mil ron





As a conclusion, no matter whether the tax rate increased or decreased between 1991 – 2006, the fiscal revenues kept growing. Should we understand that the tax rate is still on the left side of the optimal point? We tend to believe it does, because if the tax rate was at the right of the optimal tax rate any increase of the tax rate would have determined a fiscal revenues decrease and this doesn't happen in our study.

One may notice in the chart that at a 25% tax rate the level of the fiscal revenues is very low, approximately RON 48 mil, but we also refer to the early transition economy, in 1991, when an approximately 12% tax rate led to RON 40486 mil fiscal revenues in 2006. We also have to consider the fact that in that period Romania went through a transition process from the centralized economy to a functional market economy, a process accompanied by multiple economic changes, privatizations, industry releasing, foreign investment that brought a huge contribution to the economic growth. We can neither pin this economic growth solely on taxation, but on an aggregate of many different factors as well, nor can we quantify exactly the taxation influence.

If we analyze the shape of the Laffer curve for Romania we may notice that it is more shaded than the theoretical model, not a smooth parable. It still is continuously increasing from the point of view of the fiscal revenues which makes us consider that the optimal point hasn't been exceeded yet. Generally speaking, the level of the tax rate is decreasing leading to a fiscal revenues increase. There were only a few exceptions when the tax rate grew from one period to another, meaning 1999 and 2000, but that increasing also caused the enhancement of the fiscal revenues. Therefore we apply the hypothesis according to which

the growth of the tax rate causes the growth of the fiscal revenues but only to a certain point, the optimal point, after which the exceeding of this point causes the decrease of the fiscal revenues.

Since the fiscal revenues in Romania only had an ascending trend it seems that this optimal point hasn't been reached.

The standard 16% tax rate measure actually aimed for a fiscal relaxation that would in turn influence in a positive way direct investment, business expansion, remission of the underground economy weighing, a sustainable economic growth, unemployment remission and an increase in savings and investment.

The reality proves that only the big companies and propertied people benefited from this measure. If we analyze the situation we will notice that most of the strong companies in Romania are multinational companies carrying their activity here in order to benefit from certain fiscal facilities and cheap labor force exporting their income instead. If the income of the propertied people grows, it causes much deeper discrepancies between the rich and the poor, a misfortunate yet real experience.

From an analysis of the unemployment rate one may notice that it registered a 8.4% decrease in 2002 to 7.2% in 2005 but it is not a spectacular drop. Seems that the standard taxation rate didn't achieve its goal in this matter. The main cause would be that, concerning the labor force, we witnessed a false fiscal relaxation due to the fact that the share of the social insurance contributions remained high exceeding the share in the European Union. Therefore the companies with high staff costs will keep on using illegal or semi-legal labor. To expect feedback from the employment rate, meaning its increase, is not enough to reduce the income tax rates, first of all the level of the social contributions must be complied with.

As for foreign direct investment the analysts state that the target has been reached, as their level reached the maximum level in 2006, but they are expected to decrease in the following years considering the fact that in the previous years the privatization level was high.

The economic growth rhythm will slow down because of the future consumerism ease, which also poses a positive side because it removes overheating risks. According to the recent statistics the taxation basis didn't record a high increase, which makes us believe that the standard taxation rate neither had the effect aimed upon the remission of the underground economy nor will it have this effect unless this tax reduction is correlated with a series of harsh punitive measures towards those that avoid paying the taxes and rates. Corruption control should be a priority in this matter when it comes to tax inspectors.

Another objective was the growth of people's savings and investment rate. When analyzing the expansion of the consumption loans in the previous years in Romania one may notice that there has been a consumption increase instead of a savings or investment increase. One of the analysts biggest fears was related to this very consumption increase. One of the harshest critiques against the introduction of the standard taxation rate was the fact that its objectives only aimed for the aggregate offer, neglecting thus the effects on the aggregate demand, when the tax reduction first of all influences the demand, and lets' see how! Tax reduction enhances available income with the population causing thus inflationist pressure, the very reaction analysts feared. By analyzing the inflation rate between 2003 – 2006 published by the National Institute for Statistics one may notice that it drops from 15.3% in 2003 to 6.65% in 2006. That means that until now this highly disputed inflationist pressure didn't happen.

Another aspect we have to approach is the increase of the revenues considered to be caused by the standard taxation rate, as a well deserved effect. If we make a structural analysis of these revenues we easily notice that they didn't grow because of the cash ins from the income tax and corporate tax as initially foreseen but on the contrary, this type of taxes recorded a slight decrease. The revenues increase was supported by the increase in the VAT revenues which is normal considering the fact that the fiscal relaxation determined the increase of the population income, enhancing thus consumption and implicitly the VAT.

What will it happen in return in the future to the revenues provided the analysts' predictions on the consumerism ease will confirm? What will it happen to deficit of the external current account which is high enough anyway and which could hardly be covered given that the public costs are growing? Here are some of the problems we will face unless the necessary measures will be taken to optimize the enforcing of the standard taxation rate.

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Petre Caraiani
Institute for Economic Forecasting, Romania

AN ANALYSIS OF MONETARY POLICY IN ROMANIA USING AN ESTIMATED NEW KEYNESIAN MODEL WITH STICKY PRICES

Abstract: *In this study I estimate and analyze a New Keynesian model with sticky prices for Romanian economy. The degree of price rigidity is found to be moderate. The estimation of the Taylor rule shows that the central bank looks first of all to stabilize the inflation but also pays attention to the output dynamics. The impact of monetary policy shocks is found to be moderate in terms of persistence.*

Key words*: monetary policy, business cycles, econometric methods.*

JEL Classification: *C11, C15, E31, E32.*

1. Introduction

Toward the end of the `90's in the macroeconomics we could see come-back of the Keynesian approach. What differed from the middle `70s, when the dominating approach was that of the simultaneous equations models, was that the new approach was based on the dynamic stochastic general equilibrium models. The dynamic general equilibrium models originate from the real business cycles approach (RBC, hereafter), which was initiated by Kydland and Prescott (1982). In the RBC theory the business cycles were caused by fluctuations in total factor productivity. In the new approach, which is known as the New Keynesian approach (NK, hereafter), the RBC model was extended through the consideration of imperfect competition, and nominal or real rigidities, which allows for a complex analysis of inflation, production and monetary policy, see Gali (2002) for a detailed approach.

The present study uses one of the most known models in the literature, namely the dynamic NK model, characterized by rigid prices, with a Calvo (1983) specification for the price rigidity, and it uses this model to study monetary policy in Romania.

The NK approach implies three fundamental elements. First of all, the demand side is modeled through a linearized approximation of the Euler equation for the optimal choice of consumption. The second fundamental element is the inflation equation derived from the optimal condition of firms' behavior under monopolistic competition and sticky prices. The final fundamental element is the monetary policy rule, usually a Taylor (1993) type rule.

Although the hypothesis of nominal rigidities at the level of prices and wage is generally accepted, there is an ongoing trend that not only denies the importance of such rigidities, but it also sustains that the real frictions are more important. This trend includes papers like those of Fuhrer and Moore (1995), Fuhrer (2000) or Chari, Kehoe and McGrattan (2001).

There are a several papers who applied the NK approach to the study of monetary policy in USA, Euro Area or other developed economies, like those of Clarida, Gali and Gertler (1999), Woodford (1999, 2000), or McCallum and Nelson (1999).

This study proposes itself to answer under which degree a dynamic NK model can contribute to the understanding of the monetary policy in Romania. Most of the studies for the monetary policy in Romania, or for the CEE countries, used multivariate techniques, like classical or Bayesian VAR, or cointegration techniques. In this study I contribute to the ongoing process of the extension of the application of DSGE models by using a DSGE model applied for Romania.

2. The New Keynesian Model

For the analysis of monetary policy in Romania, I use a NK model with rigid prices. The model is that used by Rabanal and Rubio-Ramirez (2003b), and it was used by them to study American economy, but also for the Euro Area, in Rabanal and Rubio-Ramirez (2003a). The model considers a closed economy. This implies that characteristics like liquidity effect (which is a feature of Romanian economy nowadays due to capital inflows), cannot be analyzed.

The model is presented in the following equations:

$$y_t = E_t y_{t+1} - \sigma(r_t - E_t \Delta p_{t+1} + E_t g_{t+1} - g_t) \quad (1)$$

$$y_t = a_t + (1-\delta) n_t \quad (2)$$

$$mc_t = w_t - p_t + n_t - y_t \quad (3)$$

$$mrs_t = g_t + \frac{1}{\sigma} y_t + \gamma n_t \quad (4)$$

$$r_t = \rho_r r_{t-1} + (1-\rho_r)\left[\gamma_\pi \Delta p_t + \gamma_y y_t\right] + ms_t \quad (5)$$

$$w_t - p_t = w_{t-1} - p_{t-1} + \Delta w_t - \Delta p_t \quad (6)$$

$$a_t = \rho_a a_{t-1} + \varepsilon_t^a \quad (7)$$

$$g_t = \rho_g g_{t-1} + \varepsilon_t^g \quad (8)$$

$$ms_t = \varepsilon_t^m \quad (9)$$

$$\lambda_t = \varepsilon_t^\lambda \quad (10)$$

$$\Delta p_t = \beta E_t \Delta p_{t+1} + k_p (mc_t + \lambda_t) \quad (11)$$

$$w_t - p_t = mrs_t \quad (12)$$

The first equation represents the relationship between production, (y_t), and the real interest rate. r_t represents the nominal interest rate, g_t stands for the preferences shock, p_t for the price level, while σ is the elasticity of intertemporal substitution. E_t is the expectations operator, while Δ is the difference operator.

The second equation expresses the production function. a_t is the technological process, n_t the number of hours worked while δ capital retribution. The following equation shows the relationship between marginal cost and the nominal wage, w_t.

Equation (4) represents the relationship between the marginal rate of substitution and the hours worked. γ is the inverse of the labor supply elasticity with respect to the real wage. Equation (1) and equation (4) show that the preferences shocks influence both the Euler equation and the marginal rate of substitution.

The monetary policy is specified through a Taylor policy rule, where γ_π şi γ_y are the long run responses of the monetary authority to the deviations of the inflation and the output gap from their steady state. I follow here Clarida, Gali şi Gertler (2000), and introduce a smoothing parameter for the interest rate, ρ_r.

Equation (6) is a relationship between the dynamic of the real wage and the dynamic of the nominal wage and the inflation.

The last two equations, (11) and (12) express the equations for wages and prices. Under the hypothesis of Calvo (1983) type rigidities for the prices, the equation for the dynamic of prices is given by (11), where:

$$k_p = \frac{(1-\delta)(1-\theta_p)(1-\beta\theta_p)}{\theta_p\left(1+\delta\left(\bar{\varepsilon}-1\right)\right)} \quad (13)$$

and $\bar{\varepsilon} = \frac{\bar{\lambda}}{\bar{\lambda}-1}$ is the steady state of ε, the elasticity of substitution for the different types of goods. Θ_p is the probability that prices stay fix in the current period.

Equation (11) is the New Keynesian Phillips Curve. The current inflation is determined by the expectations on the future inflation, the real marginal cost and the shocks on the prices mark-up.

3. The Estimation of the Model

In this section I estimate the model given by equations (1)-(12). The variables in the model are y_t, a_t, r_t, Δp_t, Δw_t, n_t, mc_t, rw_t, mrs_t, g_t, λ_t şi ms_t which stand for production, total factor productivity, nominal interest rate, inflation, nominal wage growth rate, labor effort, marginal cost, real wage, the marginal rate of substitution, preference shock, inflation shock and interest rate shocks.

The set of parameters to be estimated is given by $\{\sigma, \beta, \gamma, \theta_p, \varepsilon, \rho_r, \gamma_r, \gamma_\pi, \delta, \rho_a, \rho_g, \sigma_a, \sigma_m, \sigma_g, \sigma_\lambda\}$. Before applying the Bayesian estimation, several of the parameters are calibrated, namely β, δ and ε. The calibration is done according to the literature, following mainly Rabanal and Rubio-Ramirez (2003b).

The rest of the parameters are estimated using Bayesian techniques. The data series which are used are the GDP, inflation rate, the interest rate and the wage rate, between 2000 and 2006. All the data is at a quarterly frequency. The GDP series is the quarterly GDP in 1995 constant prices. The inflation rate is given by the annualized monthly rate given by the harmonic consumer price index, the quarterly series being computed as the quarterly average. The interest rate is the refi rate and is computed as the quarterly average. The real wages are the average quarterly wages which are deflated by the quarterly inflation rate. All the initial series were logged, deseasonalized and then filtered with the Hodrick Prescott filter.

The Bayesian estimation was done through 20.000 Metropolis Hastings extractions. The final acceptance ratio is a good one, of 30%. The multivariate statistics indicated that the convergence was achieved.

Table 1

Bayesian Estimation Results

Parameters	Prior Mean	Posterior Mean	Confidence Interval	Confidence Interval	Prior Distribution	Standard Deviation
Gampi	1.5	1.69	1.15	2.18	Normal	0.50
Gamy	0.12	0.14	-0.02	0.32	Normal	0.12
ρ_r	0.5	0.90	0.86	0.94	Uniform	0.28
ρ_a	0.9	0.89	0.85	0.93	beta	0.02
ρ_g	0.9	0.88	0.84	0.92	beta	0.02
θp	0.75	0.71	0.67	0.75	beta	0.02
σ	0.67	0.25	0.16	0.34	Inv. Gamma	0.02
e_a	0.10	0.03	0.03	0.08	Inv. Gamma	Infinite
e_g	0.10	0.06	0.04	0.09	Inv. Gamma	Infinite
e_ms	0.10	0.019	0.015	0.024	Inv. Gamma	Infinite
e_lam	0.10	3.02	1.82	4.15	Inv. Gamma	Infinite

Source: Own Computations

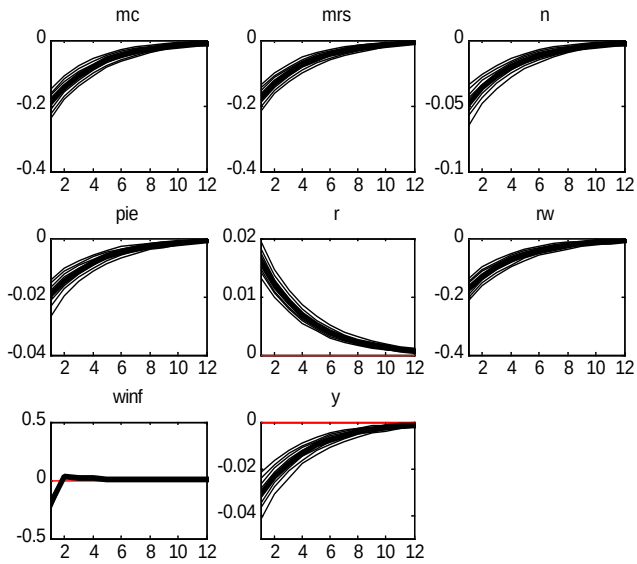
The above table shows the results of the Bayesian estimation. The parameters from the Taylorian rules are estimated at 0.9 for ρ_r, 1.69 for γ_{pi}, and 0.14 for γ_y. These results indicate that the national bank establishes the interest rate by pondering more the inflation, than the previous period interest rate, or the production. These results confirm the fact that the national bank followed, first of all, the inflation stability.

Rabanal and Rubio-Ramirez (2003b) estimated for the Euro area, a posterior mean for the Taylor rule coefficients of 1.3 for γ_{pi}, 0.26 for γ_y, and 0.73 for ρ_r. We see that even with respect to the monetary rules estimated for Euro Area, the estimation for Romania indicate a higher preference for the inflation, confirming the adoption of the inflation targeting during the sampled considered.

As for the degree of price rigidity, I obtained that the mean average for the probability that prices stay fixed during current period is of 0.71, which implies that, for the representative firm, it takes about four quarters to adjust its prices.

Figure 1

Impulse Response Functions to a monetary policy shock



Source: Own Computations

There is a current consensus in monetary economics that the central bank can influence the real production as far as it influences the real interest rate through the nominal one, see Walsh (2003) and Gali (2002). Gali (2002) showed that, for the American economy, a monetary shock leads to a strong and persistent effect on production. For Romania, the results indicate a strong effect (as the production decreases by more than 2%, and the inflation by 2%), but a less persistent effect (the impulse response functions last for about 10 -12 quarters).

Thus, a positive shock in the interest rate leads to effects expected by the economic theory. The inflation rate decreases, the effect lasting for about 12 quarters. The effect on the production is stronger, but it lasts less. In accordance with other studies on the effects of monetary policy on the real wage, like Peersman şi Smets (2001), the real wage decreases. The behavior of the real wage can also be derived from equation (12). Due to price rigidities, the households will adjust nominal wage following the marginal rate of substitution. As the prices adjust themselves slower and with a lower rate than the wages, it results a decrease in the real wages. This dynamic is specific only to the flexible wages case.

Conclusion

I found a degree of price rigidity in Romania closer to that in US than that in the Euro Area. This results suggests that, either for Romania the wage rigidities are important, or the fact that there are other types of frictions with important aggregate effects.

Another important result is that the impact of monetary policy shocks leads to strong but not very persistent effects.

The results here can serve as a foundation of future studies in using DSGE models to study monetary policy in Romania. Future studies should consider a larger number of rigidities, starting from the wage rigidities, and considering other nominal and real rigidities. The feature of small open economy should also be considered, as this would improve the understanding of the monetary transmission mechanism.

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Ph.D. Student Valeriu Cîndea
University of Paris X, France
Lecturer Ph.D. Student Lucian Belaşcu
"Lucian Blaga" University of Sibiu, Romania

CREDIT MARKET IN ROMANIA: FROM COMMUNISM TO EU MEMBERSHIP

Abstract: *Credit market strongly contributes to the development of an economy and especially of efficient activities. This article analyzes the way in which credit evolved in the Romanian economy, the transformations it underwent and the effects these transformations had on the evolution of the economy in general. The analysis concentrates over two distinct periods: the communist era and the post communist period (followed by the integration in EU). This article highlights that the essential feature of the credit relation in Romania during the communist era was the lack of concern for economic efficiency. At that time banks could not exert their mission of intermediation and all the advantages which derive from it (lower transaction costs, shared risks and reduction of information asymmetry). The essential function of the banks at that time was to ensure the achievement of the national plan objectives. The rebuilding process of the Romanian credit market began, as in all the ex communist European countries, with the reform of the banking system, as main financial intermediary. In 17 years of transition, the banking system became and remained the most important financial intermediary and credit supplier in the Romanian economy. After 1989, the total amount of credits granted by the banking system increased continually, contributing directly to the strong economic growth recorded by the Romanian economy recently. The improvement in the credit market is not limited to a quantitative aspect. Structural adjustments which occurred in the credit relation are even more important than the quantitative aspect. Loans are now granted following efficiency criteria. The reforms carried out for integrating the European Union were a catalyst, an acceleration of the reform process started after the fall of the communism. As a conclusion, the current credit market configuration is better adapted to the economy's needs and participates actively to the economic development.*

Key words*: Credit market, transition, banking reform*

JEL Classification*: G14, G21*

Introduction

Romania's integration in the European Union was conditioned by the respect of convergence criteria. These criteria relate to almost all the aspects of the society. Thus, this process involved the reform of major institutions and had a very important influence on the evolution of the Romanian society as a whole. These transformations could not avoid the credit market, which is in the center of the economic life and which has a crucial importance for the economic development of a country. The accession of Romania to the European Union was thus conditioned, inter alia, by the reform of the credit market.

It is thus interesting to analyze the way in which credit evolved in the Romanian economy, the transformations it underwent and the effects these transformations had on the evolution of the economy in general. This analysis must concentrate over two distinct periods: the communist period and the post communist period. The reason for which we must make this distinction is that, to these two periods correspond two different forms of organization of the credit market. The credit market was not only improved after 1989, but it was completely reformed. In 1990 Romania begun to rebuild a capitalist banking system. The reforms carried out for integrating the European Union were a catalyst, an acceleration of the reform process started after the fall of the communism.

First of all, to determine credit's effects on the general performance of the economic system, we must establish the role of the credit market in the Romanian economy before and after 1989. Once this aspect established, we can look further into the analysis to determine the effectiveness of the credit relation. For this, it is important to understand the nature of lender – borrower relation and how the credit relation evolved. It is also important to analyze the effectiveness of the credit relation to understand which were the principles respected in granting a credit and which is the role of banks and other financial institutions in distributing the credit in economy.

1. Credit market in the Romanian economy before 1989

The essential feature of the credit relation in Romania during the communist era was the lack of concern for economic efficiency. This is somehow coherent with the communist doctrines which seek "social effectiveness" and tend to neglect pure economic reasoning.

The changes in the credit market during the communist time started at August 13th, 1948 when the Law n° 197 was promulgated. This law created the legal frame for shutting down the last Romanian private banks of that time. The Romanian banking system became a state owned one. From this moment only public owned banks were authorized to grant loans. The essential function of the banks at that time was to ensure the achievement of the *national plan* objectives by all the means they had. This criterion exceeded in importance any efficiency evaluation. The only difference between subsidies and loans was that the latter were to be returned with a low interest rate.

During all this period, the banks were deprived of a function which is essential for the economy: *intermediation*. In fact intermediation was achieved by the state. Banks didn't collect exceeding resources of the economic agents in order to redistribute them to those in need. The banks granted loans using their own resources or state budget grants. In this manner, the banks could not exert their mission of intermediation and all the advantages which derive from it (*lower transaction costs*, *shared risks* and *reduction of information asymmetry*). However, in order to reduce information asymmetry, banks were allowed to exert controls on the companies' management.

Banks are known as *sources of financing for efficient projects*. This statement is founded on the functions achieved by banks in market economies. This statement is not valid for the banks that operated in Romania before 1989. Bank credit lost the quality of stimulating profitable activities, because the banks did not grant loans respecting efficiency criteria. The only function kept by the banking system was that of *management of the payment system*.

The major attribute which must be noticed regarding *interest rates* at that time is that they did not reflect a market reality. They did not reflect price equilibrium between credit supply and demand, they were just *administered prices*. As national statistics of the time did not include the economic category of *inflation*, we cannot speak about a possible relationship between the real interest rate and the nominal interest rate. However, specialists estimate that there was a masked inflation. It is even possible that this inflation was larger than some interest rates; therefore that there were negative real interests rates.

In 1948 the Communist Party makes the decision to stop the operation of stock markets. From this moment the banks remain the only financial institutions able to grant financing for companies. The insurance companies were also liquidated. In 1952 it was created the Administration of State Insurances (ADAS), but this institution was not authorized to grant loans to companies, its benefits being directed to the state budget.

Deprived of its essential prerogatives, the banking structure could not ensure an efficient financing of the economy by the credit mechanism. The destruction of the banking structure had harmful consequences on the Romanian economy. Without an efficient credit activity, the new created financial system provided financing for many inefficient projects from an economic standpoint. The effects of this handicap were felt in the Romanian economy for a long time, even after 1989. Indeed, we could say that his effects are still felt, credit level in the Romanian economy being much lower than the average of the western states.

2. Evolution of the credit market in the Romanian economy after 1989

The rebuilding process of the Romanian credit market began, as in all the ex communist European countries, with the reform of the banking structure, as main financial intermediary. The banking reform started in 1990, when the commercial functions of the National Bank of Romania (NBR) were taken by a new banking entity, the Romanian Commercial Bank, and the specialized banks (Bank for Agriculture and Food Industry, Bank for Investments, Romanian Bank for Foreign Trade) were transformed in limited companies. The number of commercial banks evolved from 6 banks in 1991 to 45 in May 1999 (36 Romanian banks and 9 branches of foreign banks) and to 41 in 2008 (32 Romanian banks and 9 branches of foreign banks). However, the Romanian banking system remains dominated by a small number of large banks. The main difference, compared to the communist period, is that the current system is better adapted to the economy's needs and far more developed. The integration in the European Union determined the arrival of new players in the Romanian banking landscape. La Caixa and Fortis Bank were the first European banks to benefit from the European unique passport and to establish branches in Romania after January 2007.

In 17 years of transition, the banking system became and remained the most important financial intermediary and credit supplier on the Romanian market. Before 1989 we cannot consider the banking system as a financial intermediary, because it did not fill the collection of funds function. After 1989, the total amount of credits grated by the banking system increased each year, as well in nominal as in real terms. Thus, the total amount of credits existing in the Romanian banking system increased from 1.375.159 million lei (137,5 million RON) in 1991 to 154.253,2 million RON in January 2008.

Table 1. Evolution of the credit market in Romania (million RON)

Year	Loans granted	Loans granted in leu	Loans grated in foreign

			currencies
1991	137,5	131,7	5,8
1992	191,3	169,9	21,4
1993	490,2	406	84,2
1994	948,5	743,5	205
1995	1643,5	1157,5	486
1996	2684,1	1694,3	989,8
1997	3590,1	1623,2	1966,8
1998	5908,7	2427,3	3481,4
1999	5771,9	2444,5	3327,5
2000	7500,7	3041,1	4459,6
2001	11825,4	4753,3	7072,1
2002	17962,6	6672,9	11289,8
2003	30287,9	13504	16783,9
2004	41762,4	16386,7	25375,7
2005	59806,3	27091,6	32714,7
2006	92378,5	48637,3	43741,2
2007	148180,7	67713	80467,7
Jan 2008	154253,2	69335,6	84917,6

Source: Annual reports of the National Bank of Romania

However, these figures do not give an accurate image of the reality. Although the volume of credit strongly increased, this growth is not explained entirely by economic growth. Other factors which contributed to the increase in the volume of credit were inflation and devaluation of the national currency. To obtain a proper image of the reality, we will convert the credit value in dollars, by respecting the medium exchange rate RON/dollar for each year.

Table 4.3. Evolution of the credit market in Romania

Year	Total loans	Exchange rate RON/dollar	Value of loans in dollars
1991	137,5	0,0076	18092,1
1992	191,3	0,0308	6211
1993	490,2	0,0760	6450
1994	948,5	0,1655	5731,1
1995	1643,5	0,2033	8084,1
1996	2684,1	0,3082	8709
1997	3590,1	0,7168	5008,5
1998	5908,7	0,8876	6656,9
1999	5771,9	1,5333	3764,4
2000	7500,7	2,1693	3457,7
2001	11825,4	2,9061	4069,2
2002	17962,6	3,3055	5434,2
2003	30287,9	3,3200	9122,9
2004	41762,4	3,2637	12796
2005	59806,3	2,9137	20525,9
2006	92378,5	2,9137	31704,9
2007	148180,7	2,8090	52752,1
Jan 2008	154253,2	2,4383	63262,6

Source: Calculations using annual reports of the National Bank of Romania

With these corrected data, we can clearly see the effects of the 1997-1998 crisis on the credit market. Indeed, in 1997 the Romanian credit market dropped. There are several factors which contributed to this situation. The first one is the financial crisis which struck all the countries of the area. Another factor regards the procedures adopted by the NBR in order to avoid an aggravation of the financial crisis, as the situation

faced by Bulgaria. The fall in the credit market was also caused by the exit of "non efficient" banks from the market, by thus decreasing the total amount of credit available for the economy.

The recession ends in 2000, marking the beginning of a new period of reinforcement on the credit market. Many specialists talk about a "credit boom" when analyzing the strong increase of the credit market between 2000-2007. The main reasons for this strong increase are:

- Strong increase of the GDP and fall in inflation. In the 7 years, the GDP increased by 5.5% each year in average and inflation dropped to a one digit level
- Structural reforms. Major improvements were recorded in privatization, corporate governance and reorganization of inefficient state owned companies, enhancement of the banking environment, liberalization of the interest rate, development of the infrastructure.
- Macroeconomic stabilization after the crisis.
- Restoration of the confidence in the banking environment.
- External flows of capital. Seizing the new opportunity, foreign banks reinforced their presence on the local market, contributing to the increase in the credit supply.

Among the most important characteristics of the credit evolution during this time we can count:

- Fast increase in loans granted to households. The period 2000 - 2007 is characterized by a strong increase in mortgage and consumer credit. The NBR intervened several times in order to moderate this growth and to stimulate investment credit. These measures were imposed by the need to stabilize the balance of the external payments (the consumer credits stimulated the imports by thus increasing the external deficit of account).
- Increase in loans granted in foreign currencies. Costs expected for loans in foreign currencies were smaller than those for loans in leu.
- The majority of loans is granted to industrial and services companies. This situation is also a result of the policy followed by the NBR.
- Migration of the short-term credits towards medium and long term credits.
- Regarding credits' source, banks increased their credit offer mainly by using deposits. Economy's general dynamics also stimulated individuals to save and deposit money in banks.

The increase in credit supply had and continues to have a crucial importance for the economic development. However, the improvement in the credit market is not limited to a quantitative aspect. The structural adjustments which occurred in the credit relation are even more important than the quantitative aspect. From 1990, once the reform of the banking system started, the way in which loans are granted changes too. Banks become autonomous, their goal being to maximize their earnings. This moment marks a fundamental change in the way loans are granted. Henceforth, the criteria taken into account for granting a loan are economic ones: business plan feasibility, capacity of the borrower to refund the credit, history of the borrower – lender relation etc. For some time, especially at the transition's beginnings, loans were also granted on failing criteria, such as the relation of banks' managers with people requiring credit lines or even the government's decision. With regard to the loans granted following the decision of the government, after 1989 the government continued to credit in a preferential way certain branches of industry, without considering economic efficiency criteria. It is mainly the case of the agricultural and energy sectors. The privatization of the Agricultural Bank and the taking over of BANCOREX by BCR mark the end of these practices. From now on, the banks and the bank credit take again its normal place in the development of the economy.

Banks do not have any more the function to achieve the missions established by the state but to maximize their own profits. That determined an improvement in efficiency in all the economy. The interest rates are established freely on the market according to the scarcity of resources, inflation, risk, etc. The interest rate thus reflects the price of the money in the economy. The most important transformation relates to the role of intermediation regained by banks. To develop their own activities, and by extension their benefits, banks must increase their resources. The principal resource for this is the deposits. Thus, banks started to exert again the mission of intermediation, with all the advantages which derive from it: *lower costs of transaction*, *shared risks* and *reduction of information asymmetry*. Banks played an important role in reducing information asymmetry even during the communist period, as we mentioned before. The banks kept this function but they exert it in another manner. They do not control any more companies' management, but keep data bases on the history of their operations with various customers. The banks thus regained the statute of financer of efficient activities.

With regard to the form of the credit contract, at the beginning there was a tendency to create a more complex contract, with many requirements for the borrower, in order to avoid *moral hazard*. More recently, the increase in competition on the credit market and the good health of the economy motivate banks to reduce their requirements in credit granting, especially when they work with former customers.

By regaining a central place in the financing of the economy, the credit market strongly contributes to the development of the economy and especially of the efficient activities. Becoming increasingly strong and mature, the banking system becomes a point of support for all the other activities of the economy.

The banking system evolved in a very positive way. However, it is not the only form of financial intermediation to have followed this way to Romania: beside a fast growing banking system, the capital markets and the insurance companies started to strongly develop lately, though with more delay, especially for the capital market.

Conclusion

In this article, we tried to analyze credit evolution in the Romanian economy from the communism era to its current status of EU member. We can conclude that, during the communism era, the credit represented only an instrument to carry out the plan established at national level (which had a strong implication on the efficiency of companies, of the economy, and the general life of people). This situation changed after 1989, when, progressively, the bank credit became a source of financing of the profitable activities. The stability of the relation banks - borrower did not have any importance before 1989. The companies could not choose the bank with which they wanted to work. At the same time, the bank could not refuse to finance a project drawn up in the national plan. This aspect took another dimension after the fall of the communism since from now on, the companies which maintain stable relations with their bank can obtain facilities.

For the communist period, the bank credit was the only form of external financing (besides that of the state budget). After 1989 the banking system developed rapidly, therefore sources of bank credit. At the same time, a multiplication of the nonbanking sources of financing has occurred (development of the insurance, capital market).

Although they experienced a significant development during the last seventeen years, the Romanian credit market remain, however, under dimensioned compared to the needs and the potential of the Romanian economy.

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Ec. Bogdan Ionut Corneanu
Sibiu, Romania

THE ELECTRONIC BANKING SYSTEM

Abstract: *For many consumers, electronic banking means 24-hour access to cash through an automated teller machine (ATM) or Direct Deposit of paychecks into checking or savings accounts. But electronic banking now involves many different types of transactions.Electronic banking, also known as electronic fund transfer (EFT), uses computer and electronic technology as a substitute for checks and other paper transactions. EFTs are initiated through devices like cards or codes that let you, or those you authorize, access your account. Many financial institutions use ATM or debit cards and Personal Identification Numbers (PINs) for this purpose. Some use other forms of debit cards such as those that require, at the most, your signature or a scan. The federal Electronic Fund Transfer Act (EFT Act) covers some electronic consumer transactions.*

Key words*: Electronic, Transfer, Internet, Card, Information*

Electronic Fund Transfers

EFT offers several services that consumers may find practical:

Automated Teller Machines or 24-hour Tellers are electronic terminals that let you bank almost any time. To withdraw cash, make deposits, or transfer funds between accounts, you generally insert an ATM card and enter your PIN. Some financial institutions and ATM owners charge a fee, particularly to consumers who don't have accounts with them or on transactions at remote locations. Generally, ATMs must tell you they charge a fee and its amount on or at the terminal screen before you complete the transaction. Check the rules of your institution and ATMs you use to find out when or whether a fee is charged.

Direct Deposit lets you authorize specific deposits, such as paychecks and Social Security checks, to your account on a regular basis. You also may pre-authorize direct withdrawals so that recurring bills, such as insurance premiums, mortgages, and utility bills, are paid automatically. Be cautious before you pre-authorize direct withdrawals to pay sellers or companies with whom you are unfamiliar; funds from your bank account could be withdrawn fraudulently.

Pay-by-Phone Systems let you call your financial institution with instructions to pay certain bills or to transfer funds between accounts. You must have an agreement with the institution to make such transfers. Personal Computer Banking lets you handle many banking transactions via your personal computer. For instance, you may use your computer to view your account balance, request transfers between accounts, and pay bills electronically.

Debit Card Purchase Transactions let you make purchases with a debit card, which also may be your ATM card. This could occur at a store or business, on the Internet or online, or by phone. The process is similar to using a credit card, with some important exceptions. While the process is fast and easy, a debit card purchase transfers money — fairly quickly — from your bank account to the company's account. So it's important that you have funds in your account to cover your purchase. This means you need to keep accurate records of the dates and amounts of your debit card purchases and ATM withdrawals in addition to any checks you write. Also be sure you know the store or business before you provide your debit card information, to avoid the possible loss of funds through fraud. Your liability for unauthorized use, and your rights for error resolution, may differ with a debit card.

Electronic Check Conversion converts a paper check into an electronic payment in a store or when a company receives your check in the mail. In a store, when you give your check to a cashier, the check is run through an electronic system that captures your banking information and the amount of the check. You're asked to sign a receipt and you get a copy for your records. When your check has been handed back to you, it should be voided or marked by the merchant so that it can't be used again. The merchant electronically sends information from the check (but not the check itself) to your bank or other financial institution, and the funds are transferred into the merchant's account. When you mail-in a check for payment to a merchant or other company, they may electronically send information from your check (but not the check itself) through the system, and the funds are transferred into their account. For a mailed check, you should still receive advance notice from a company that expects to send your check information through the system electronically. The merchant or other company might include the notice on your monthly statement or under its terms and

conditions. The notice also should state if the merchant or company will electronically collect from your account a fee — like a "bounced check" fee — if you have insufficient funds to cover the transaction.

Be especially careful in Internet and telephone transactions that may involve use of your bank account information, rather than a check. A legitimate merchant that lets you use your bank account information to make a purchase or pay on an account should post information about the process on their website or explain the process over the telephone. The merchant also should ask for your permission to electronically debit your bank account for the item you're purchasing or paying on. However, because Internet and telephone electronic debits don't occur face-to-face, you should be cautious with whom you reveal your bank account information. Don't give this information to sellers with whom you have no prior experience or with whom you have not initiated the call, or to companies that seem reluctant to provide information or discuss the process with you.

Not all electronic fund transfers are covered by the EFT Act. For example, some financial institutions and merchants issue cards with cash value stored electronically on the card itself. Examples include prepaid telephone cards, mass transit passes, and some gift cards. These "stored-value" cards, as well as transactions using them, may not be covered by the EFT Act. This means you may not be covered for the loss or misuse of the card. Ask your financial institution or merchant about any protections offered for these cards.

Disclosures

To understand your legal rights and responsibilities regarding your EFTs, read the documents you receive from the financial institution that issued your "access device." That is, a card, code or other means of accessing your account to initiate electronic fund transfers. Although the means varies by institution, it often involves a card and/or a PIN. No one should know your PIN except you and select employees of the financial institution. You also should read the documents you receive for your bank account, which may contain more information about EFTs.Before you contract for EFT services or make your first electronic transfer, the institution must tell you the following information in a form you can keep.

- A summary of your liability for unauthorized transfers.
- The telephone number and address of the person to be notified if you think an unauthorized transfer has been or may be made, a statement of the institution's "business days" (which is, generally, the days the institution is open to the public for normal business), and the number of days you have to report suspected unauthorized transfers.
- The type of transfers you can make, fees for transfers, and any limits on the frequency and dollar amount of transfers.
- A summary of your right to receive documentation of transfers, to stop payment on a pre-authorized transfer, and the procedures to follow to stop payment.
- A notice describing the procedures you must follow to report an error on a receipt for an EFT or your periodic statement, to request more information about a transfer listed on your statement, and how long you have to make your report.
- A summary of the institution's liability to you if it fails to make or stop certain transactions.
- Circumstances under which the institution will disclose information to third parties concerning your account.
- A notice that you may be charged a fee by ATMs where you don't have an account.

In addition to these disclosures, you will receive two other types of information for most transactions: terminal receipts and periodic statements. Separate rules apply to passbook accounts from which pre-authorized transfers are drawn. The best source of information about those rules is your contract with the financial institution for that account. You're entitled to a terminal receipt each time you initiate an electronic transfer, whether you use an ATM or make a point-of-sale electronic transfer. The receipt must show the amount and date of the transfer, and its type, such as "from savings to checking." When you make a point-of-sale transfer, you'll probably get your terminal receipt from the salesperson.

You won't get a terminal receipt for regularly occurring electronic payments that you've pre-authorized, like insurance premiums, mortgages, or utility bills. Instead, these transfers will appear on your periodic statement. If the pre-authorized payments vary, however, you should receive a notice of the amount that will be debited at least 10 days before the debit takes place.You're also entitled to a periodic statement for each statement cycle in which an electronic transfer is made. The statement must show the amount of any transfer, the date it was credited or debited to your account, the type of transfer and type of account(s) to or from which funds were transferred, and the address and telephone number for inquiries. You're entitled to a quarterly statement whether or not electronic transfers were made.Keep and compare your EFT receipts with your periodic statements the same way you compare your credit card receipts with your monthly credit card

statement. This will help you make the best use of your rights under federal law to dispute errors and avoid liability for unauthorized transfers.

Errors

You have 60 days from the date a periodic statement containing a problem or error was sent to you to notify your financial institution. The best way to protect yourself if an error occurs — including erroneous charges or withdrawals from an account, or for a lost or stolen ATM or debit card — is to notify the financial institution by certified letter, return receipt requested, so you can prove that the institution received your letter. Keep a copy of the letter for your records.If you fail to notify the institution of the error within 60 days, you may have little recourse. Under federal law, the institution has no obligation to conduct an investigation if you've missed the 60-day deadline.Once you've notified the financial institution about an error on your statement, it has 10 business days to investigate. The institution must tell you the results of its investigation within three business days after completing it and must correct an error within one business day after determining that the error has occurred. If the institution needs more time, it usually may take up to 45 days, in most situations, to complete the investigation — but only if the money in dispute is returned to your account and you're notified promptly of the credit. At the end of the investigation, if no error has been found, the institution may take the money back if it sends you a written explanation.An error also may occur in connection with a point-of-sale purchase with a debit card. For example, an oil company might give you a debit card that lets you pay for gas purchases directly from your bank account. Or you may have a debit card that can be used for various types of retail purchases. These purchases will appear on your periodic statement from the bank. In case of an error on your account, however, you should contact the card issuer (for example, an oil company or a bank) at the address or phone number provided by the company. Once you've notified the company about the error, it has 10 business days to investigate and tell you the results. In this situation, it may take up to 90 days to complete an investigation, if the money in dispute is returned to your account and you're notified promptly of the credit. If no error is found at the end of the investigation, the institution may take back the money if it sends you a written explanation.

Lost or Stolen ATM or Debit Cards

If your credit card is lost or stolen, you can't lose more than $50. If someone uses your ATM or debit card without your permission, you can lose much more.If you report an ATM or debit card missing to the card issuer before it's used without your permission, you can't be held responsible for any unauthorized withdrawals.If unauthorized use occurs before you report it, the amount you can be held responsible for depends upon how quickly you report the loss to the card issuer. If you report the loss within two business days after you realize your card is missing, you won't be responsible for more than $50 for unauthorized use. If you fail to report the loss within two business days after you realize the card is missing, but do report its loss within 60 days after your statement is mailed to you, you could lose as much as $500 because of an unauthorized transfer. If you fail to report an unauthorized transfer within 60 days after your statement is mailed to you, you risk unlimited loss. That means you could lose all the money in your account and the unused portion of your maximum line of credit established for overdrafts.If you failed to notify the institution within the time periods allowed because of an extenuating circumstance, such as lengthy travel or illness, the issuer must reasonably extend the notification period. In addition, if state law or your contract imposes lower liability limits, those lower limits apply instead of the limits in the federal EFT Act.

Once you report the loss or theft of your ATM or debit card, you're no longer responsible for additional unauthorized transfers occurring after that time. Because these unauthorized transfers may appear on your statements, however, you should carefully review each statement you receive after you've reported the loss or theft. If the statement shows transfers that you did not make or that you need more information about, contact the institution immediately, using the special procedures provided for reporting errors.

Limited Stop-Payment Privileges

When you use an electronic fund transfer, the EFT Act does not give you the right to stop payment. If your purchase is defective or your order is not delivered, it's as if you paid cash. That is, it's up to you to resolve the problem with the seller and get your money back.There is one situation, however, when you can stop payment. If you've arranged for regular payments out of your account to third parties, such as insurance companies, you can stop payment if you notify your institution at least three business days before the scheduled transfer. The notice may be oral or written, but the institution may require a written follow-up within 14 days of the oral notice. If you fail to provide the written follow-up, the institution's responsibility to stop payment ends.Although federal law provides only limited rights to stop payment, individual financial institutions may offer more rights or state laws may require them. If this feature is important to you, you may want to shop around to be sure you're getting the best "stop-payment" terms available.

Other Rights

The EFT Act protects your right of choice in two specific situations regarding use of electronic fund transfers: First, the Act prohibits financial institutions from requiring you to repay a loan by electronic transfer. Second, if you're required to receive your salary or government benefit check by EFT, you have the right to choose your institution.

Suggestions

If you decide to use EFT,you will have to keep these tips in mind:

- Take care of your ATM or debit card. Know where it is at all times; if you lose it, report it as soon as possible.
- Choose a PIN for your ATM or debit card that's different from your address, telephone number, Social Security number, or birthdate. This will make it more difficult for a thief to use your card.
- Keep and compare your receipts for all types of EFT transactions with your periodic statements. That way, you can find errors or unauthorized transfers and report them.
- Make sure you know and trust a merchant or other company before you share any bank account information or pre-authorize debits to your account. Be aware that some merchants or companies may use electronic processing of your check information when you provide a check for payment.
- Review your monthly statements promptly and carefully. Contact your bank or other financial institution immediately if you find unauthorized transactions and errors.

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Lect. univ. dr. Marian Pompiliu Cristescu
"Lucian Blaga" University of Sibiu, Romania

C.A.S.R.E. – STATISTICAL TOOL USED FOR MEASUREMENT AND MODELLING THE SOFTWARE REALIBILITY

Abstract: *there are many tools available to help the Software Engineer evaluate reliability for the software they develop. We will look at the CASRE (Computer Aided Software Reliability Estimation) tool and apply real world project data to derive a reliability evaluation and prediction. It is acknowledged that proficiency in using CASRE cannot occur in just a few weeks and that the project data used here is too small a set to provide accurate results for reliability modelling.*

Key words*: statistical tools, modeling, estimation, software reliability, software quality models.*

JEL Classification*: C6, C61,*

1. *C.A.S.R.E.* INTRODUCTION

The CASRE (Computer Aided Software Reliability Estimation) program is a Software Reliability Estimation tool that runs on the Microsoft Windows and Unix X-Windows platforms. CASRE extends the original SMERFS (*Statistical Modeling and Estimation of Reliability Functions for Software*) package, by providing a workable menu based graphical user interface. The CASRE program uses an ASCII text based file input, and displays the calculated results in both graphical and tabular formats.

CASRE was developed in 1993 at the Jet Propulsion Laboratory at NASA. One of the more powerful features of CASRE is the ability to combine the results of several reliability models. This can potentially result in greater accuracy in the resultant reliability predictions than individual models could obtain.

2. *C.A.S.R.E.* CAPABILITIES AND FUNCTIONS

2.1. Data Input

Input data is provided to CASRE as an ASCII based text file with the '.dat ' extension. The input file can be in one of the following two formats:

- *time between failures format* – using this format, the first line of the file contain one of the seven key words used to indicate how the time is measured (Seconds, Minutes, Hours, Days, Weeks, Months, or Years), followed by a carriage return. The second and subsequent lines of the file should contain information on the error number (integer), time since last failure (float), and error severity (integer). The error numbers begin at one and increase sequentially. The values for error severity can vary from one to nine;
- *failure counts format* – as with the previous file format, , the first line of the file contain one of the seven key words used to indicate how the time is measured (Seconds, Minutes, Hours, Days, Weeks, Months, or Years), followed by a carriage return. The second and subsequent lines of the file should contain information on interval number (integer), number of errors occurring in the interval (integer), length of the interval (float), and error severity (integer). An interval must have a line in the input file for every type of error severity encountered in that interval. For intervals in which no error has occurred, a line with the number of errors and error severity set to zero must be added.

Individual data elements in the input file must be separated by either TABS, commas, or spaces. The predefined format of the input data file must be followed rigorously, or the program will terminate with an error message. Although CASRE does not allow the user to edit the input data within the program, menu links to common text editors (Notepad, Write) simplify the process of modifying the input data.

2.2. *C.A.S.R.E.* Models

CASRE allows the user to choose from a number of different Software Reliability Models depending on whether your failure data is based on "time between failures" or "failure counts". This includes 4 predefined model combinations. Additional combinations can be made which allows many more unique

predication models. Each of these will be explained briefly to allow the reader to understand the applicability of each.

Time between failure models included with the CASRE package are:

- Geometric;
- Jelinski-Moranda;
- Littlewood-Verrall Linear;
- Littlewood-Verrall Quadratic;
- Musa-Basic;
- Musa-Okumoto;
- NHPP (TBE);

Failure count models included with CASRE are:

- Generalized Poisson;
- Generalized Poisson - user specified interval weighting;
- Nonhomogeneous Poisson (NHPP);
- Schneidewind;
- Schneidewind - ignore first "s-1" test intervals;
- Schneidewind - total failures in first "s-1" test intervals;
- Shick-Wolverton;
- Yamada S-shaped;

The 4 predefined combination models are:

- DLC/S/4;
- ELC;
- MLC;
- ULC

A). *Littlewood-Verrall (Linear and Quadratic)*

The Littlewood-Verrall model tries to account for fault generation in the correction process. It is therefore a far more complex model with the following assumptions:

- ✓ Successive execution times between failures, that is X_i's, are assumed to be independent exponential random variables with parameter ξ_i, $i = 1, \ldots . n.$;
- ✓ The ξ_i's form a sequence of independent random variables, each with a gamma distrubution of parameters α and $\psi(i)$. The function $\psi(i)$ is taken to be an increasing function of i that describes the quality of the programmer and the difficulty of the task. A good programmer would have a more rapidly increasing function than a poorer one;
- ✓ The software is operated in a manner similar to the anticipated operational usage.

This model takes the form $f(x_i|\alpha, \psi(i)) = \frac{\alpha[\psi(i)]^{\alpha}}{[x_i+\psi(i)]^{\alpha+1}}$ (1)

The linear and quadratic forms differ in their failure intensity formulas.

$$\lambda_{linear}(t) = \frac{\alpha-1}{\sqrt{\beta_0^2+2\beta_1 t(\alpha-1)}} \quad (2)$$

$$\lambda_{quadratic}(t) = \frac{v_1}{\sqrt{t^2+v_2}}\left(\left(t+(t^2+v_2)^{1/2}\right)^{1/3} - \left(t-(t^2+v_2)^{1/2}\right)^{1/3}\right) \quad (3)$$

B). *Musa-Basic*

The Musa-Basic model makes the following assumptions:

- ✓ The software is operated in a similar manner as the anticipated operational usage;
- ✓ The detections of failures are independent of one another;
- ✓ The software failures are observed (ie. the total number of failures has an upper bound);
- ✓ The execution times (measured in cpu time) between failures are piecewise exponentially distributed;
- ✓ The hazard rate is proportional to the number of faults remaining in the program;
- ✓ The fault correction rate is proportional to the failure occurrence rate;
- ✓ Perfect debugging is assumed.

The Musa-Basic model is one of the most widely used software reliability models. It uses execution time rather than calendar time and has a mean value function μ of $\mu(t) = \beta_0(1 - e^{-\beta_1 t})$ and a failure intensity λ of $\lambda(t) = \beta_0\beta_1 e^{-\beta_1 t}$.

β_0 and β_1 are parameters to fit the model. Setting β_0 equal to the number of faults in the system ν_0 and defining β_1 as a "fault reduction factor" equal to $B\phi$ where ϕ is the hazard rate per individual fault results in a good approximation.

The Musa-Basic model also makes use of a "test compression factor" C in several of its formulas. For example, at time t the total number of errors is

$$n(t) = n_0\left[1 - \exp\left(-\frac{C}{n_0 MTTF_0}t\right)\right] \quad (4)$$

3. THE PROJECT

The CASRE models should only be used on data where the reliability is increasing as testing continues. Reliability is increasing if the mean time between failures is increasing as the total number of failures accumulates during the testing phase. In the plot above, the slope of the cumulative time between failures is decreasing as the total number of failures accumulates, due to the fact that the mean time between failures is increasing. Therefore the input data is applicable for use with the CASRE models. In order to determine which models would provide the best fit for the Project X fault data, we ran calculations using all applicable reliability models available in CASRE (including one combination model): Geometric, Jelinski-Moranda, Littlewood-Verrall, Musa Basic, Musa-Okumoto, Combination of Jelinski-Moranda and Musa Basic.

3.1. Project Results

The first result examined was the goodness of fit test. The goodness of fit test is used to determine how close the model predictions were to the actual data. The diagram below displays the goodness of fit test for all models that were used in this paper.

Goodness of Fit: wellflo.dat

Plot Results Display Settings Copy Help

Model Name	KS Distance	95% Fit?
Jelinski-Moranda	3.501364e-001	No
Musa Basic	3.616586e-001	No
Geometric	3.885301e-001	No
Littlewood-Verrall	3.720550e-001	No
Musa-Okumoto	3.812972e-001	No
Combo JM-MB	3.558975e-001	No

Figure 1 – Goodness of fit results

For the results above, we see that none of the models achieved the 95% fit criteria on our test data. One possible reason could be the rather small number of test points in our input data. In regards to the size of the input data, the CASRE 3.0 user manual states the following:

- "You should only apply CASRE to modules in which you expect to see 40 to 50 failures. If you expect to see fewer failures you may reduce the accuracy of your estimates";
- This may have resulted in a decrease in the accuracy of the model estimates.

In order to determine which models demonstrated the best prediction accuracy for our input data, the CASRE 'Model Ranking' option was used. An equal weight was applied to the five evaluation criteria: goodness of fit, prequential likelihood, bias, bias trend, and model noise. The results of the model rankings are displayed below.

Model Ranking Summary: wellflo.dat

Plot Results Display Settings Copy Help

Model Name	Rank	Reliability
Jelinski-Moranda	1	3.641147e-001
Combo JM-MB	2	3.030141e-001
Musa Basic	3	2.323975e-001
Geometric	4	1.615702e-001
Littlewood-Verrall	5	1.260950e-001
Musa-Okumoto	6	1.968036e-001

Figure 2 – Model ranking

From this we can see that the Jelinski-Moranda, Musa Basic, and Combination of Jelinski-Moranda and Musa Basic models were the most accurate models for our input data. The results of these three models are compared to the input data on the 'Time between Failures' plot displayed below.

4. CONCLUSIONS

The CASRE GUI is fairly user friendly, making it an easy software reliability tool to learn. Mechanisms such as "Parameter Estimation" make it far simpler to use the various reliability models contained within the software. The ability to combine the results of several reliability models is a powerful feature. It is possible to create a combination of models in which the calculated results from the combination model more closely match a given set of input data than the standard models do. Results from CASRE are available in tabular and graphical formats. The user can apply various filters and noise reduction functions in CASRE to affect the shape of the failure data.

Some disadvantages of the CASRE tool are listed below.

CASRE was found to be unstable at times. Mistakes in the input data file (i.e. addition of a blank line, non-sequential failure count, etc.), or use of advanced features (i.e. creating a combination model) occasionally caused the program to crash. Not being able to edit the input data file directly from CASRE made any input data changes a multi-step process. The limitation of displaying the results of a maximum of three models on an output plot was a minor annoyance.

Overall we would have to conclude that CASRE is a valuable tool for software reliability estimation. The learning curve for the program is not steep, making it possible to become proficient at the software in a fairly short order. The flexibility of the program allows advanced users to apply combinations of models and apply various filtering effects to the data. We should note however, that for greater accuracy in the calculated results, CASRE is best applied to projects where the expected number of failures is greater than 40-50 failures. For projects where the expected number of failures is less than 40, the accuracy of the calculated results from CASRE may not be acceptable.

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Associate Lecturer Sandor Csegedi
Sapientia University of Targu Mures, Romania
Professor Ioan Bătrâncea
Teodor Pop
"Babeş – Bolyai" University of Cluj Napoca, Romania

ANALYSIS OF THE INFLUENCE OF THE FACTORS ABOVE INCOME TAXATION

Abstract. *In the paper the authors present the modalities of calculating the influences of different factors on income taxation.*

Key words: *taxation rate, income tax, tax rate changes*

1.Introduction

The taxation base is the notion used for designating the sum on which there is applied a tax rate in order to determine the quantum of the due tax. In practice, the taxable base represents the sum obtained after performing all the legal deductions and applicable facilities.

The objective of the public income is the economic phenomenon on the existence of which the law makes the creation of fiscal obligation depends. Objects of the public income may be: the income made by an individual, goods, certain juridical facts or acts etc. since, in law, the object of the taxation is indicated in general, impersonal, in order to create the fiscal juridical report it is necessary to determine it accurately quantitative as qualitative, according to the nature and the dimension of the phenomenon generating budgetary income.

The establishment of the taxable base is accomplished through two operations: the identification of the object of public income and the determination of its nature (quality) and the evaluation (measurement), that is its quantitative characterization for a 1 year period. The accurate determination of the public income object is very important from a political, economic, social, financial and juridical point of view, since, on it, depends the dimension of the public income itself, which has to be paid by the tax payer.

Taking into account the fact that the taxation base represents incomes, expenses and capital, analyzing the taxable mass of public income, we reach the conclusion that, in the case of certain taxes, the component of the taxable object is mixed. For example, with tax on profit and income, the taxable base represents non deductible incomes and expenses.

When taxing labor force, salaries incomes represent the taxation base and, on the other hand, the expenses with the total fund of salaries represent the taxation base for contributions of social and health insurances.

When taxing capital and determining the taxation base, there is taken into account the quality and quantity of the taxable object, evaluated as monetary expression. For example, a corporeal intangible loses its value on the account of the expenses with amortization and the taxation base is at the level of the initial value or may be increased after the evaluation by correction coefficients etc.

We may state that, when determining the taxation base, the three components (incomes, expenses and capital) form a relation of convergent interdependence and form a three-polar structure: INCOMES – EXPENSES – CAPITAL.

With indirect taxes, the taxation base is not exclusively determined on the account of expenses or exclusively on the account of capital. These components mingle when the taxation base is determined.

The expanding of the taxation base by the increase of incomes and decrease of expenses represents a main objective of companies.

2. Method and Results

The taxation rate is a technical element of taxes and represents the sum or the percent applied to the taxation base and with the help of which there can be determined the dimension of the tax owed by the tax payer.

The rate represents the amount of tax per evaluation unit of the taxable fund. Before the rate is applied, there has to be determined the tax calculation base, starting with the volume of the taxable fund.[1]

[1] C. Tulai – Public Finance, House of Science Pub., Cluj-Napoca, 2003, p.277

When the rate is the same, irrespective of the nature of the taxable fund, the assessment is uniform. There is a discriminating fiscal treatment when the rate varies according to the nature of the taxable fund. If, in the case of progressively, the differentiation of the fiscal treatment is made according to the size of the taxable fund, in the case of fiscal discrimination, the difference is made according to the nature of the taxable fund.[1]

The assessment in percents may be seen under the form: in proportional rates, in progressive rates, in regressive rates. The level of the rate increases or decreases as the taxation base increases or decreases, so that the dynamics of the tax would outrun that of the taxable fund.

Discrimination is a more complex fiscal technique then the uniform assessment. It can be made either by using a reduced rate for certain objectives of the assessment, or by over taxing others. Fiscal determination is often analyzed in relation with the possibilities of concealing the taxable fund. Fiscal determination may also become an instrument of the economic politics, encouraging certain activities by offering fiscal facilities and discouraging other by over taxation. The intervention ought to be moderated so that fiscal icy would change neither the economic structure, nor the traditional structure of consumption.

In the following we will present a case study regarding the influence of base on tax rates modification, as shown in the table below.

Table 1 **The analysis of the influence of base and tax rate changes**

CASES	TAXATION BASE Q		TAX RATE C	
	PERIOD		PERIOD	
	(t) Q_0	(t+1) Q_1	(t) C_0	(t+1) C_1
a	1000	2000	25 %	20 %
b	1000	1000	25 %	20 %
c	1000	2000	25 %	30 %
d	1000	2000	25 %	25 %
e	1000	500	25 %	25 %
f	1000	500	25 %	30 %
g	1000	500	25 %	20 %

The analysis model is determined through the relation:

I = Q x C

I = tax

Q = taxation base

C = tax rate

The analysis of the influence of base and tax rate changes

a) The increase of the taxation base and the decrease of the tax rate

(1) Determining the absolute change of the phenomenon:

$\Delta I = (Q_1 \times C_1) - (Q_0 \times C_0) = (2000 \times 20\,\%) - (1000 \times 25\%) = 400 - 250 = 150$

(2) Determining the influence of the factors:

- **For taxation base Q:**

  $\Delta I_Q = \Delta Q \times C_0 = (Q_1 \times Q_0) \times C_0 = (2000 - 1000) \times 25\% = 250$

- **For tax rate C:**

  $\Delta I_C = Q_1 \times \Delta C = Q_1 \times (C_1 \times C_0) = 2000 \times (20\% - 25\%) = 2000 \times (-5\%) = -100$

(3) Determining the reality relation:

$\Delta I = \Delta I_Q + \Delta I_C = 250 - 100 = 50$

(4) Influence of the changes:

$\Delta Q \times \Delta C = (Q_1 - Q_0) \times (C_1 - C_0) = (2000 - 1000) \times (20\% - 25\%) = 1000 \times (-5\%) = -50$

Note: **We may state that, in this case, the fiscal pressure decreases**

b) The taxation base does not change and the tax rate decreases

(1) Determining the absolute change of the phenomenon

$\Delta I = (Q_1 \times C_1) - (Q_0 \times C_o) = (1000 \times 20\%) - (1000 \times 25\%) = 200 - 250 = -50$

[1] ibidem, p. 282

(2) Determining the influece of the factors:

- **For taxation base Q:**

  $\Delta I_Q = \Delta Q \times C_0 = (Q_1 \times Q_0) \times C_0 = (1000 - 1000) \times 25\% = 0$

Note: **It is obvious that, if the taxation base does not change, there is no influence over the phenomenon**

- **For tax rate C:**

  $\Delta I_C = Q_1 \times \Delta C = Q_1 \times (C_1 \times C_0) = 1000 \times (20\% - 25\%) = -50$

(3) Determining the reality relation:

$\Delta I = \Delta I_Q + \Delta I_C = -50$

Note: **In this case we may state that the fiscal pressure decreases**

c) The increase of the taxation base and the increase of the tax rate

(1) Determining the absolute change of the phenomenon:

$\Delta I = (Q_1 \times C_1) - (Q_0 \times C_o) = (2000 \times 30\%) - (1000 \times 25\%) = 600 - 250 = 350$

(2) Determining the influence of the factors:

- **For taxation base Q:**

  $\Delta I_Q = \Delta Q \times C_0 = (Q_1 \times Q_0) \times C_0 = (2000 - 1000) \times 25\% = 250$

- **For tax rate C:**

  $\Delta I_C = Q_1 \times \Delta C = Q_1 \times (C_1 \times C_0) = 2000 \times (30\% - 25\%) = 100$

(3) Determining the reality relation:

$\Delta I = \Delta I_Q + \Delta I_C = 250 + 100 = 350$

(4) Influence of the changes:

$\Delta Q \times \Delta C = (Q_1 - Q_0) \times (C_1 - C_0) = (2000 - 1000) \times (30\% - 25\%) = 50$

Note: **We may state that, in this case, the fiscal pressure increases**

d) The taxation base increases and the tax rate does not change

(1) Determining the absolute change of the phenomenon

$\Delta I = (Q_1 \times C_1) - (Q_0 \times C_o) = (2000 \times 25\%) - (1000 \times 25\%) = 500 - 250 = 250$

(2) Determining the influece of the factors:

- **For taxation base Q:**

  $\Delta I_Q = \Delta Q \times C_0 = (Q_1 \times Q_0) \times C_0 = (2000 - 1000) \times 25\% = 250$

- **For tax rate C:**

  $\Delta I_C = Q_1 \times \Delta C = Q_1 \times (25\% - 25\%) = 0$

Note: **The unchanged tax rate doe not influence the phenomenon**

(3) Determining the reality relation:

$\Delta I = \Delta I_Q + \Delta I_C = 250$

(4) Influence of the changes

$\Delta Q \times \Delta C = 0$

Note: **In this case we may state that the fiscal pressure is constant**

e) The decrease of the taxation base and the tax rate do not change

(1) Determining the absolute change of the phenomenon

$\Delta I = (Q_1 \times C_1) - (Q_0 \times C_o) = (500 \times 25\%) - (1000 \times 25\%) = 125 - 250 = -125$

(2) Determining the influece of the factors:

- **For taxation base Q:**

  $\Delta I_Q = \Delta Q \times C_0 = (Q_1 \times Q_0) \times C_0 = (500 - 1000) \times 25\% = -125$

- **For tax rate C:**

  $\Delta I_C = Q_1 \times \Delta C = Q_1 \times (C_1 - C_0) = 0$

(3) Determining the reality relation:

$\Delta I = \Delta I_Q + \Delta I_C = -125$

(4) Influence of the changes

$\Delta Q \times \Delta C = (Q_1 - Q_0) \times (C_1 - C_0) = 0$

Note: **In this case we may state that the fiscal pressure increases**

f) The decrease of the taxation base and the increase of the tax rate

(1) Determining the absolute change of the phenomenon:

$\Delta I = (Q_1 \times C_1) - (Q_0 \times C_o) = (500 \times 30\%) - (1000 \times 25\%) = 150 - 250 = -100$

(2) Determining the influence of the factors:

- **For taxation base Q:**

  $\Delta I_Q = \Delta Q \times C_0 = (Q_1 \times Q_0) \times C_0 = (500 - 1000) \times 25\% = -125$
- **For tax rate C:**

  $\Delta I_C = Q_1 \times \Delta C = Q_1 \times (C_1 - C_0) = 500 \times (30\% - 25\%) = 25$

(3) Determining the reality relation:

$\Delta I = \Delta I_Q + \Delta I_C = -125 + 25 = -100$

(4) Influence of the changes:

$\Delta Q \times \Delta C = (Q_1 - Q_0) \times (C_1 - C_0) = -25$

Note: **We may state that, in this case, the fiscal pressure increases**

g) The taxation base increases and the tax rate does not change

(1) Determining the absolute change of the phenomenon

$\Delta I_C = (Q_1 \times C_1) - (Q_0 \times C_o) = (500 \times 20\%) - (1000 \times 25\%) = 100 - 250 = -150$

(2) Determining the influece of the factors:

- **For taxation base Q:**

  $\Delta I_Q = \Delta Q \times C_0 = (Q_1 \times Q_0) \times C_0 = (500 - 1000) \times 25\% = -125$
- **For tax rate C:**

  $\Delta I_C = Q_1 \times \Delta C = Q_1 \times (C_1 - C_0) = 500 \times (25\% - 20\%) = 25$

(3) Determining the reality relation:

$\Delta I = \Delta I_Q + \Delta I_C = -125 + 25 = 100$

Note: **In this case we may state that the fiscal pressure decreases**

3. Conclusions

From this analysis we may notice that the taxation base and, respectively, the tax rate are influence factors for determining taxes and contributions. The increase or decrease of the tax rate and taxation base directly influence the size of the taxes and contributions, the taxation base and tax rate determine taxes and contributions and their sum the budgetary draw.

Considering that the taxation base and the tax rate determined through the product relation taxes and contributions and the total amount of taxes and contributions reflect the fiscal pressure in report with the gross domestic product, added value and individual incomes. The increase and decrease of the taxation base and rates has a direct influence in the respect of fiscal pressure.

Taxes and contribution are, besides draw and distribution methods of public financial resources, instruments with the help of which the decisional authorities try to orientate the economic and social development of a country in the chosen direction.

The product relation of the taxation base and tax rate is a means for dimensioning the necessary of financial resources to be formed and used in national economy, a means for stimulating and sanctioning companies and their employees.

As a result, we believe that, in the field of fiscal policy, it is necessary to create a stable taxation base and to maintain the report between the taxation base and the tax amount, contributing to the accomplishment of fiscal equity.

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Bogdan Dima
West University of Timisoara, Romania
Stefana Maria Cristea
"Lucian Blaga" University of Sibiu, Romania

A WEB OF INTERCORRELATIONS: CULTURE, FINANCIAL REPORTING AND SOCIAL OUTPUT

Abstract: *In the context of a growing literature on the connection between cultural variables and accounting regulations, the general objective of the paper is to provide a theoretical framework and empirical evidence on the recent trends in financial reporting and on their impact on the dynamics of the social output. Thus, the specific objectives are: 1) to provide an operational definition of culture; 2) to advance a model of the interactions between culture, design of accounting regulations and the economic growth; 3) to test some of these interactions at the European based on an empirical pool data model. The dependent variable are: a dummy aiming to capture the specificity of the IFRSs endorsement in EU; the average real GDP rates of growth; and the explanatory variables which are represented by the cultural descriptors derived from World Values Survey questions. The main results of the paper consist in the following theses: the culture is relevant for the national characteristics of IFRSs implementation in European Union; and the accounting framework matters for the outcomes of social decisions.*

Key words: *Accounting harmonization, culture, financial reporting, social output, IFRSs*

JEL Classification: *C23, M41, M48*

INTRODUCTION

Starting with the seminal work of Harrison & McKinnon (1986) and Gray (1988), a growing literature addresses the issue of the connections between the cultural variables and the accounting regulations and tries to explain and predict by using such variables the international differences in accounting systems. Several studies have tested Gray's hypothesis including Pourjalali & Meek (1995) who identifies a match between changes in cultural dimensions and the accounting environment in Iran following the revolution. On the other hand, Amat, Blake, Wraith & Oliveras (1999) link the national culture to the characteristics of the Spanish accounting environment. Also, Dunn (2002) concludes that cultural and political barriers are some of the most important limitative factors for the international accounting harmonization.

Meanwhile, there is a significant literature dealing with the situations of "imperfect information" and its consequences on the quality of decisional act. Since the introduction of the "bounded rationality" concept initiated in the '50s by Herbert Simon, several works have taken into account both the economic implications of this decision-making mechanism and the difficulties to describe it. This literature has discussed the "procedural rationality", knowledge, memory, choice of what to know, and group decisions by challenging the dominant paradigm of the "rational" decision-making process ("have raised great doubts as to whether this schematized model of economic man provides a suitable foundation on which to erect a theory - whether it be a theory of how firms do behave or of how they 'should' rationally behave", Rubinstein, 1998; 16).

Thus, the general objective of this paper is to provide a simple theoretical framework and some empirical evidence within the fervent debate over the recent evolution in European countries' financial reporting. The paper is organized as it follows: *Section 1* provides a general framework of the decisional determinants of IFRSs adoption together with an operational definition of culture - as the dominant collective mental model that individualizes a society from another by being the subject of a learning and inter-generational transmission process - along with an analysis of the impact of IFRSs adoption status on the social output. Moreover, this section identifies some particularities of the accounting regulations in the European Union which make the general conceptual background a feasible descriptor; *Section 2* tries to provide an empirical support for the thesis that there are some significant connections between the characteristics of the **cultural paradigm** and the financial reporting in the European Union and also for the connections between the impact of financial reporting on the social output dynamics *via* the **quality of the informational social system**; *Section 3* includes derived comments and (auto) critics.

Therefore, the main results of the paper consist in the theses that the culture matters in explaining the national characteristics of the accounting standards' implementation whereas the accounting framework matters for the outcomes of social decisions.

1. THE CONCEPTUAL BACKGROUND

The European accountancy undertakes the most significant revolution since the issuance of the IVth Directive in 1978. Since 2005, *IAS Regulation* (Regulation No.1606/2002/EC) has required European companies listed in a European securities market to use **International Financial Reporting Standards** (**IFRSs**) for the preparation of their consolidated financial statements. This requirement affects almost 8000 European listed companies. In addition, Article 5 of the IAS Regulation allows Member States to permit or require the unlisted entities to draw up their individual and consolidated accounts according to IAS.

In order to provide an auto-consistent explanation for the different countries' decisions to adopt or converge with **IFRSs,** it is minimally necessary: 1) to provide a general framework of regulations adoption by different authorities; 2) to identify the particularities of the **IFRSs** adoption mechanisms susceptible to allows the usage of this framework.

1.1. A framework of the regulations adoption

The manner in which a *formal public, semi-public or private authority* adopts different regulations depends on a complex set of "objective" and "subjective" determinants originating from economic, social and psychological fields. Of course, it could be simply argued that a certain set of regulations will be adopted if such process leads to attain at least a "second best" state. But this sounds a little bit like "Hamlet without the prince of Denmark". While the "hard" economic factors were analyzed in a large number of studies, less attention was paid to the "psychic" motivations of the regulatory mechanism. In fact, each authority acts based on a *social mandate*. Or, one could observe that the nature of the *social contract* is critical for the soundness of the entire proposed argumentation. As Hirshleifer (2001: 126) notices: "It is useful to distinguish vertical from horizontal social contracts. The vertical alternative, Thomas Hobbes's version, would be represented by arrangements such as hierarchical in the biological realm or dictatorship on the human level. John Locke's version, the horizontal alternative, corresponds to more egalitarian arrangements in either sphere". Each of such arrangements will generate different costs of *imposing/supervising/punishing the non-followers* for a given set of regulations.

For the development of the analytical framework, it is useful to distinguish between *objective* and, respectively, *subjective* costs of the regulatory process. We admit it is difficult to *ex ante* discriminate between these types of costs and also between their individual components. However, in general terms, such costs could be described as:

- ***Objective costs*** involves material, human capital and financial resources, infrastructure, time and information necessary to apply, supervise and punish the non-observance of one or more regulations;
- ***Subjective costs*** are linked both to the *internal* as well as *external* involved authority's environments. Usually, these are institutional costs generated by the perception of how the adopted regulations will affect the authority's output.

Both categories of costs could be "variables" ("time-depending) or "fix" ("constant over a given time period"). Also both of them could take a quantifiable form or could be perceive in a "fuzzy" "low"/ "high" form. Finally, both of them could be connected to the authority's capacity to fulfill its *social mandate*.

It may be observed that the existence of the *subjective* costs raises an "aggregation problem": if some "micro" psychological factors could at a certain extent explain the adoption of a particular set of regulations, it is necessary to extent such determinants at a "macro" level in order to systematically explains different authorities' decisions on the "long-run". Or, in other words, it is necessary to take into account the **cultural paradigm** in which these authorities operate as an "aggregate" of their individual set of values and "subjective" motivations.

Also it could be perceived that both types of costs are depending *inter alia* on the **volume, structure and quality** of the available information: if the deciding authority is able to collect and manage a corresponding amount of current and relevant information, then it will be able to make decisions implying lower decisional costs. But with the exception of the "perfect information" situations, there have always been involved some corresponding **informational costs**. As a consequence, it will be necessary to have a

corresponding balance for the "excess output" induced by a better informational mechanism and also for the "costs saving" with the aggregate informational costs implied by the design and function of such mechanism.

According to the Merriam-Webster Dictionary, culture is "the act of developing by education, discipline, and social experience" or "training or refining of the moral and intellectual faculties". In a different view, Cozzi (1998) understands by culture a "social asset" whose acquisition by an agent generates no individual utility but has positive external effects. UNESCO (1992)[1] had described culture as follows: "... culture should be regarded as the set of distinctive spiritual, material, intellectual and emotional features of society or a social group, and that it encompasses, in addition to art and literature, lifestyles, ways of living together, value systems, traditions and beliefs". Such definitions are more focused on the static aspects of the culture as given social artifacts. But cultural characteristic are changing over time; the content of the shared intellectual products does not rest the same over long time spans. Societies are reacting to the variation of the external and internal environment. So that, a more comprehensive view of cultural paradigm admits that its architecture is "stable" only in a "short enough" time horizon.

However, we agree with the definition of **paradigm** provided by Talpoş et al. (2005: 20) <<Through paradigm we understand the dominant collective mental model that individualizes a society from another. This paradigm represents a societal integration factor, by offering common values and goals for the members of the society. Also, this represents the subject of some learning and inter-generational transmission process, which slowly modifies itself, in "long cycles">>.

Hence, we consider the cultural paradigm as representing "something much more" then a set of "shared values". This way, one could remark that an interesting definition for the culture as "shared values" is given by Kroeber & Kluckhohn (1952) (cited in Adler, 1986). According to them, culture consist of patterns, explicit and implicit of and for behaviors acquired and transmitted by symbols, constituting the distinctive achievement of human groups, including their embodiment in artifacts; the essential core of culture consists of traditional (i.e., historically derived and selected) ideas and especially their attached values; culture systems may, on the one hand, be considered products of action, on the other conditioning elements of future action.

In consequence, culture is:

- Something that is shared by all or almost all members of some social group;
- Something that the older members of the group try to pass on to the younger members; and,
- Something (as in the case of morals, laws and customs) that shapes behavior, or structures one's perception of the world.

Our vision is much closer to Hofstede (1991) who defines culture as "the collective programming of the mind which distinguishes the members of one group or category of people from another". Like him, we emphasize that culture is, at least partially, learned, and not only inherited. Supplementary, it is useful to understand by **culture** a "relational product" generated in the interactions between the social entities and their micro and macro environment. Or, according to Trompenaars & Woolliams (2003: 21) "Culture is rather the contextual environment, defining much of the essence of the relationships between an organization and the environment in which it operates".

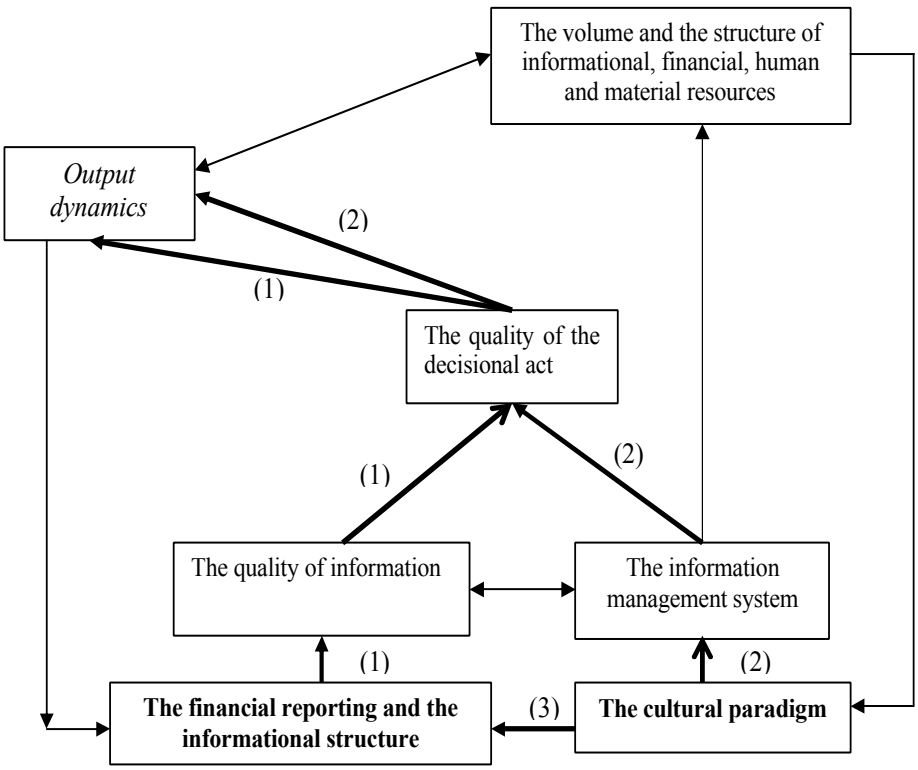
A critical consequence of the culture consists in the fact that it modulates the way in which the decisional mechanisms work. The decisional authority is not "neutral" in respect to a certain informational set: according to its own **paradigm**, the usage of the information, the relative informational weight and the estimated importance of certain information are decided based on the cultural variables such as "time perspective", "uncertainty avoidance", "performance focused decisions" or "social justice in resources allocation".

Overall, this conceptual framework could be described as in Figure 1, where are presented three main categories of functional connections:

(1) the linkage between financial reporting (FR) and the informational structure and the output dynamic *via* the quality of the information generated by FR and implicitly by the decisional quality;
(2) the linkage between the configuration of the cultural variables and the status of financial reporting;
(3) the linkage between the cultural paradigm and the output dynamic *via* the configuration of the information management system and the information usage and its *subjective* importance.

Figure 1: Information, culture and the decisional output

[1] Universal Declaration on Cultural Diversity.



With these features, a ***compact model of the regulation mechanisms*** could be formally described as:

$$r_{i_t} = \lambda_{1_t}\left[E_t\left(I^*_{i_t}\right) - \sum_{j=1}^{t-1} I_{ij}\right] -$$

$$- \lambda_{2_t}\left(k^a_{it} + E_t\left(k_{i_t}\right)\right) - \lambda_{3_t} E_t\left(C_t\right) + \lambda_{t_t}\left(\sum_{j=1}^{t-1} F_{ij} + E_t\left(F_t\right) - \sum_{i=1}^{t-1} z_{ij} - E_t\left(z_t\right)\right) +$$

$$+ E_t\left(\varepsilon_t\right) \quad (1)$$

Where r_{i_t} is a state variable which describes the regulatory conditions for a certain issue i in the current period t, I^* is an output index describing the results in the presence of the regulations as I status for the output index in the absence of such regulations, k^a are the current adoption costs for the regulatory set as k describes the imposing/supervising/punishing costs. C is a set of cultural variables characteristics for the **paradigm**, F is an **informational index** described to capture the amount, structure and relevance of the information from the past and current periods as well as anticipated to be obtain in the next period, z are the corresponding **informational costs** for past, current and future periods, $\boldsymbol{\varepsilon}$ is a "black box" which counts for the influence of other "hidden" variables and $\boldsymbol{\lambda_1}, \boldsymbol{\lambda_2}, \boldsymbol{\lambda_3}, \boldsymbol{\lambda_4}$ are the relative sensitivity coefficients.

We assuming that I^* could be written as:

$$I^*_{i_t} = \sum_{l=0}^{\infty} \beta_I^{\,l}\left(I_{i_{t+l}} + \phi^I_i + \eta^I_{i_{t+l}}\right) \quad (2)$$

where $\boldsymbol{\beta}$ is a discount factor, $\boldsymbol{\varphi^I}$ is a state effect that captures the role played by "fix" elements able to affect the regulations' impact and $\boldsymbol{\eta^I}$ measures the "omitted" specific factors. As a further step, we suppose that the expected future output could be predicted inside a *mix* mechanism by incorporating both past and current values[1]:

[1] The adopted framework for the expectations derived from a *bounded rationality* approach in which the information is imperfect but is "completely" used by the social subjects.

$$E\left(I_{i_{t+l}}\right) = c_{I\,l}(L)I_{i_t} + c_I{}^r I_{i_t} \quad (3)$$

where L is the lag operator.

Similarly,

$$k_{i_t} = \sum_{l=0}^{\infty} \beta_k{}^l \left(k_{i_{t+l}} + \phi^k{}_i + \eta^k{}_{i_{t+l}}\right) \quad (4)$$

with $\boldsymbol{\varphi^k}$ the "fix" component of maintaining the regulations and

$$E\left(k_{i_{t+l}}\right) = c_{k\,l}(L)k_{i_t} + c_k{}^r k_{i_t} \quad (5)$$

also:

$$F_{i_t} = \sum_{l=0}^{\infty} \beta_F{}^l \left(F_{i_{t+l}} + \phi^F{}_i + \eta^F{}_{i_{t+l}}\right) \quad (6)$$

$$z_{i_t} = \sum_{l=0}^{\infty} \beta_z{}^l \left(z_{i_{t+l}} + \phi^z{}_i + \eta^z{}_{i_{t+l}}\right) \quad (7)$$

$$E\left(F_{i_{t+l}}\right) = c_{F\,l}(L)F_{i_t} + c_F{}^r F_{i_t} \quad (8)$$

$$E\left(z_{i_{t+l}}\right) = c_{z\,l}(L)z_{i_t} + c_z{}^r z_{i_t} \quad (9)$$

Since cultural variables adjust in "long cycle", it is possible to consider under a "short enough" time period that:

$$E_t\left(C_{i_t}\right) \approx C_{i_t} \quad (10)$$

Finally, if $\boldsymbol{\varepsilon}$ is a random exogenous shock then

$$E_t\left(\varepsilon_t\right) = 0 \quad (11)$$

Relations (1) - (11) could be combined in order to obtain the result from the relation (12). Relation (12) describes a ***general framework for the adoption of a regulations' set***. A particular case is represented by the situation in which the authority that should decide on a certain topic *i* is not unique in a given / different social space. More exactly, if there is more than one authority to decide then the individual output *could* (if certain conditions are fulfilled)[1] depend not only on the *intrinsic* connections between the regulations and their effects but also on the *extrinsic* correlations with the other authorities' output.

[1] The description of the nature and the impact of such conditions exceed the analytical framework of the present paper.

$$r_{i_t} = \lambda_{1_t}\left[\begin{array}{l}\sum_{l=0}^{\infty}\beta_I{}^l\left(c_{Il}(L)I_{i_t} + c_I{}^r I_{i_t} + \phi^I{}_i + E_t\left(\eta^I{}_{i_{t+l}}\right)\right) - \\ -\sum_{j=1}^{t-1} I_{ij}\end{array}\right] -$$

$$-\lambda_{2_t}\left[k^a{}_{it} + \sum_{l=0}^{\infty}\beta_k{}^l\left(c_{kl}(L)k_{i_t} + c_k{}^r k_{i_t} + \phi^k{}_i + E_t\left(\eta^k{}_{i_{t+l}}\right)\right)\right] -$$

$$-\lambda_{3_t}C_t + \lambda_{4_t}\left[\begin{array}{l}\left(\sum_{j=1}^{t-1}F_{ij} - \sum_{j=1}^{t-1}z_{ij}\right) + \\ - \\ +\sum_{l=0}^{\infty}\beta_F{}^l\left(c_{Fl}(L)F_{i_t} + c_F{}^r F_{i_t} + \phi^F{}_i + E_t\left(\eta^F{}_{i_{t+l}}\right)\right) - \\ -\sum_{l=0}^{\infty}\beta_z{}^l\left(c_{zl}(L)z_{i_t} + c_z{}^r z_{i_t} + \phi^z{}_i + E_t\left(\eta^z{}_{i_{t+l}}\right)\right)\end{array}\right] \quad (12)$$

It could be noticed that such thesis could be valid even in the situation of a weak *linkage* between the involved authorities but generally it stands in a *higher interdependence* context. If this is taken into account then the relation (12) should be rewrite as:

$$r^e{}_{iX,Y_t} = \lambda_{1X,Y_t}\left[\begin{array}{l}\sum_{l=0}^{\infty}\beta_I{}^l\left(c_{Il}(L)I^e{}_{iX,Y_t} + c_I{}^r I^e{}_{iX,Y_t} + \phi^I{}_i + E_t\left(\eta^I{}_{i_{t+l}}\right)\right) - \\ -\sum_{j=1}^{t-1} I_{ij}\end{array}\right] -$$

$$-\lambda_{2_t}\left[k^a{}_{it} + \sum_{l=0}^{\infty}\beta_k{}^l\left(c_{kl}(L)k_{i_t} + c_k{}^r k_{i_t} + \phi^k{}_i + E_t\left(\eta^k{}_{i_{t+l}}\right)\right)\right] -$$

$$-\lambda_{3_t}C_t + \lambda_{4_t}\left[\begin{array}{l}\left(\sum_{j=1}^{t-1}F_{ij} - \sum_{j=1}^{t-1}z_{ij}\right) + \\ - \\ +\sum_{l=0}^{\infty}\beta_F{}^l\left(c_{Fl}(L)F_{i_t} + c_F{}^r F_{i_t} + \phi^F{}_i + E_t\left(\eta^F{}_{i_{t+l}}\right)\right) - \\ -\sum_{l=0}^{\infty}\beta_z{}^l\left(c_{zl}(L)z_{i_t} + c_z{}^r z_{i_t} + \phi^z{}_i + E_t\left(\eta^z{}_{i_{t+l}}\right)\right)\end{array}\right] \quad (12.1)$$

where the superscript ***e*** denotes the differential between two authorities ***X***,***Y*** output.

It could be observed that:

- The relation (12.1.) takes into account only the <u>output differential</u>: there is not *objective* costs' linkage between authority's regulatory measures. The main reason for such approach consists in the fact that such linkage must be explained under a supplementary set of conditions with adequate descriptions of the costs *transfer/contamination* mechanisms which are far to be trivial ones. So that, for the sake of the simplicity, this extension is ignored;
- The relation does not account for <u>cultural differential</u>: the *subjective* costs are supposed to not be interrelated. Since each authority operates <u>inside</u> its own **paradigm**, the analytical price of such simplification is apparently low. But in fact there could be some important *cultural values transfers* so that the isolation of the cultural impact on regulatory processes is susceptible to affect the description realism. The only possible counter-argument consists in the thesis of the "long-run" viability of the transfer mechanisms and complementary the postulation of their non-efficiency on a "short" time frame;

- The relation does not account for <u>informational differential</u>: it is supposed that there is not an information exchange between the authorities and / or an *institutional specialization* in the process of information gathering and usage. In other words, the involved authorities are seen working in an "informational autonomy". Such an hypothesis is more than debatable and could hold only for the "pure internal" regulatory decisions;
- Finally, there is supposed no connection between the "fix" components of the outputs and costs. If such components are supposed to have especially an <u>institutional</u> nature, the "long-run" argument holds and such approach is consistent with the previous observations.

The relation (12.1.) permits to establish the conditions in which an authority will adopt regulatory measures on a certain topic: this will happen as long as the "net" output of such measures will be positive or:

$$\left[\begin{array}{l}\sum_{l=0}^{\infty}\beta_I{}^l\left(c_{Il}(L)I^e{}_{iX,Y_t}+c_I{}^rI^e{}_{iX,Y_t}+\phi^I{}_i+E_t\left(\eta^I{}_{i_{t+l}}\right)\right)-\\ -\sum_{j=1}^{t-1}I_{ij}\end{array}\right]>$$

$$>\frac{\lambda_{2_t}}{\lambda_{1X,Y_t}}\left[k^a{}_{it}+\sum_{l=0}^{\infty}\beta_k{}^l\left(c_{kl}(L)k_{i_t}+c_k{}^rk_{i_t}+\phi^k{}_i+E_t\left(\eta^k{}_{i_{t+l}}\right)\right)\right]+$$

$$+\frac{\lambda_{3_t}}{\lambda_{1X,Y_t}}C_t-\frac{\lambda_{4_t}}{\lambda_{1X,Y_t}}\left[\begin{array}{l}\left(\sum_{j=1}^{t-1}F_{ij}-\sum_{j=1}^{t-1}z_{ij}\right)+\\ \quad -\\ +\sum_{l=0}^{\infty}\beta_F{}^l\left(c_{Fl}(L)F_{i_t}+c_F{}^rF_{i_t}+\phi^F{}_i+E_t\left(\eta^F{}_{i_{t+l}}\right)\right)-\\ \quad -\sum_{l=0}^{\infty}\beta_z{}^l\left(c_{zl}(L)z_{i_t}+c_z{}^rz_{i_t}+\phi^z{}_i+E_t\left(\eta^z{}_{i_{t+l}}\right)\right)\end{array}\right] \quad (13)$$

According to relation (13):

P₀: *In **caeteris paribus** conditions, an authority will adopt regulatory measures if the "excess" "fix" and "variable" output of such measures as well as the influence of the "omitted" factors over the output observed in a certain past period in absence of regulations will exceed the "objectives" current and future "fix" and "variable" adopting/imposing costs weighted with their relative sensitivity.*

P₁: *In **caeteris paribus** conditions, an authority will adopt regulatory measures if the "excess" "fix" and "variable" output of such measures as well as the influence of the "omitted" factors over the output observed in a certain past period in absence of regulations will exceed the "subjective" current costs reflected by the **cultural paradigm** weighted with their relative sensitivity.*

P₂: *In **caeteris paribus** conditions, an authority will adopt regulatory measures if the "excess" "fix" and "variable" output of such measures as well as the influence of the "omitted" factors over the output observed in a certain past period in absence of regulations will exceed the "net" current informational costs (the "brut" informational costs corrected with the "excess" of the output generated by the* amount, structure and relevance of the available information) *reflected weighted with their relative sensitivity.*

Also it could be noticed that ***P₃***: *the "net" output in the presence of the regulations will depend on the regulatory conditions status, "objectives" current and future "fix" and "variable" adopting/imposing costs weighted with their relative sensitivity, "subjective" current costs and "net" current informational costs*:

$$\left[\begin{array}{l}\sum_{l=0}^{\infty}\beta_I{}^l\left(c_{Il}(L)I^e{}_{iX,Y_t}+c_I{}^rI^e{}_{iX,Y_t}+\phi^I{}_i+E_t\left(\eta^I{}_{i_{t+l}}\right)\right)-\\ -\sum_{j=1}^{t-1}I_{ij}\end{array}\right]=$$

$$=\frac{1}{\lambda_{1X,Y_t}}r^e{}_{iX,Y_t}+\frac{\lambda_{2_t}}{\lambda_{1X,Y_t}}\left[k^a{}_{it}+\sum_{l=0}^{\infty}\beta_k{}^l\left(c_{kl}(L)k_{i_t}+c_k{}^rk_{i_t}+\phi^k{}_i+E_t\left(\eta^k{}_{i_{t+l}}\right)\right)\right]+$$

$$+\frac{\lambda_{3_t}}{\lambda_{1X,Y_t}}C_t-\frac{\lambda_{4_t}}{\lambda_{1X,Y_t}}\left[\begin{array}{l}\left(\sum_{j=1}^{t-1}F_{ij}-\sum_{j=1}^{t-1}z_{ij}\right)+\\ \quad -\\ +\sum_{l=0}^{\infty}\beta_F{}^l\left(c_{Fl}(L)F_{i_t}+c_F{}^rF_{i_t}+\phi^F{}_i+E_t\left(\eta^F{}_{i_{t+l}}\right)\right)-\\ \quad -\sum_{l=0}^{\infty}\beta_z{}^l\left(c_{zl}(L)z_{i_t}+c_z{}^rz_{i_t}+\phi^z{}_i+E_t\left(\eta^z{}_{i_{t+l}}\right)\right)\end{array}\right] \quad (14)$$

1.2. The particularities of IFRS implementation

There is no doubt that exist a direct connection between international accounting harmonization and globalization. The first concept could be perceived as an internationalization of accounting by promoting accounting standards in which the global interest prevails in front of the national one (Volker, 2000; Cooke, 2001). The evolutions of a more and more real and nominal integrated global economy, the changes in the architecture of the international financial system, the predominance of the multinational firms, the consequences of technological and informational transfers, all these requires an increased harmonization of the accounting practices. Thus, **IFRSs** arise as a product of the globalization forces, becoming the best choice for many national authorities in ensuring transparency and comparability of the financial information. The main reason for this consists in the fact that a "symbolic economy" implies uniform mechanisms for efficiency estimation since the economic subjects are in a certain sense "detached" from the objects of their decisions. Or, in other words, "abstract" economic relationships are based on uniform, regular and non-specific mechanisms to obtain the relevant information for the "benefits / looses" analysis.

In order to fulfill this task, there became obvious that a choice must be made between **US GAAPs** and, respectively, **IAS/IFRSs**. But, in the last decade, **IFRSs** gained a widely acceptance so that almost 110 countries around the world have adopted them in the issued form or with different modifications / limitations. In this context, FASB and IASB are determined to find a mutual compromise of adopting compatible and high quality solutions for present and future accounting issues. For this purpose, two memorandums of understanding were signed during the years (2002 – *Norwalk Agreement*; 2006). Still, the convergence process is far to be completely and there is not a clear short run perspective for a single international set of standards compatible with both sets of standards.

For the proposed analysis, the critical point consists in the identification of **IFRSs'** main characteristics, which will allow the *application of the general decisional model advanced in the previous subsection*. A brief analysis of the standards highlights that **IFRSs** are:

- A formal set of regulations with a clearly structural internal organization of the information and a uniform prescription of the accounting treatments to be applied;
- A "multi-authority" decisional result since a large number of bodies is involved (**IASC Foundation** that names the members of the Board and IFRIC, **IASB** which issues the standards, **IFRIC** responsible with the issuance of standards' interpretations, **SAC** which provides advisory support – all these being separate but interlinked structures; the European Commission with its entire network of bodies with analysis and advisory duties – EFRAG, TEG, SARG, ARC, Contact Committee, roundtable; the national regulators and so on);
- A product of a specific cultural and business environment - the Anglo-Saxon one - destined to be assimilated in various other environments characterized by different **cultural paradigms**.

Also:

- The **IFRSs** appliance is susceptible to generate both *objective / subjective outputs* (in terms of an increased informational efficiency of financial statements, a more comprehensive decisional sources and a

coherent support for the international placements of financial resources) and *costs* (material, human capital and institutional ones). However, the "costs / benefits" matrix should be carefully judge: the advantages of the increase reliability of international financial information, the better adequacy of the codified standards in the accounting and auditing fields, the contribution to the raise of direct / capital foreign flows of investments, the improvements of the fiscal systems in terms of social resources (re)distribution processes and the increase of international financial markets liquidity are balanced by the important differences between the national accounting practice which requires significant resources to fill the gaps, the lack of specialized professional accountancy bodies for some countries and the importance of socio-economic architecture particularities for different countries;

- As is defined in Art. 1 of the Regulation No.1606/2002/EC, the **IFRSs**' purpose is "harmonizing the financial information presented by the companies… in order to ensure a high degree of transparency and comparability of financial statements and hence an efficient functioning of the Community capital market and of the Internal Market". So that, it could be considered that this regulation concerns the informational quality of the financial reporting and its appliance is able to generate an "output differential" both at a micro as well at a macro level;
- The **IFRSs** appliance is a "work in progress" under a significant time horizon so that there are some limitations of the "short-run" argument.

If these postulates stand, then it could be concluded that the general decisional framework is also applicable for the **IFRSs.** However, it should be noted that in the particular case of the European Union a discriminate analysis is applicable only for domestic unlisted companies since all the listed companies are required to use the **IFRSs.**

2. AN EMPIRICAL ANALYSIS: THE EUROPEAN UNION'S CASE

The P_1 , P_3 propositions could be empirically tested in order to provide some support for the existence of some connections between the characteristics of the **cultural paradigm** and the implementation of the **IFRSs** in the European Union. The purpose of this section is to advance a brief description of an adequate testing strategy.

Minimally, such a strategy implies the next stages:

1. The construction of a fuzzy *score* variable able to capture the "permitted / required" adoption of the domestic unlisted companies **IFRSs**. A possible codification system for the construction of this variable is presented in Table 1. This variable takes values in a scale between "0" (meaning that the usage of **IFRSs** is prohibited both for individual and consolidated financial statements) and "2" (which reflects the situation of **IFRSs** requirement). The main statistical characteristics of the *pool* data constructed base on the individual values for the EU countries are displayed in Table 4. It could be observed that data tends to be concentrated in two main subgroups - first with value "1" which counts for 37.5% of the cases and second with value "1.5" representing 45.9% of the cases. This two groups reflects the corresponding combinations of "permitted / prohibited" and respectively "permitted / permitted" for the **IFRSs** adoption status. There are also two "extreme" values of "0" (prohibited / prohibited) for the cases of Latvia and Lithuania as well as two "extreme" values of "2" (required / required) for Malta and Slovakia. These "extreme" values count for 16.6% of the cases.
2. The selection of the relevant components of the **paradigm**. It could be noticed that in the literature the variables are usually deduced from Hofstede (1980) in order to explain the cultural differences between the countries from the data analysis set (eventually by taking into account some limitation in their sphere and content). But one of the most sensitive characteristics in the present analysis of these variables consists in the fact that they are too general to address the particular issue of **IFRSs**. An alternative approach consists in taking into account some of the variables defined by the questions included in ***World Values Surveys***. As Inglehart (2008) notes: "The World Values Surveys were designed to provide a comprehensive measurement of all major areas of human concern, from religion to politics to economic and social life and two dimensions dominate the picture: (1) Traditional / Secular-rational and (2) Survival / Self-expression values. .. The Traditional/ Secular-rational values dimension reflects the contrast between societies in which religion is very important and those in which it is not. The second major dimension of cross-cultural variation is linked with the transition from industrial society to post-industrial societies-which brings a polarization between Survival and Self-expression values". The selected questions are described in Table 2. These questions are linked with *work valorization and ethic,*

freedom of decisions at "macro" and "micro" level, the "moral entitlement" of social (re)distributions processes and an *social auto-referential about the norms and rules obedience*. The involved values are extracted from 1999/2000 waves of survey[1].

3. The test of the connections between the *score* variable and the answers to the mentioned questions as a *proxy* for some empirical support of P_1.
4. The test between the dynamics of the output and the configuration of the *score* variable (between the regulations status and its results). The output is considered at a macro level as the average of the real GDP growth rate for 2001-2006. Such choice is designed to provide a more smooth *proxy* for the output by "cutting off" possible "jumps" in output caused by exogenous factors.

The "stem-and-leaf" plots (not presented in the paper due to size limitations) indicate that in general terms the median values of *score* variable are associated with median values of the considered cultural variables and correlatively its "extreme" values appears in the presence of particularly high / low values for those.

The *pool* data regressions reported in Table 5 suggest that:

- All the cultural variables are positive and statistical significant associated with the *score* variable;
- The strongest explanatory cultural variables are in terms of the **t-test** the questions concerning the support for *following the regulation* and the non-justifiable character of obtaining *"un-entitled" benefits from public resources* and to commit *"illegal" tax evasion*. In other words, C_0 **:** *If a society has a strong "legalist" architecture of the* ***paradigm*** *(a strong tendency to formalize the rules of the "social game") it will tend to require the adoption of the* ***IFRSs*** *for the domestic unlisted companies both at the level of individual as well as at the consolidate financial statements*.
- At a second level, a large capacity to explain the structure of the *score* variable is associated with the *social importance of work*. So that, C_1 **:** *If a society has a strong "work ethic" it will tend to require the adoption of the* ***IFRSs***.
- Three variables with a similar nature, *a low level of freedom of choice and control of social subjects actions* and, respectively, *a low level of individual initiative both at the general social level as well as inside the work processes* explain the adoption of regulations in this matter. C_2 **:** *If a society has a more "rigid" system of hierarchical social structures*" *it will tend to require the adoption of the* ***IFRSs***.
- Correlatively, the variables linked with the perception of the social behavior in terms of *"un-entitled" benefits from public resources* and *"illegal" tax evasion* has the weakest explanatory capacity. Or, C_3**:** *The auto-referential perception of a society about the capacity of its own members to respect the regulations influence less the process of the* ***IFRSs*** *adoption.*

In addition, in accordance with results reported in Table 6:

- The status of **IFRSs** adoption is positive and strongly statistical significant associated with the economic evolution;
- Cultural variables are positive and statistical significant associated with GDP dynamics. The highest explanatory capacity is associated with a larger importance of *freedom of choice and control of social subjects' actions*: the societies focused more on individual autonomy and on individual initiative benefit from a stronger economic development. Or, in other words, C_4: *The social output will be higher in the societies with a more "flexible" system of hierarchical social structures*;
- Interesting enough, the *work over valorization and the strong legalist structure* seems to constitute a second group of explanatory factors for the economic growth. So that, C_5 : *If a society has a strong "legalist" architecture of the paradigm and also a strong "work ethic" it will benefit from a more suitable evolution of social output* ;
- As in the case of **IFRSs,** the lowest explanatory importance is connected to the perception regarding the "right" behavior in terms of "*un-entitled" benefits from public resources* and *"illegal" tax evasion*. As a consequence, C_6: *The auto-referential perception of a society about the capacity of its own members to respect the regulations influence less the economic dynamics.*

The $C_0 - C_3$ findings could be grouped in a single one as follows: C: *As a society is placed in the area of the "semi-open" of the societal spectrum (as it have a preference for clearly and extended formal formulation of the social rules, with a strong work ethic and with more rigid hierarchical social structures and with a higher preference for the "moral" distribution/redistribution of the social resources processes) it will tend more to* ***require*** *the adoption of* ***IFRSs*** *for the domestic unlisted companies*. Furthermore, the C_4 –

C_6 findings could be grouped as: ***O***: *As a society is placed in the area of the "open societies" (as it have a preference for clearly and extended formal formulation of the social rules, with a strong work ethic but with less rigid hierarchical social structures and with a higher preference for the "moral" distribution / redistribution of the social resources processes) it will benefit from a better evolution of the social output.*

It could be noticed that these findings could be interlinked. For instance, taking into account their different combinations, ***it could be predicted*** that the influence of the **IFRSs** adoption status on the social dynamic output will be:

	C_0	C_1	C_2	C_3
C_4	Undecided	Undecided	Low	Undecided
C_5	Higher	Higher	Undecided	Undecided
C_6	Undecided	Undecided	Undecided	Low

3. CONCLUSIONS

The results presented in the previous section are quite puzzling. On one hand, the image drawn by the cultural variables is *consistent*: at a "median" level the cultural variables and the characteristics of the regulatory set for the **IFRSs** adoption are significant linked. On the other hand, there are no mechanisms to discriminate between the autonomous national decisions and the influence of the extra-national involved bodies. Also, the most "liberal" societies, in terms of individual autonomy but with a stronger focus on respecting the "rules of the social game", tend to benefit more from the economic dynamics.

More generally, the proposed analysis is affected by some important limitations both at the theoretical as well as at the empirical level. Among these limitations, one could note:

3.1. Theoretical "white spots"

1) Culture and individual utility function: what is the connection?

The core argument of this paper is that the social subjects are not "perfectly rational" so that they adopt their decisions (including the decision to regulate on a certain topic) also under the influence of a certain set of psychological factors. The aggregate reflection of such factors is "culture" so that the set of social norms, rules and regulations will be affected by it. But such approach is more an *ex post* one since it implies two rounds of aggregation: one for individual migration decisions and one for the subjective variables. Even more no description of such aggregation mechanism is provided and is not clearly why a "synthetic" macro-view is possible.

2) How could be "culture" measured?

The appeal to the Hofstede's cultural variables could be criticized due to the fact that these have obviously a certain self-referential in the "occidental" culture and are not able to sustain a more accurate distinction between the characteristics of the cultural artifacts. But isn't the same situation for the ***World Values Surveys*** variables? In our opinion, the fact that the questions are based on a "valorization approach" for some universal human values, addresses at least partially this issue.

3) Where are the inter-generational mechanisms?

If "we emphasize that culture is, at least partially, learned, and not only inherited" than, at least on "long run" the relation (8.1.) does not stands anymore and the general decisional model should provide a description of the adaptation mechanism at the level of the cultural variables.

4) What kind of informational mechanisms?

The paper status that the considered anticipation mechanism is derived from a bounded rationality model without clearly explaining the nature of such model.

5) Different types of authorities: what is the difference between them?

In the paper is status that the decisional model is valid for the decisions adopted by *formal public, semi-public or private authorities*. But it is very difficult to sustain the postulate of institutional aspects neutrality: the meta-framework of the *social mandate* implies the fact that different authorities have different specific mandate and so that different "utility function" at the base of their decisions.

6) No connections between outputs and costs for different authorities: at what analytical price?

For the sake of simplicity, there are not objective/subjective outputs and costs linkages between authority's regulatory measures. It is not clearly in the advanced analysis how such a hypothesis affects the realism of the decisional models. This issue is particularly important since the IFRSs adoption process is a "multi-authority" one.

7) What is specific for the national differences in the **IFRSs** adoption?

There are quite few details about the intrinsic mechanisms of adopting / supervising / punishing the non-follows of the regulations for **IFRSs** and is not very clearly if in fact all the required conditions implied by the global decisional framework are fulfilled in this particular case and even more there is not enough highlighted the decisional particularities.

8) How are really influencing the cultural variables the dynamics of the social output?

This paper claims that the cultural variables are influencing the output dynamics. But it could be easily observed the not enough developed analysis of the linkage between the cultural variables and the social transfers as a key factor of economic growth, the absence of any description of the possible "transmission" mechanism of the "institutional" and "behavioral" impact on the sustainable development as well as the absence of any EU case study particularity description as well as many others "blank" aspects.

9) What means the "informational quality"?

In the theoretical framework, the concept of "informational quality" is widely used in order to explain the impact of the regulatory status of financial information on the economic dynamics. But there is nowhere a clear definition on this concept which appears to be a "blank box".

10) What are in fact the connections between different findings?

The "predictions" from the previous section about the **IFRSs** impact on social output are based on different possible combinations between the $C_0 - C_6$ *findings*. But in fact no detailed mechanisms of the interactions mechanism inside of each combination are yet provided.

3.2. Empirical estimation problems

Not only the theoretical but also the empirical part of the paper is affected by imperfect clarifications. Some of them are connected with:

- The stability of the regression models and the quality of the results (for instance, in terms of properties of the residuals variables);
- The identification problems for the involved parameters;
- The possible existence of non-linear interactions between the variables and the effects of such interactions;
- The insufficient number of observation and the absence of an explanation for the composition of the samples;
- The fact that the *pool* data are not constructed based on individual time-series so that there is no possibility for cross-section analysis, etc.

Therefore, despite all these caveats, we argue that the paper could be seen as a small breakdown into a usual yet manner to deal with the decisional problems in general and with the **IFRSs** topic in particular like they are isolated for their "subjective" aspects. The human specie is not motivated in its fight for control over the natural and artificial environment only by "rational" motifs. Instead, the emotions could balance the logic and fear, solidarity, empathy and hope twins could shape the way in which people are doing business and are living together in the same social realm.

ANNEX

Table 1. **The codification system for the domestic unlisted companies- the use of IFRSs (**Consolidated financial statements - CFS; Individual financial statements - IFS)

CFS	*IFS*	*Score*
required	*required*	*2,00*
required	*permitted*	*1,75*
permitted	*required*	*1,75*
permitted	*permitted*	*1,50*
permitted	*prohibited*	*1,00*
prohibited	*permitted*	*1,00*
prohibited	*prohibited*	*0,00*

(*Source:* inspired by Use of IFRS by Jurisdiction updated at 11.01. 2008, www.iasplus.com; accessed January 14, 2008)

Table 2. **The *World Values Survey* questions**

CODE OF QUESTION	*FORMULATION*	*DATA REPRESENTS*
A005	*Please say, for each of the following, how important it is in your life-Work*	*Very important*
A173	*Some people feel they have completely free choice and control over their lives, while other people feel that what they do has no real effect on what happens to them. Please use this scale where 1 means "none at all" and 10 means "a great deal" to indicate how much freedom of choice and control you feel you have over the way your life turns out.*	*None at all*
C016	*Here are some more aspects of a job that people say are important. Please look at them and tell me which ones you personally think are important in a job?-An opportunity to use initiative*	*Not mentioned*
C034	*How free are you to make decisions in your job?*	*None at all*
C061	*People have different ideas about following instructions at work. Some say that one should follow one's superior's instructions even when one does not fully agree with them. Others say that one should follow one's superior's instructions only when one is convinced that they are right. With which of these two opinions do you agree?*	*Follow instructions*
F114	*Tell me for each of the following statements whether you think it can always be justified, never be justified, or something in between, using this card. Claiming government benefits to which you are not entitled*	*Never justifiable*
F116	*Tell me for each of the following statements whether you think it can always be justified, never be justified, or something in between, using this card. Cheating on taxes if you have a chance*	*Never justifiable*
F145	*According to you, how many of your compatriots do the following?-Claiming state benefits to which they are*	*Almost all*
F146	*According to you, how many of your compatriots do the following?-Cheating on tax if they have the chance*	*Almost all*

(*Source:* http://www.worldvaluessurvey.org/; 2008)

Table 3: **The countries cross section identifiers set**

Austria	*Denmark*	*Germany*	*Italy*	*Netherlands*	*Slovakia*
Belgium	*Estonia*	*Greece*	*Latvia*	*Poland*	*Spain*
Bulgaria	*Finland*	*Hungary*	*Lithuania*	*Portugal*	*Sweden*
Czech Republic	*France*	*Ireland*	*Malta*	*Romania*	*United Kingdom*

Table 4: **The general characteristics of the *pool* data for the *score* variable**
(Minimum – Min.; Maximum – Max.; Statistic – Sta.)

Descriptive Statistics												
	N	*Range*	*Min.*	*Max.*	*Mean*		*Std.*	*Variance*	*Skewness*		*Kurtosis*	
Score	*Sta.*	*Sta.*	*Sta.*	*Sta.*	*Sta.*	*Std. error*	*Sta.*	*Sta.*	*Sta.*	*Std. error*	*Sta.*	*Std. error*
	24	*2.00*	*.00*	*2.00*	*1.2292*	*.09972*	*.48855*	*.239*	*-1.093*	*.472*	*1.873*	*.918*

One-Sample Test						
	Test Value = 0					
	t	Degree of freedom	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
Score	12.326	23	.000	1.22917	1.0229	1.4355

Table 5: **Pooled One-Stage estimations for *score* variable**

Dependent Variable: Score variable	Cross-sections included: 24
Method: Pooled Least Squares	Total pool (balanced) observations: 24
Included observations: 1	White diagonal standard errors & covariance (degree of freedom. corrected)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
A005	0.020220	0.001988	10.17280	0.0000
A173	0.284716	0.056652	5.025712	0.0000
C016	0.020879	0.003045	6.855877	0.0000
C034	0.080380	0.037177	2.162077	0.0413
C061	0.037014	0.002730	13.55577	0.0000
F114	0.019632	0.001458	13.46530	0.0000
F116	0.022028	0.001598	13.78075	0.0000
F145	0.040559	0.017313	2.342729	0.0282
F146	0.044607	0.016425	2.715853	0.0123

Table 6: **Pooled One-Stage estimations for output**

Dependent Variable: 2001-2006 average real GDP growth	Cross-sections included: 24
Method: Pooled Least Squares	Total pool (balanced) observations: 24
Included observations: 1	White diagonal standard errors & covariance (degree of freedom. corrected)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Score variable	2.205980	0.378649	5.825917	0.0000
A005	0.058733	0.009263	6.340836	0.0000
A173	1.158734	0.159079	7.284036	0.0000
C016	0.068561	0.008966	7.646994	0.0000
C034	0.404220	0.064473	6.269601	0.0000
C061	0.097876	0.015178	6.448497	0.0000
F114	0.052601	0.009193	5.722116	0.0000
F116	0.059662	0.009769	6.107195	0.0000
F145	0.110572	0.046106	2.398236	0.0250
F146	0.121409	0.044721	2.714811	0.0124

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Lecturer PhD Alexandra Renate Daea
University of Craiova, Romania

FINANCIAL INTEGRATION AND GLOBAL FINANCIAL INSTABILITY

Abstract: *Integration of global financial markets and increased monetary and financial interdependence of national economies had a significant impact on domestic as well as international economics. Increased interdependence also has integrated such once-isolated policy issues as trade flows and exchange determination, thus immensely complicating the task of managing the world economy and raising important questions about the adequacy of the rules governing international economic affaires. The Bretton Woods rules-based international monetary system was replaced by a shaky political agreement among the dominant economic powers G-7; this change made the central banks of the major economic powers de facto managers of the international monetary system. Financial integration is an important part of the Lisbon Agenda and the European Union's Single Market Program. In particular, among industrial countries the free flow of capital across borders unleashes competitive pressures that reduce the cost of capital and allows for better sharing of risk for consumers and firms. It is therefore the long-standing view of the Eurosystem that financial integration is an important process for the general well-functioning of the European economy. The decline of the G-7 and of monetary cooperation bears a special responsibility in the development; the decline has substantially weakened the scope of preventive action by the multilateral financial institutions in response to governments' economic policies and to unstable investor behavior. Countries whose financial systems had not been adjusted were allowed to lift all controls on capital movements with the rest of the world, and in some cases they were actually encouraged to do so. The world's rising monetary and financial instability is due to fixed exchange rates and the support they have received from the international community, notably the International Monetary Fund.*

Key words: *Financial integration, European Central Bank, global economy*

JEL Classification: *F3*

Financial integration is an important part of the Lisbon Agenda and the European Union's Single Market Program. In particular, among industrial countries the free flow of capital across borders unleashes competitive pressures that reduce the cost of capital and allows for better sharing of risk for consumers and firms. It is therefore the long-standing view of the Eurosystem that financial integration is an important process for the general well-functioning of the European economy. While it has certainly made a lot of important progress in European financial integration over the last decades, not the least through the introduction of the euro, available research also suggests that a lot of benefits in terms of cross-country risk sharing are still to be reaped and therefore further efforts are necessary.

Financial integration is also of key importance for the performance of the tasks of the Eurosystem. First, a well-integrated financial system enhances the smooth and effective transmission of monetary policy throughout the euro area. Second, financial integration is relevant for the ECB's task of contributing to the safeguarding of financial stability. Integrated markets reinforce the shock-absorption capacity of the system, as they are more liquid and offer better opportunities for financing and risk distribution. Finally, without prejudice to the main objective of price stability, the European Central Bank (ECB) supports the general economic policies of the European Union.

The degree of integration in the euro area varies considerably across different market segments. The euro money market is already highly integrated, as it is closest to the single monetary policy and supported by area-wide large-value payment systems, such as TARGET or EURO 1. An important exception is the market segment for short-term debt securities, which shows some fragmentation owing to the prevailing differences in market standards and practices. The bond markets are also relatively well integrated. For instance, the cross-border holdings already constitute around 40% of the total of the long-term debt securities held by monetary financial institutions. Equity markets are less advanced than bond markets but show signs of increasing integration. For example, the proportion of variance of equity returns explained by euro area shock is around 38% when measured over the period of 1999-2007. Still relatively fragmented securities clearing and settlement systems continue to constitute obstacles to the further integration of securities markets in Europe.

In general, wholesale and capital market-related activities of banks show solid signs of increasing integration, while retail banking and the underlying retail payment systems have remained more fragmented, as has been the case for mortgage markets. Finally, financial markets in the member states that joined the

European Union in 2004 are significantly less integrated than those in the euro area. In sum, a lot has been achieved in the past, not the least through the introduction of the euro, but more needs to be done in the future to reap the full benefits of the Single Market for Financial Services.

It is necessary to mention some examples where ECB has focused the efforts to contribute –within the realm of ECB's competencies – to improving and financial integration where ECB plans further work. The ECB tends to group the efforts relating to financial integration in four types of activities: (i) giving advice on the legislative and regulatory framework; (ii) acting as a catalyst for collective private sector initiatives; (iii) enhancing knowledge and raising awareness; and (iv)providing central bank services.

As regards legislative and regulatory advice, the Eurosystem was fully involved in the review of the Lamfalussy framework that took place at the end of 2007 and published a contribution to the assessment regarding the banking sector. The ECB generally shares the broad agreement among EU bodies that the Lamfalussy framework has significantly increased the efficiency and effectiveness of financial regulation and supervision in the EU. At the same time, however, a number of further improvements seem warranted to reap all the benefits. First, increased regulatory convergence is called for, in particular for reducing national options and discretions in EU directives. Indeed, the inconsistent implementation as well as the "gold plating" of EU rules at the national level give rise to significant compliance costs for financial institutions operating across borders. Second, the ECB needs to strengthen the basis and decision powers of the "level 3" committees of supervisory authorities pursuing supervisory convergence and cooperation Third, further improvements in the arrangements for the supervision of cross-border financial groups should be achieved. All authorities need to be adequately informed to effectively perform the ongoing supervision of cross-border institutions as well as to be fully prepared to address potential cross-border situations of financial distress. Given the increased scope and intensity of the cross-border activities of EU banking groups, the need for effective information-sharing and cooperation in their supervision is now more important than ever. In this respect, the Eurosystem underscores in particular the importance of strengthening information sharing also between supervisory authorities and central banks without supervisory responsibilities with respect to the major EU banking groups.

The ECB is also very active in enhancing knowledge about financial integration. The ECB's research network on "Capital Markets and Financial integration in Europe" is one good example. A major task of the ECB in this area is also the "Report on Financial integration in Europe". This report was published for the first time in 2007 and it displays, among other things, the most important indicators to assess the degree of financial integration in different parts of the financial system. It is important to mention the contribution of the ECB to the possible extension of the market transparency provisions in the Market in Financial Instruments Directive (MiFID) to financial instruments other than equities.

The interest of the ECB in this issue follows in particular from the great importance of well-functioning markets for the transmission of monetary policy impulses. The officials of the ECB explained their view at a public hearing held by the European Commission in September 2007. Focusing on post-trade transparency in retail and wholesale bond markets, the ECB proposed a market-led controlled experiment about the trade-off between transparency and liquidity. In such an experiment, post-trade transparency could be gradually introduced, starting for example with the most liquid bond market segment, in order to assess its effects on market liquidity. The ECB stands ready to support such an experiment. In the present time, the importance of transparency in financial markets to allow for an efficient processing of information has of course become particularly evident.

Finally, the ECB provides central banking services that also foster financial integration. For example, most recently the ECB successfully launched TARGET2, the second generation of ECB's large-value payment system. By moving from a system composed of mutually interconnected national real-time gross settlement systems to a common system with a single shared platform for payments, the ECB achieves further harmonization for users in different countries and realize considerable scale economies.

The ECB achieved a single price structure for both domestic and cross-border transactions, the possibility of consolidated liquidity management for cross-border financial institutions and a harmonized set of cash settlement services for a variety of connected systems. The new system started in November 2007 with the first wave of countries. With a view to maximizing the benefits from TARGET2, the Eurosystem is currently also exploring the possibility of providing settlement services in central bank money for euro-denominated securities transactions. The objective of this project, called TARGET2-Securities, is to concentrate securities and cash settlements within Europe on an efficient, single platform. The user requirements of the system are currently the subject of a public consultation. The Governing Council will take into consideration the views of the stakeholders as well as the relevant public authorities prior to making a decision, by mid-2008, on whether to launch the project.

Integration of global financial markets and increased monetary and financial interdependence of national economies had a significant impact on domestic as well as international economics. Increased interdependence also has integrated such once-isolated policy issues as trade flows and exchange determination, thus immensely complicating the task of managing the world economy and raising important questions about the adequacy of the rules governing international economic affaires. The Bretton Woods rules-based international monetary system was replaced by a shaky political agreement among the dominant economic powers G-7; this change made the central banks of the major economic powers de facto managers of the international monetary system.

The decline of the G-7 and of monetary cooperation bears a special responsibility in the development; the decline has substantially weakened the scope of preventive action by the multilateral financial institutions in response to governments' economic policies and to unstable investor behavior. Countries whose financial systems had not been adjusted were allowed to lift all controls on capital movements with the rest of the world, and in some cases they were actually encouraged to do so. The world's rising monetary and financial instability is due to fixed exchange rates and the support they have received from the international community, notably the International Monetary Fund.

In a universe in which all agents were perfectly informed, we might assume that this recipe would ensure international monetary and financial stability-provided that economic policies converged. In practice, policy convergence-whether in the monetary or the fiscal sphere-has not proved to be a sufficient guarantee of monetary stability. In my view, international financial integration and the state of the international financial system are far less abstract topics than one might think at first glance. They reflect one of the most complex, intriguing and powerful aspects of the phenomenon that is generally referred to as globalization. This phenomenon represents a key issue that policy-makers in Europe and beyond have to deal with. Policy-makers often face very specific concerns about economic uncertainty and the risk of instability. There is also a more recent phenomenon that is less visible, but even more dynamic, namely global financial integration. By this, I mean the integration of local and national financial markets into a more unified international financial market.

Only a few decades ago, the realization of an investment project was largely contingent on the availability of capital in the local economy. Today the opportunities to raise finance as well as to invest capital are truly global. The substantial number of bilateral investment treaties and the liberalization of capital accounts have further encouraged cross-border investment.

While in the 1970s over 80% of all countries restricted access to foreign capital, today only 60% of developing countries and no industrialized countries have capital accounts which are still more or less closed. In the 1970s, worldwide cross-border holdings of assets amounted to only one tenth of world GDP. Since then, cross-border capital flows have steadily increased, and countries have now accumulated foreign assets in an amount equivalent to the annual GDP of the entire world. In 2003, euro area residents held foreign capital with a total value of 7.6 trillion euro, a figure that is somewhat higher than the euro area's annual GDP. But financial integration is also intrinsically linked to the real economy. Over the past 30 years, annual foreign direct investment (or FDI) worldwide grew from around 8.5 billion euro (10 billion US dollars) to almost one thousand billion euro (about 1200 billion US dollars).

The value of foreign-owned companies around the world – the stock of FDI – is equal to the annual GDP of the euro area. Taken together, these companies would make up an economy approximately one third of the size of the euro area. For Europe, these international linkages are of particular importance. European corporate businesses are among the most dynamic in the world, as they provide half of world FDI. At the same time, half of world FDI is invested in Europe. Foreign-owned companies contribute between 10% and 20% of euro area GDP. As a consequence, the relationship between the euro area and the global economy is today characterized more by financial linkages than by trade. The policy-makers have to be aware of these linkages because they can be a very powerful and fast transmission mechanism for shocks.

The measures needed to improve the organization of the international monetary system can be summed up in some proposals. First, the G-7 should reform its own operating procedures in order to achieve greater efficiency in the type of actions required. It must no longer be paralyzed by conflicts of interest in the short run, notably between its governments and central banks. The G-7 also should force itself to define a more coherent doctrine for the use of the International Monetary Fund (IMF). Second, the IMF should become the guarantor of the quality of its members' currencies. For this, it must incite its members more forcefully than in the past to abide by strict prudential rules. When concrete risks of a national or international liquidity crisis develop, the Fund should also make sure that the role of lender of last resort is effectively performed at the global level. Third, the creation of target zones would certainly be the best way to ensure orderly currency fluctuations; there is no unanimous support for the idea, but it will be a long-term

alternative. In the short run, however, an arrangement involving mandatory concerted-action mechanisms-triggered by the crossing of preset limits-would have the practical advantage of being rapidly negotiable among the G-7.

The benefits of this integration are obvious – a greater variety of goods and downward pressure on prices benefiting consumers and households. But the benefits are even more substantial, as production requires both human and financial capital. A skilled workforce cannot unleash its full potential without financial capital. Europe's impressive economic recovery after World War II would have been inconceivable without its integration into the global economy and its concentration on high-quality exports. Today, many Asian economies are benefiting from global economic integration. Investment in the appropriate technologies enables these countries to compete on the world market and increase welfare substantially. This is by no means a phenomenon which only appears in national accounts. Income disparities across the world have declined significantly. Not surprisingly, the benefits of this financial integration are particularly clear for open economies, which have recorded higher average growth rates in recent years.

How should we assess these recent developments in the international financial system? We realize that the benefits outweigh the costs. But there are costs of adjustment, often front-loaded and concentrated on specific regions and sectors, which need to be taken into consideration.

The change in the structure of the global economy also requires structural adjustments to be made in local economies. We know that the ability of a country to benefit from global financial integration very much depends on the quality of its institutional and structural environment. All economies, including advanced ones, such as the euro area, have to adapt to the changing needs of the world economy. The European economy has undergone and will continue to undergo substantial structural changes, which are necessary and beneficial because they will secure Europe's place in the global economy. This structural adjustment has been and will continue to be a major phenomenon in the coming years. As the world's largest exporter, Europe clearly has a major interest in global economic integration and is well placed to benefit from it. Sceptics are concerned about the sustainability of global financial integration; they argue that financial integration has gone too far, that market turnover has reached levels that are unhealthy.

Financial integration is regarded by some as having the potential to destabilize the global economy; but there is also an opposing view. This view states that global financial integration not only contributes to higher growth but also reduces the risks to the global economy; it states that the availability of finance and opportunities to invest are crucial for the stabilization of economic outcomes.

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Professor Elena Dragoescu
„Dimitrie Cantemir" University of Targu Mureş, Romania
Eleonora Laura Avram
„Dimitrie Cantemir" University of Targu Mureş, Romania

LOCAL COMMUNITY – ADMINISTRATIVE AND TERRITORIAL DECENTRALIZATION AND THEIR FINANCIAL SELF - SUFFICIENCY

Abstract:*In this paper I want to explore conceptual frameworks with reference to local administrative units and also the idea of decentralized government as entailed by these definitions. We can easily see that the appearance of local communities and their investment with local authority, both in the administrative and also the economic and financial sense, lead to what is nowadays known as "local finances". To put it plainly, together with the definitions conferred upon the concept of "local communities", we are confronted with two major possibilities of defining this, which differ only according to the perspective. The first perspective situates the state at the top level of the administrative, legal and financial hierarchy and from this central administrative unit the local communities are seen as smaller administrative units cut off from the central body. The second perspective offer the local communities a possible role and function that does not necessarily derive from the central power since, historically speaking, these can be considered to have been formed even before the state or at the same time with the state.*
We consider that a conceptual approach would contribute to a clear delimitation of the term as well as to a better understanding of the functioning of the financial body with major consequences for the understanding of their limits and the manipulation possibilities.

Key words: *local community,*

The administrative and territorial decentralization and also the financial self-sufficiency refer to the local public finance. The separate existence of the public finances would not have been possible without respecting the two principles on which they are based. If the state admits the self-sufficiency of the local communities, that is the territorial decentralization, they have their own finances. To be more explicit, they have the power to decide with respect to their own costs and their finances, establishing their own revenues (local taxes, local loans), which means in fact, financial self-sufficiency.

From the above mentioned we can conclude that the financial self-sufficiency of the local community represent an essential factor of administrative and territorial decentralization. Therefore, in this paper we will present the content and the role of the administrative and territorial decentralization and the financial self-sufficiency, and their positive influence on the national economy. Therefore, we considered to be necessary to explain, from the conceptual point of view, the collocation „local community", thereupon the decentralization and financial self-sufficiency is relegated.

THE LOCAL COMMUNITY

The state has to satisfy two kinds of interests: general interest and local interest, in between which there is a strong independence.

The interest, in the sense we use it in this paper, is "*the concern to satisfy certain needs*" [1] . From the state's point of view, this means that, the interest consists of *the efforts of the state administration, that is the entirety of the state organs, through which its activity (administrative and regulatory) it's accomplished in order to fulfill its functions.* [2] The functions and tasks that the state has to accomplish represent, in fact, the performance for the benefit of the community of a different kind of public services: social, economic, financial etc.

The state bodies competent to take measures and to emit compulsory dispositions in order to achieve the functions and duties of the state are called "public authorities".

According to the interests they satisfy, public authorities are divided in two categories: central and local.

1. As the name is already suggesting, *the central public authorities* lead and deploy their administrative and regulatory activities at the central level, so they occupy the major position regarding the competences to achieve the functions and duties of the state.

[1] Romanian language explanatory dictionary (DEX), Romanian Academy, „Iorgu Iordan" Linguistics Institute , Second edition, Univers Enciclopedic Printing House, Bucharest 1998, pg. 498
[2] Idem, pag.13

2. But the state cannot solve all the problems properly and promptly, using only instruments at its disposal. Therefore, several public services are delegated to the *local public authorities*. Local administrative units in Romania are: villages, towns, counties.

So, by distinction from the central authorities, the local public authorities fulfill their attributions at the administrative and territorial level, and they promote the interests of the people from the administrative and territorial units.

The local public authorities' competence and attributions are established and delimited by constitution or law.

In conclusion, the local public authorities are organs of state administration which deploy the administrative and regulatory activity at the local community level.

What are the local communities?

Following from the above mentioned, the usage of the concept of „local communities" always depends on the state organization which is determined by the existent interests at its level. One successful definition that we completely agree with for its synthetic but also comprehensive character, is the following "a local community can be assimilated with an open system, characterized by certain parameters, which are giving stability and distinct personality to the respectively group". [1]

In the Romanian context we note a constant preoccupation regarding the meaning of the content of the concept of "local community", according to their organization.

As a first definition of the concept we consider the following: „... *dismembered* (my emphasis) units of the state, created by law for administrative purposes or simple territorial units upgraded to the status of legal persons" [2] and "… invested with certain rights by the central authorities" [3].

According to another interesting definition, the local communities were regarded as „... natural societies at their origin, which appeared simultaneously or previously to the state, which enjoy rights recognized by the state instead of these being assigned by the state" [4].

Current thinking, prescribe for the local community several given criteria such as: administrative self-sufficiency, competence and the necessity of elected bodies by direct universal suffrage[5].

I – The first criterion suggests that for the state to confer to a unit the status of local community, endowed with administrative self-sufficiency, this must be invested with the status of legal person, because the status of legal person necessarily contains recognizing the existence of some personal interests and \ or some specific local issues.

II – With reference to the second criterion for the existence of the local community – the relegation and the fulfillment of its own attributions and competences – it is shown that, while the state enjoys full and primary competences, the local communities have to assign, through constitution or special laws, restrictive competences and attributions. Therefore, the more the local institutional structures are developing, the more the state has to pass up on the social services monopole, and to sustain the local communities in taking over and to perform a bigger and bigger part of the services.

The state also offer in this purpose total or partial financing for the respective community needs, with beneficent effects for general economic and social developing of the state.

Nowadays, together with the new wave of enlargement of the European Union, this tendency towards widening the local communities' attributions and competences is perceived as "a necessity of administrative and territorial decentralization", a statement that we consider to be incorrect because it suggests that, until now, decentralization did not exist in the domain of the administrative and territorial practice.

On the contrary, for a long time, at the basis of public administration organization there have been two principles: centralization and decentralization. Centralization represents the administrative system where the specialized public authorities and the local ones are named by the central public authorities and are subordinated to these. Decentralization, as opposed to centralization, represents the transfer of authority and responsibility from the central to the local level. [6]

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[1] Iftimoaie C. Ş.a. – The local public administration in Romania in European integration perspectives, Economic Printing House, Bucharest 2003, pag.37

[2] Teodorescu A. – Administrative law treaty, Vol I, Second Edition, Institutul de arte grafice "Eminescu", Bucharest 1929, pag. 239

[3] Negulescu P., Alexian G. – Public law treaty, Vol I, Casa Scoalelor Pronting House, Bucharest 1942, pag.72

[4] Teodorescu A., op.cit., pag. 285

[5] Welz C., Eisenberg E. – L'organisation teritoriale en Republique Federal d'Allemagne

[6] Cocoşatu M. – Decentralization – organization form of the public administration in Romania, Journal of The Economic and Local Administration, nr. 7/2005

Nowadays, most of the world's states are combining the principles of centralization with those of decentralization. In this way a decentralization of central power is ensured by combining the system of distributing administrative prerogatives to the local level with "relegating of the administrative and financial self-sufficiency to certain regions, administrative and territorial units, on the condition that this self-sufficiency will not affect the state's unitary character and, therefore, any abuse of local power is automatically and legally considered as unconstitutional." [1]

From the above presented we consider that the administrative and territorial decentralization can be most accurately described as "development and improvement of decentralization", in as much as decentralization exists in most countries, as previously mentioned.

Considering the competences and attributions which determine the second distinctive criterion for the existence of a local community, we can say that, in order to be given such competences the local communities have to fulfill three conditions:

1. to be a legal person
2. to have its own administrative authorities
3. the overseeing the local communities should only be performed by the central authorities within and through methods established by law.

Recognizing the local communities' own competences and attributions presupposes the existence of material and financial means to cover the needs appearing as a result of fulfilling their tasks, such as: financial resources, a body made up of public servants for its administration and implicitly, a certain financial self-sufficiency. All of these depend on a preexistent local budget, a public budget, which would ensure not only the revenues and costs established by the local communities, as an administrative object, but also its authorization by the leading community administration bodies.

Within this fundamental frame, the local communities will have the possibilities to participate in their own name to the domestic economic and financial circuit and even internationally. On this basis "… The local communities, organized in administrative districts that may coincide or not with the state's administrative and territorial units, will become legal persons"[2].

III – The third criterion for the local communities, that is, the competence and the necessity of elected bodies by direct universal suffrage, emphasizes the fact that the enforcement of the legal persons' attribution is given to the local community's own authorities by law. Such local authorities must be the result of free choice, and the decisions must be taken by the locally elected bodies and made public, this being the only possibility that will ensure the fair representation of local interests. Local authorities' decision power cannot elude state control exerted within the legal framework. But, this is a jurisdictional control limited to overseeing the legal character of the acts and not their pertinence.

In conclusion, the collocation "local communities" represent a public administrative structure with a particular juridical nature resulting from the fact that its decision power is not authorized by the state, but by the local electorate, who are the constituents of the administrative and territorial units, on behalf of whom they act.

We consider that the contemporary conditions together with the Romania's integration to the European Union, the local communities' sphere of activity will be increased more and more, their existence entailing many advantages, such as:

1. – more efficient usage of the material, financial and human resources
2. – increasing the undertaking/entrepreneurial spirit of the community and of social solidarity
3. – increased diversity of local public services according to the multiple needs of the communities, at the same time with the general development of the society.

DECENTRALIZATION – FORM OF THE PUBLIC ADMINISTRATIVE ORGANIZATION

The increasing role and the importance of local finances among the general public finances are due to the decentralization of public finances. Decentralization is only made from an administrative point of view, although this process assumes some other components through which it is realized in practice and to which we are going to refer:

1. The administrative decentralization represents a system of organization characterized by the fact that the state allows to a number of human territorial communities to manage them ensuring the function of the services. This means that they make administrative documents under the state supervision which offers them juridical personality, allows them to form their own authorities and ensures them all the necessary resources. This form of decentralization is linked to the legal recognition of local communities and their right

[1] Iorgovan A. – Administrativ law, vol I şi II, Editura Hercules, Bucureşti 1993, pag. 220
[2] Vida I. – Executive power and public administration, RA „Monitorul Oficial" Bucharest 1994, pag. 19

to manage themselves. So, it represents an administrative document without any politic principle for implying the state influence power.

2. Political Decentralization is a compound of the administrative decentralization which proposes it to pay a lot more influence both on the citizens and local chosen ones in the decisions taking process.

3. Financial and fiscal decentralization is a very important compound of decentralization process considering the fact that local public authorities have the most completed information for basing the decisions on whose base can take more founded decisions better than any other organs in the domain from the central level about the mobility and giving the local financial resources. Without a financial and fiscal decentralization the local autonomy would be formal, addicted to the central administrative resources and to the subjective way in which these are distributed.

4. The economic decentralization represents the cooperation, in different forms, between the public authorities and business environment having as a purpose the financial insurance, forming management rehabilitee, the maintenance of infrastructure or provider of some public services (under contraction of public services, desettlement or the partnership between public and private sectors).

As we mentioned before the decentralization of local public finances has an important role in increasing the positive influence of public finances upon our national economy. This is the reason why more considers plead in the favor of decentralization such as:

a) decentralization represents a factor for democracy differently from other countries which only focus the administration influence on the central authorities because decentralization allows the citizens to take a real part in decisions to follow their accomplishments and to see in their chosen ones representatives and not only mandatory;

b) decentralization is a way of controlling the chosen or named public officers (mandatory) and to asses and correct operatively their financial policy;

c) decentralization allows a better control of the provided public services because they assume intermediaries (politicians and all kind of bureaucratic) fact that does not allow a direct control of users such as in the case of services on the market, these create risks connected to overproduction , excessive costs, low quality of the provided services;

d) decentralization is also a factor of developing the market economy.

Obviously, the administrative and territorial organization of the country also marks the public financial decentralization. That is why decentralization is not realized on a uniform structure and presents different stages from country to country.

States of unitary types are organized in administrative and territorial units for which influent and administrative local state bodies function. So, in Romania, the basic administrative and territorial units are counties which are subdivided in cities, towns and villages. Italian territory is organized in autonomous regions, countries and villages. In France the territory is divided in departments and villages. As far as the federal types of stats are regarded, the decentralization of the public financial deals with every state, country or region component of the federation. These are subdivided in administrative and territorial units which are led by local organs of the state influence and administration.

FINANCIAL SELF – SUFFICIENCY - AN ESSENTIAL ELEMENT OF DECENTRALIZATION

Financial self – sufficiency is it known as a sum of elements of this kind nature among the "self – sufficiency of local communities". Referring to the European context, the local financial self – sufficiency is conceived as a compound element of democratic principles common to all the member states of European Boarding which through its legal settlement and its correct application makes the power decentralization possible. The financial self – sufficiency of administrative and territorial units has been internationally established by the concept of the "financial resources of local collectivities" foreseen firstly in the "European book for local self – sufficiency" signed in 1985 at Strasbourg, edited by the initiative of Permanent conference of local and regional powers from Europe and after that the European book entitled "The autonomous exercise of local power" proposed by the European boarding. According to art. 3 of the book through the local communities self – sufficiency is understood "the effective right and capacity of local communities to settle and manage, according to the law, on their own responsibility and on the respective population's profit, an important part of the public businesses", and in art 9, align. 1 financial resources are settled of local communities regarding that they "have the right, in the national economic policy, to sufficient proper resources by which they can freely dispose in their competence exercise".

The importance of European book about local self – sufficiency is impressive being compared from significance point of view to the "*Convention for human rights protection and fundamental liberties*".

Local self – sufficiency is considered a necessity determined by some factors:

1) It is in conformity with a principle proper to the marked economy on which base the initiative has to be sustained for increasing the efficiency;

2) The needs are better and more operative known to a level situated to society base of the respective community;

3) There is a regional, spatial difference of the respective individual's and collective's needs and preferences;

4) The management of a number of projects, many times specific, can be more effective realized if the local authority is respected, that means the respect for the decentralized self – sufficiency of management authorities.

Analyzing the elements of financial elements of local communities' self – sufficiency from Romania, the public financial law context specifies the fact that they consisted in "the right of every administrative and territorial unit to have an annual own budget and the competence of the leading boarding council of cities, towns, villages and counties for making the respective budget establishing the expenses according to the local needs as well as the tax payments, taxes and the correspondent loans for their back-up. We underline that *the base of the financial self – sufficiency of the local communities is formed by the autonomous budget fact that signifies the idea that the local budget is autonomous unlike the general budget of the country and other local budget.*

As far as the local budget quality is concerned as being autonomous, in the Romanian specific literature 2 opinions have been expressed:

1) a first one sustained by Professor Ioan Gliga[1] who qualified the autonomous budget of local boarding's as being exceptions from the principle "budgetary unit", next to the state social insurance and autonomous regional budget organized in the strategic branches of national economy;

2) the second opinion regarding the autonomous character of local budget belongs to Professor D.Drosu Saguna[2] whose opinion agrees with the first one till a certain point when he does not recognize the autonomous character of local budget. What is common to both opinions is the general characterization of the autonomous budget notion as being a budget made by autonomous institutions and approved by their own leading organs without the Parliament's debate and approval, as it is the budget process.

Considering the mentioned things and our membership of the European Committee we can reach the conclusion that the financial self – sufficiency appears obviously as a principle of repartition the competences between the individual and group, between the local communities and the state and between the state and the European Community. If the self – sufficiency assumes the localizing competences to the individual's interest level or to the local community who now better their own needs and the ways they have for accomplishing this, the same principle also justifies the other authorities' intervention when the efficacy of local actions is not fulfilled. As it follows, the lack of local actions is the basic criterion according to which the state can interfere in the local problem, the same way in which to the European Community level its competence for settlement interferes every time a member state cannot solve its problems in an efficient manner.

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Lecturer PhD student Mihaela Dumitru
PhD senior Lecturer Marcela Bengescu
University of Piteşti, Romania

THE PROCESS OF ADOPTION OF IAS/IFRS IN ROMANIA

Abstract: *In practice, the trial of harmonization with two accounting systems was a success. Even if IAS/ IFRS were considered to be a component of the harmonization settlements in 1999 and 2001, in many cases, the conformity was only a partial one, in practice turning up many disparities. The European Union at its turn is trying, to line up the European Accounting Standards at the International Financial Reporting Standards, in order to establish a convergence point between the European accountancy and the American one.*

Key words*: harmonization, normalization, international organisms, accounting system, qualitative criteria.*

JEL Classification: *M, M4, M41.*

The international accounting standards (that means IAS, IFRS, as well as their interpretations) are elaborated by IASB. Their publication by this organism does not make them directly applicable in Europe. In order to be applicable in Europe, the international accounting standards must be adopted by the European commission (EC)- only after the notice from the normalization committee has been asked, with a previous control and after they have been published integrally, in each of the official languages of the European Union having the aspect of a JOCE norm (article 3 of the norm1606/2002 , from July 19, 2022 whose objective is the adoption and application of international accounting standards in the European Union) The international accounting standards cannot be adopted only if(article 3):

- they do not contravene to the principle of faithful idea;
- they answer to the European people's interest;
- they satisfy the criteria of intelligibility, pertinence, reliability and comparability, necessary to the financial information used in the economic decisional process and the process for the evaluation of the society's administration by its leadership. .

With the help of the professional organisms from France, Italy and Great Britain, in Romania , there have been organized seminars in order to prepare specialists in common domains of interest as : Italy- Evolutions in the legislations of organizations, the fiscality and accountancy in Italy, the Evaluation of the unincorporated immobilizations, The Recording in the balance sheet and the evaluation of the financial and commercial assets and liabilities, France- the Analytical Accountancy and the administration control, CNCC- Insurances and financial institutions. At these seminars 180 founders from the Body of Accountants and representatives of the examination organizations, members of the Body of Accountants, have participated. A series of meetings have also been organized with the representatives of the South Eastern European Partnership on Accountancy Development (SEEPAD), on the occasion of the third General Meeting from 2004, organized in Sofia, the president of the CECCAR (The Body of Expert and Licensed Accountants of Romania) who was elected as chairman of this regional organism, as well as the representatives of the Program for the Accountancy and Auditing Development in Romania (DEFID).

Starting with 2004, the European states as well as the United States have begun to put into practice their own standards, using a common language for the business background. Romania is finding itself in a process of transition, taking into account the fact that the application has started to be made since 2007, initially for almost 300-400 societies (an estimative figure), enterprises of national and public interest, banks, insurance societies, mutual funds. Since 2006, everything has been made ready, remaining only two accounting systems in Romania: The International Financial Reporting Standards, and Romanian accounting standards, has also declared Marin Toma, the president of CECCAR (The Body of Expert and Licensed Accountants of Romania). Now, the only ones that have remained outside the applicability sphere of the International Financial Reporting Standards are going to be the enterprises which at December 31, 2005 recorded an inferior turnover to the limit of € 5 million, a level of the assets inferior to the limit of €2.5 million and less than 50 wage-earners.

Excepting the criterion regarding the size, the enterprises which in 2007 had to put into practice the stipulations of the International Financial Reporting Standards are the one of public interest, for these ones being a high interest from the investors and shareholders, these ones counting on the external financial

settlements to obtain information about the respective enterprise. In the same time, the international norms are applicable to the enterprises whose offer is connected to the public services in accordance with the developed activity.

It has been emited the assumption that the international settlements are going to be assimilated only if the benefits surpass the implementation costs. Romania's passage to a system based on the IAS-IFRS standards is the result of a political decision of the organisms for the accounting settlements (The Ministry of Public Finance) and it represents a radical change in the course of accounting activities, because the reform of accountancy took place immediately after the fall of communism, when a continental accountancy system was implemented-the French model.

The new approach was doubtful for many reasons. Firstly, the organisms of settlement have tried to harmonize the Romanian accountancy with two divergent accounting models –the forth European Directive and the International Accounting Standards, in a moment in which the European Union has not declared yet its position as regards to IAS. Secondly, the settlements in the harmonization domain aimed at a high number of enterprises, without taking into account their capacities of implementing the new-appeared settlements. The third reason was that these settlements were in fact , some interpretations of the International Accounting Standards these ones being useless to the enterprises which needed their financial statements to be totally in accordance with the International Accounting Standards; these ones had to revise their financial statements, thus appearing supplementary costs. Lastly, the attitude of the organisms of settlement was an ambiguous one, so that in 2005 we witnessed a reorientation towards the European Directives and a delay regarding the putting into practice of the IAS-IFRS by 2007.

The objective of the International Financial Reporting Standards is being reduced because the eligibility criteria have changed; the banks will apply the standards only in accordance with the principles having a compulsory character, the other companies will act in the same manner depending on the possibilities, where as other companies which are not classified as companies of public interest are excluded. The Ministry of Public Finance has delayed the putting into practice of the International Financial Reporting Standards because of the individual transactions. The settlements from 2005 specify the fact that the requirements of the European Union and the evaluations of different organisms of settlement and supervising are finally establishing sure conditions of application of the International Financial Reporting Standards, starting with the financial statements of 2007.

At the Ministry of Public Finance level, it was established the fact that the harmonization norms from 1999 based on a pilot study made at 13 companies quoted at the stock market and the results of this study, have not been given to the public. The contracts with the business background suggests the fact that there is the idea that the decision of introducing the harmonized settlements in 1999 did not take into account the capacity of implementation of the enterprises, or the effects upon the eligible enterprises.. It was considered that the sectors of activity which needed external financing were normally ready to use IAS-IFRS. Because of the fact that the big enterprises have higher possibilities for obtaining an external financing, these are also the ones that need to elaborate financial statements in accordance with IAS-IFRS so they are practically elaborating two sets of financial statements. Thus, the enterprises which appeal to foreign financial markets, have applied IAS-IFRS before their introduction by the harmonization settlements, the enterprises which appeal to foreign financial markets elaborate tow sets of financial statements; the great enterprises elaborate financial statements either trough the revise of legal financial statements, or through the complete application of IAS-IFRS, thus practicing a double report.

Because of the fact that the Romanian harmonization norms are only an approximate application of the IAS-IFRS, the enterprises which need financial statements in accordance with IAS-IFRS have made some revisions which may lead to supplementary costs. The great enterprises supported much higher costs of implementation of the IAS-IFRS than other enterprises, the same thing happening with the ones that needed to make a double report.

The objective has in view the concentration of the effort upon the harmonization of the accounting and auditing standards with the international standards and the ones of the European Union for the entities of public interest (EIP). EIP is a term proposed by the European Union, which is not officially defined in the Romanian legislation. However it was established the principle on the basis of which the identification of the key sectors of economy are being made, which also need an increased attention. The Romanian legislation defines the concept of entity with a character of special raporteur (ERRS). ERRS and EPI, established by the European Union, overlap in a large measure and they include the credit institutions, insurance companies and companies quoted on the stock market. One of the measures included within the plan concerns the fact of taking into consideration the impact of the European Union's requirements regarding the definition of EIP in Romanian and the establishment of the recommendations.

The choose of EIP as a leader for the reform in the accounting and auditing domain emphases two aspects: the importance of the credit institutions and of the insurance companies for the economy and for the increase in the public interest; the importance of developing a capital market for future investments, including the one regarding the development of some investment centers for the capital as a result of the reform. Moreover these companies represent the supporting pillar of the introduction process of new standards in other economic sectors, too. The measures which lie at the basis of this objective are mostly found again within the program of Implementation and Maintenance. The most important series of measures implies the possibility of some translations of a high-level quality in the Romanian language, of all the relevant materials at international level, as for the control standards and systems, the elaboration of materials and the assurance of professional formation of the accountants and financial auditors in the IAS-IFRS domain, as well as the subsequent change of experience in the practical domain. Counting on some preliminary discussions and on the signals coming from the business background, we may anticipate the fact that the financial managers of the quoted companies consider that the implementation benefits IAS-IFRS do not meet the expenses which were done. The decision taken in 2005 by the organism of settlement in order to attract the harmonization settlements and to limit the integral application of the IAS-IFRS for the entities of public interest, this is equivalent, in our opinion, to a tacit recognition of the fact that their publication was in a certain way, useless, before the European Union define its position as regards the IAS-IFRS.

For the first time in Romania, the ACCA representatives (The Association of Chartered Certified Accountants) organized in September 2005, in Bucharest, the first conference regarding the integration of International Financial Reporting Standards, in our country. For a correct application of the International Financial Reporting Standards firstly we need to observe the existing rules at December 31st, 2004, and then to apply the new ones. The decision of adjournment with one year of the International Financial Reporting Standards application was taken by the Consultative College of Accountancy**,** after a thorough evaluation of the existing conditions on the market. The analysts consider that, after the application of international rules, the banks will confront themselves with numerous capital requirements, taking at the same time into account the country risk, the size of banks clients and the company's rating. In the case of individual clients there may appear a decrease in the financing requirements

The intense activity of the CECCAR (The Body of Expert and Licensed Accountants of Romania) has created at an international level optimistic perspective regarding the practice at international accounting level of the Romanian EXPERTI. Marin Toma, the president of CECCAR (The Body of Expert and Licensed Accountants of Romania) pointed out: "The evaluation realized by the European experts concerning the profession of expert accountants and of licensed accountants has at its basis European norms and principles, too, who certify the fact that the Romanian profession of accountant may be practice anywhere in the world".

During 2004, the international activity intensified the CECCAR (The Body of Expert and Licensed Accountants of Romania) benefiting of a high quality level representation at international level. Having as main target the recognition of the profession of Romanian accountant at international and European level, The Body of Expert and Licensed Accountants of Romania made all the efforts in order to achieve this target.

The activities met an increased progress in a bilateral plan; the CECCAR (The Body of Expert and Licensed Accountants of Romania) has undertaken a series of actions in Romania with different international professional organisms. They have continued the collaboration with professional organisms with which CECCAR (The Body of Expert and Licensed Accountants of Romania) concluded a series of agreements of cooperation, especially from France, Italy, Great Britain, reunions with French and Italian experts, organizing these reunions in order to develop the projects of cooperation which had been concluded with English experts in order to improve the collaboration relations.

FEE (The European Federation of Accountants) believes that the completion of an EU internal market for accountancy services is necessary because accountants deliver services to companies operating on the enlarged EU internal market. Professionals and firms need clear provisions allowing them to work without unjustifiable discriminatory barriers.

A very strong impact of the IAS-IFRS introduction is being noticed as regards to the informatics component, a basic element of the informational-accounting system. The informational-accounting system adapted for each enterprise suggested to supply useful information for taking economic decisions, indispensable for the internal report, for the fulfillment of their own administration needs, but also for the external report. The supplied information by the system has to:

- present to the owners of the enterprises what they own and owe;

- present to the majority of shareholders the real value of securities they own, taking into account the direct activity made at the enterprises, and also the one made through the agency of their own partners;
- present to the minority shareholders the value of their own securities, taking into account the fact that these ones distinguish from the classic creditors by the fact that they cannot ask the refunding of their own securities, they do not have the right to a remuneration in the absence of beneficiaries and they are directly interested in the good development of the enterprise's activity;
- present the fortune (patrimony) of the enterprise as operational economic entity which has all the economic means and the sources of origin in order to obtain results.

All the mentioned aspects in this article take into account the fact that, in order to obtain a faithful image the information must be built on the principle of the economic prevalence upon the juridical one. The financial accounting information is restricted by the accounting settlements in force.

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Conf. univ. dr. Nicolae Eşanu
University „Lucian Blaga"of Sibiu
Faculty of Economic Sciences

BUDGETARY ADMINISTRATION –A COMPONENT OF ADMINISTRATIVE CONTROL

Abstract: *The major component of administrative control is represented by budget, since a foreseeing administration requires the budget of the main field activities in the company and the control over the fulfilment of the budget's clauses. Therefore, usually within the context of budget there are yearly budgets and budgetary control.*

Based on short-term plans that are deducted from the middle term programs, annual budgets are elaborated and quantified, and the necessary resources are allocated. Thus, in terms of earning capacity, responsibilities are settled in order to accomplish the company's objectives.

Thus, the budget is a planning document scheduled before the operating of anticipated actions that comprises financial data, mixed or non-financial operational data, a "quantitative expression of an action plan and of a financial assistance for the coordination and the implementation of foreseeing objectives. The inclusion of data resulted from the speculations is represented by budgets."

Keywords: *budget, budgetary control, cost*

JEL: M41, M11

Budgets are important characteristics of the most system controls. It changes the human behaviour and the decisions at the managers' will; they have to be fully aware of uncertainties, with or without a budget. The budgetary advocates claim that the profits assured through the use of budgets overrun -almost every time -the costs with respect to the composition and the budget administration.

The budgetary control is aiming at an effective development of the administration so as to reach strategic objectives. It stands for the permanent comparison of real results with the quantified foretelling that appear in budgets, so as to establish the causes of the infringements, the directive's information at different hierarchical levels, and the necessary corrective measures necessary to the appraisal of the activity performed by the budget clerk.

The budgetary system's efficient elaboration and operating is based on the following principles that have to be obeyed:

-totalitarian principle: is based on the budget of all the activities in the company, through the assurance of a balance between the different functional and operational compartments of the company;

-overlapping principle: based on authority system in the company so as to ensure responsibilities concerning its accomplishment (the sales manager is in charge of the sells budget). Thus it is necessary that the budget should be identified with a responsible person;

-solidarity principle between departments and their involvement to accomplish efficient conditions for the company's objectives;

-adaptability principle (slimness) imposes the budgetary system adaptability to the modifications of the medium or of the imperfect foretelling;

-motivational and adhesion principle of the personnel for budgeting activities, for assuring the accomplishments of budget objectives, the control over their accomplishments, and their responsibility.

For an efficient budget, the management at all levels must carefully study the output's activity factors. This requires that the attention should be firstly focused on the total sales of the economic-productive capacity, of these factors' potential, thus on the mobilization of domestic resources.

Sales budget

In a market economy, the sales figures are the dominant indicator of economic activity in a company, because the output is adjusted in terms of sells, as well as the supplies, the number and structures of the personnel and the necessary investments.

From a quantitative and value point of view, sales are to be made on periods of time, products, groups and destinations. We can distinguish two stages in its accomplishment:

a) The sales foretelling and the selling expenses

b) The annual budgetary deductions, on quarters, months, products or groups of products, consumers.

The sales foretelling is the most important stage, including all the studies and evaluations

of sales outlets and of the part that the company intends to maintain and to dominate.

The sales foretelling in a budgetary environment is situated at the foretelling jointure on a long term and on a short term. Actually, the research of the coherence between the long term developing plan, medium and budget is essential in order to avoid the short term decision making that enhances the company to take another direction than that of set via strategy.

In the field of short term foretelling, commercial services use either the models that are directly based upon the past sells evolution, or those based upon foretelling.

Marketing studies that resort to the last models, take into consideration:

-the already existing products on the market that are produced in the company, as well as the new products that are about to be produced;

-the quantity of previous sales;

-the annual sales objectives;

-external environment: concurrence, economic position, consumers' behaviour, prices' level;

-internal environment: existent output capacity, commercial politics, the sales agents' competences, prices policy of the company, seasonal fluctuation of the activity

The results for sells foretelling will be materialised in appraisals like :

a) Physical volume of possible sells, Qv, which results from the following mathematical expression:

Qv=Si+Qf-Sf, in which:

Qf stands for the physical volume of the output which is about to be made

Si, Sf are the initial and final stocks of finished products.

Final stock is influenced by the company's political stock, which, at its turn is related to the proportion between the sells physical volume and the using degree of output capacity.

The physical volume of the output that is to be made is taken within the output budget.

b) The sale value (turnover CA) established with the help of unitary sale price: Pv

$$\text{So, } CA = CA = \Sigma\, Q_v \times p_v$$

Between the two indicators there is a tight correlation, a high volume of sales makes it possible for the unitary sale price to be reduced and conversely. That is why, the sellers foretell/speculations is realised through successive simulations between different sales volumes and unitary sales volume.

Interdependent of the sales volume, the foretelling of selling expenses is established and in this way the selling expenses budget is elaborated.

An important issue is the one of separation of selling expenses with variable expenses (packing, packing materials, distributors' wages, commissions, transport charges), semi-variable charges (wages for the commercial department personnel) and fixed charges (paying off, the heating and lightning of deposits, advertising, marketing research, shiftings) I relations with selling volumes. For this reason there are used some solutions proceedings of indirect costs.

In the last stage of elaborating the selling budget, the clauses regarding annual and global selling expenses and sales in the company are deducted on products or groups of products and of short periods of time (quarters, months).

The sales budget must be correlated with the output budget, treasury, and selling expenses.

Output budget

Along with the selling budget, it forms the major budgets, which determine the shape of the other resulting budgets.

The elaboration of the output budget supposes:

a) data processing out of the selling budget concerning the product quantity that is about to be produced(output program)

b) the scheduling in time, on quarters, months, of the quantities of speculated products and on outlets.

c) Estimation of the output's physical volume.

The main objective of the output planning is the correlation of the clauses stipulated in the selling budget with the output capacity, within the context of its full uses.

The physical volume of the budget output, Qv, is taken from the selling budget.

The foretelling of output program must be in concordance with some restrictions connected to the limited character of the output factors with regard to their volume and yield; the aim is their optimal use according to the installed capacity; the realisation of the output program within the framework of the maximum of profit. Therefore the complexity of the issue is obvious. It is often used the linear programming, the PERT method, the theory of waiting threads, the optimization of stocks, computer techniques (programming of the optical output), arrangements lists, restructurings, capacity expansions, programs for the consuming of raw materials and for the use of direct and indirect productive personnel.

The physical quantity of products that are to be fabricated, taken over from the sales project, is estimated at the sale price and in this way the correlation is established between the two budgets.

After establishing the physical and value of output from the mathematical expression, another phase follows i.e. scheduling in time on quarters, months and on outlets.

In picture no 3.4.we have the correlation of output budget with the others budgets;

The output budget

Sales Budget Cost Budget Provision Budget

The manufactures' cost budget

It is a synthesis budget, that estimates, on one side, the total exploited costs on cost outlets, and on the other side, cost carriers for the output that is about to be deducted. The outlets' budget is elaborated in several stages, and each stage entail partial budgets, that integrate in the general budget of the cost centres, such as following:

a) elaboration of the budgets in auxiliary costs sections

b) elaboration of the budgets in the main sectors of manufacture

c) elaboration of the budgets for the general administrative costs.

The budgets' elaboration for the output activity presupposes, firstly, the drafting of budgets pertaining to auxiliary sections due to the specific problems that they encounter, such as: discount of mutual services, activities resulting from personal services related to the activity of those specific sections and which stand for indirect costs of the place where the activities were performed, activities that provide services to the main sections or to the third parties. The auxiliary sections' budget is elaborated for each auxiliary activity (section) considered as a cost centre; the method of evaluation of the activity volume within the characteristic unit measure; the charging of the capacity based on a catalogue of works and of provided services and of their destination; the proceedings for the evaluation and the discount of mutual services between the auxiliary sections; the assessment of costs and executed services.

The costs for auxiliary sections, considered as cost centres, are structured on the basis of accountancy; they are:

A) Personal costs, which, related to the number of work units specific to the centre, allow the determination of budgetary personal cost

B) Take-over costs that are discounted from other cost centres; in this way, a complete budgetary cost of the centre is established.

The budgetary personal cost is used for the analysis and the control of the centre's administration which is made possible through the charge of the authoritative factor agent; the costs are controllable at the level of the centre.

The complete budgetary cost allows the charge of the centre's cost according to the destination of services to the other responsible centres and it monitors the analysis and the control over the allotted resources through the prism of value carriers that made them possible. The main sectors' budget of exploitation is settled according to charges in that centre, which are structured in accordance to their nature:

a) personal costs of the centre, divided into direct costs and indirect costs in relation with the group of finished products, within that specific sector; this division is useful in terms of monitoring and supervising output costs

b) the costs for the services provided, costs that are granted through discounts from other centres.

Budgeting the costs with raw materials and direct materials

Raw materials and materials direct costs, are determined based on the rate of consumption established for different kinds of raw material and materials, separately for each product that is about to be produced, standard unit prices of materials and the production program of the budgetary period.

The rate of consumption is the principal instrument of budgeting and standardization of the usage of material resources. The elements that are sizing the material rate of consumption in the majority of the industrial fields are: the effective consumption (net) of material (Cu), technological losses (pt) and un-technological losses(pnt)*. By delimitation of these content elements it forms two categories of consumption rates which have a distinctive operational-decisional utility in the economic auto-administration, and within the framework of this management in costs-administration, namely: rates of technological consumption and rates of supplying consumption.

The rate of technological consumption (n_{ct}) is defined in literature, methodologies and is considered in practice as a proportion that sets the quantity of raw material, fuel, energy, etc. necessary to be consumed in the technological process of manufacturing a quantity on product in normal production terms. In it's structure are included the quantity afferent to the elements "effective consumption (Cu)" and "technological losses (pt)".

$$n_{ct} = Cu + pt$$

The rate of supplying consumption represents the quantity of materials necessary to be supplied for the production of a product unit, according to the technological process and in normal technical-organizing terms. It is formed by the "technological consumption" (ntc) and "un-technological losses " (pnt).

$$n_{ca} = n_{ct} + pnt$$

In the control process, the deviations between the quantities respectively the budgetary values and the effective values are determined according to:

$$A_{QV} = (Q_e \text{ x } q_e) - (Q_e \text{ x } q_s)\ P_s$$

or

$$A_{QV} = (q_e - q_s)\ Q_e \text{ x } P_s$$
$$A_P = (P_e - P_s)\ Q_e$$
$$A = A_{QV} + A_p$$
$$A = (q_e \text{ x } P_e \text{ x } Q_e) - (q_s \text{ x } P_s \text{ x } Q_s)$$

Budgeting the costs with direct manual labor

The costs with direct manual labor are determined by analytical calculation for each product manufactured, using as underlying elements labor norms, remuneration rates per unit of time and the production program of the budgeted period.

Labor norms can be expressed in many ways: **time rate**(n_{mt}), which expresses the consumption of time necessary for producing a product unit or an operation; **production rate** (n_{mp}) which expresses the quantity of products that needs to be done in a unit of time; duties area (n_s) where through the area in which the doer fulfills his duties in the labor process is estimated.

For the standardization of the direct costs with manual labor, it is regularly used the unit of time, which includes: the time for preparation and shut-down, the operative time, time of servicing the places of employment, time of normal interruptions.

From what we stated above, we can detach the idea that the *direct standardized costs* methodology with material and labor resources includes the following elements: technological consumption rates (n_{ct}); time rates (n_{mt}); working prices and rates (p); rating category of situating the study (e); rating redistribution of the category (r_{te}). With the help of these elements the direct standardized cost is determined:

$$c_{nd} = \sum_{i=1}^{n} n_{ctj} \bullet p_i + \sum_{j=1}^{n} n_{mtj} \bullet r_{tej}$$

Deviations are established: $A_{HV} = (H_e - H_s)\ Q_e \times T_s$

$$A_T = (T_e - T_s)\ Q_e \times H_s$$

$$A_M = (H_e \times T_e \times Q_e) - (H_S \times T_s \times Q_e)$$

The norming of the direct cost assumes two large categories of activities: determination of the physical consumption rates and the evaluation of the physical consumption rates.

Within this budget, besides from de manual labor there are included other staff costs, representing the contribution to the Social Security and the Unemployment fund.

Budgeting the indirect costs of the productive center

As we stated above, the indirect cost of each section, workshop, are divided in center self-costs and costs of the services received from other centers.

The estimation of the indirect self-cost of the center takes into consideration their behaviour towards the production volume. Thereby, for indirect variable self-cost (fuel, energy, water,etc.) we proceed similarly as for the direct costs, if there is the possibility to determine them on the strenght of calculation or the correlation with the production volume, taking into consideration the performance of the previous periods and the inflation index. For the period costs, we proceed differently depending on the content: the costs for the staff indirectly productive are estimated according to personnel policy, predictable modifications in the staff structure and earnings level for the budgeted period; the amortization is calculated according to the system adopted and the modifications in the structure of the capital goods; consumable materials and other expenditures according to the performance of the previous period, with the correlations imposed by the economic juncture of the budgeted period.

In the budget are accentuated at indirect costs on separate groups the cost of services received by settlement of accounts from other centers, resulting the total volume of the indirect production costs.

With a view of including in costs the cost of acquisition of grub-stake, we add at their value at the standard price of acquisition, the hoarding cost discounted by the "Supply" cost center, induced depending on the financed medium hoarding cost and on the bulk of raw materials and grub-stake allocated for the productive consuming in that profit center. As well, in the expenses group of each center, it is also included the cost of general administration discounted from the budget of "General Administration" and the distribution cost, discounted by the cost center of "Distribution" (Sale).

In this way, every profit center offers the possibility of establishing, on one hand, of the controllable costs by the responsible of the center, represented by the center's own costs; on the other hand, by adding the costs discounted by other centers arises the total bulk of production costs due to the financed production and the complete cost of the sold production.

Dividing costs in variable and fixed ensures the built of a flexible budget for indirect costs.

The budgets of the costs on the bearers of costs

The budgets of the costs centers estimate the direct and indirect costs on costs centers, establishing the responsibility on every center, and it doesn't arise the costs on the bearers of costs. Because of this, it is necessary to establish the unitary cost calculated before on each product, work or service and of the budget bearer of costs, namely of the costs of the planned products.

The unitary cost on product calculated before it is calculated on articles of calculation, depending on the used method of calculation.

In the case of the absorbing methods of calculation, as we have seen, it results from the relation:

$$Cup = \Sigma Cd + Ci$$

where:

Cup = unitary cost
Cd = direct costs
Ci = indirect costs

The indirect costs are estimated on costs centers and are assigned on each bearer of costs, depending on the known assessment methods.

At the partial methods of calculation, the unitary cost of the product is an incomplete cost, including only the variable costs reported to the bulk of production that flows from the relation:

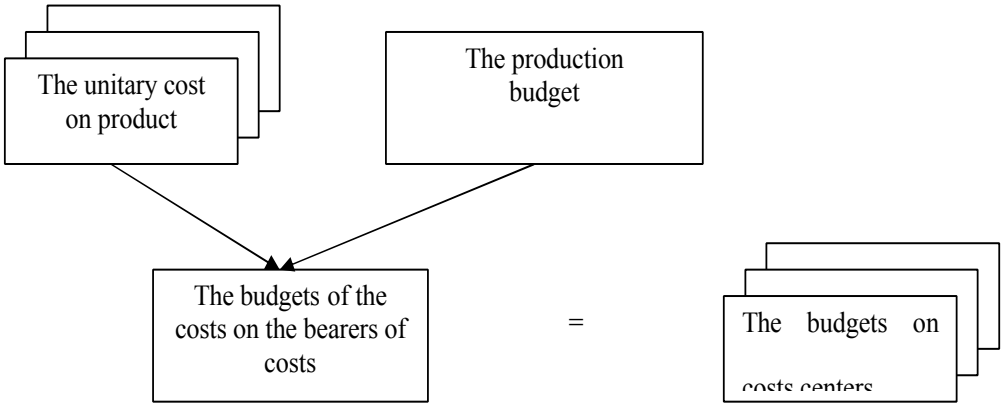
$$Cup = Cdv + Civ$$

where:

Cdv = direct variable costs

Civ = indirect variable costs

Using the unitary cost calculated before on each product and the quantity of products that will be produced from each product, taken from the production budget, we draw up *the budget of the costs on the bearers of costs*.



The budget of the costs on the bearers of costs estimates for each product the quantity that will be produced, the unitary cost and the global cost, and in the end it flows the total of the costs on bearers of costs for all the products.

The total of the costs in the structure of cost bearers has to be equal with the sum of costs in the structure of the budgets on cost centers.

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Associated Professor Victoria Firescu
University of Pitesti, Romania

LEASING OPERATIONS, A ALTERNATIVE FOR OBTAINING EQUIPMENT OF A HIGH COMPLEXITY AND TECHNICALITY

Abstract: *Leasing as financing technique is mainly developed for companies that seek to enlarge their activity and improve their performances, and more generally speaking, it ensure technical progress. Despite unfavorable economic situation, the leasing market in Romania has showed remarkable growth and it expected to show constant development in coming years. The paper tries to outline the leasing market dynamics and the structure of the leasing contracts. The purpose of case study is to show which financing method is more advantageous: leasing or bank credit. In order to do that, I have chosen BRD(Groupe Société Générale) and I shall simulate the acquisition of a good through either method.*

Key words: *leasing, period of contract, exchange rate, residual value, insurance services*

JEL Classification*: G29*

Introduction

Even in countries with very well-developed financial mechanisms, leasing operations are relatively new components of financial activities. The practical interest of leasing is to ensure the entire financing through borrowed funds for an investement, without any necessity for the user to take other insuring measures.This is the main features that make the difference between leasing and the traditional credit, where the user company bears a part of the investment value.Therefore, leasing as a financing technique is mainly developed for companies that seek to enlarge their activity and improve their performances, and more generaly speaking, it ensures technical progress. Leasing proves to be a perfect alternative for obtaining equipment of a high complexity and technicality, for which the moral depreciation has a high percent. The leasing is efficient only if the equipment can be operated over the whole period of the contract. In case the lessee could obtain a bank credit under advantageous conditions, the cost of leasing would be higher

The first Romanian independent leasing companies were established in 1994. Since then, despite unfavorable economic situation, the leasing market in Romania has continually developed. The leasing market in Romania is formed of some thousands economic agents that meet the two conditions imposed by law: the inclusion of the leasing activity in the object of activity and a registered and paid capital of 500 million Rol. Out of these, approximately 100 companies are active, and out of them 32 are members of the Romanian Leasing Association, having a market share about 40% in the last years. Although the structure of ASLR has modified over time, some of its outstanding members temporarily calling in, the market share has not modified, since other companies who joined this association partially compensated for the eventual withdrawals.

Leasing operations, a modern financing alternative

Leasing operations are those operations by which a party named lessor undertakes to transfer for a determined period of time, to another party (lessee) the right to use an asset for a period of time against a regular payment called royalty.

The main parties involved in the lease operations are: the lessor(the financer), the lessee(the user), the supplier and the insurance company.

The lessor is the owner of the asset; he transfers the usage rights of the equipment to the lessee against the rentals determined in advance by the contract. The financer can be a leasing company, Romanian and foreign legal person. During the leasing operation the user can choose, if the leasing company agrees, the supplier as well as the insurance company. Regarding the transfer of risks, there are two types of leasing: financial leasing and operational leasing.

Under the Romanian legislation, financial leasing has to fulfill the following conditions:

- the risks and benefits related to the ownership right shall be transferred to the lessee from the moment of concluding the leasing contract;
- on the expiry of the contract the ownership right of the good is transferred to the lesse;
- the lesse may chose to purchase the good and the purchase price shall represent maximum 50% from the entry value(market value)

Operational leasing does not fulfill any of the above-mentioned conditions.In the case of an operational leasing the good remains the property of the leasing company after the end of the contract.At the first sight the operational leasing contract seems much more advantageous than the financial one, but these advantages are reduced because of the fiscal implications for the leasing company.For the leasing company, the entire installment for an operational leasing contract is considered as revenue and taxed as such.By consequence, in order to maintain their profitability the leasing companies apply a higher interest rate for the operational leasing than for the financial one.Regarding the transfer of the risks, in case of operational leasing the risks are retained by the leasing company. This is one of the main reasons why leasing companies are not very enthusiastic about operational leasing.

According to the features of the market and the relations with the clients, some special forms of leasing have developed, like: lease-back, time-sharing, experimental leasing, personnel leasing, and master-leasing. The direct leasing represents the type of leasing where the lessor is also the supplier. The indirect leasing represents the type of leasing where the financing is made by a intermediary company. Because the leasing contract is a renting contract for a certain good over a period of time, the user doesn't appear with liabilities to banks in his financial statements so the company's trustworthiness is not affected. When the financing option is the credit, the financial statements show liabilities to the crediting bank.

Leasing proves to be a perfect alternative for obtaining equipment of a high complexity and technicality, for which the moral depreciation has a high percent. The leasing is efficient only if the equipment can be operated over the whole period of the contract. In case the lessee could obtain a bank credit under advantageous conditions, the cost of leasing would be higher.

The structure and the evolution of the Romanian leasing market

Pursuant to the changes occurred in the legal cadre via the issuance from National Bank of Romania of the Decree 28/2006(IFN law) the Romanian leasing market is represented by about 330 leasing companies notified at BNR until April 2006. From these 213 companies sent at BNR the necessary documentation for being notified like IFN and to accomplish the conditions impose by the low like active operators, until 03.08.06, and other 30 leasing new companies in the market in 2006.

At ASLR level from the 32 member companies, which they have around 40% of the market share, 27 companies sent the necessary documentation at BNR (until 03.08.2006), to be notified as IFN's and 5 member companies gave up financial leasing and they will continue with the operational leasing activity. In February 1996, The Association of Leasing Companies in Romania (ASLR) was established, thus opening the way for a sustained lobby in favour of promoting the benefits of the leasing system for the Romanian economy.

Although the structure of ASLR has modified over time, some of its outstanding members temporarily calling in, the market share has not modified, since other companies who joined this association partially compensated for the eventual withdrawals.

The leasing market in ASLR Cadre is structured this way:

-leasing companies affiliated to some banks-2 companies(Porsche Leasing Romania IFN SA,RCI LEASING ROMANIA IFN SA) representing 6%;

-leasing companies affiliated to some product providers-2 companies(Eurial Leasing IFN SA,Toyo Motor Leasing IFN SA) representing 2%;

-independent leasing companies - 28 companies representing 88%.

The number of ASLR members at the end of 2006 was 32, in comparison with 36 in the first 9 months of the year. The reduction in the number of members was due to the exit of 4 companies from ASLR (Romexterra Leasing IFN SA,BCR Leasing IFN SA,Tiriac Leasing IFN SA,Matco Leasing).

The total volume of the leasing contracts signed by the ASLR members in 2006 reached the level of 1.083,5 mil. Euro, in terms of the volume of goods of 841,9 mil. Euro.

The dynamics of the evolution of leasing market can be followed in the next table (after the entire amount of the contract)

Table 1: The dynamics of the evolution of leasing market(amount of the contract) - mil EUR

Year	1999	2000	2001	2002	2003	2004	2005	2006
Member companies								
ASLR	202.9	340.0	587.6	624.1	850.0	1029.0	1115	1.083,5
Member companies								-
	82.1	82.2	374.4	275.7	550	786	1100	
	285	422.2	962	899.9	1400	1815	2215	1.083,5

2215

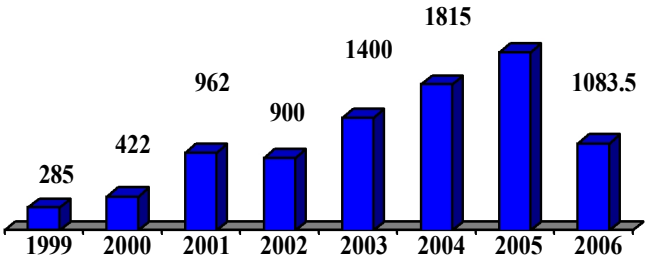

Figure 1: Total value of the leasing market(mil Eur)

As noticed, starting 1999, the volume of leasing transaction signed at the level of ASLR members raised continuously.In these conditions, at the end of 2006, the total amount of the ASLR Leasing market reached the level of 1.083,5 mil euros.One should observe the fact that the accomplishments of the ASLR leasing market for the year 2006 marked a lowering of about 2.82 % in comparison with 2005. This aspect can be explained through the fact that in comparison with 2005, 3 members of the association, leasing companies affiliated to the banks, due to the modification of the main share holder they decided to go out from the association (Romexterra Leasing IFN SA, BCR Leasing IFN SA,Tiriac Leasing IFN SA);these 3 leasing companies, 9 months later they had almost 406.989 mil euros representing the total amount of contracts, this value has been taken from the ASLR statements from 2006.

The Financial Leasing continued to represent the main direction of the unrolling of leasing contracts, this is how is rendered evident in the below table:

Table 2: Financial leasing versus operating leasing

	Financial Leasing-ASLR members				**Operating Leasing- ASLR members**			
	2005		**2006**		**2005**		**2006**	
		Cross-border		**Cross-border**		**Cross-border**		**Cross-border**
Number of Contracts	95,9%	0,8 %	94,8 %	1,6%	3,3%	–	3,6%	-
Goods Value	95,5%	1,0%	93,9 %	3,6%	3,4 %	-	2,5%	-

The external financial leasing operations represent in 2006 3,6% of the total value of the goods contracted by the ASLR members, registering an increase of aprox. 72% in comparison with 2005. In 2006 the legal persons continued to represent the most important clients of our leasing companies. The value of goods for the legal persons leasing represented 70,9% of the total market, 7,86% was represented by the public sector and the NGAs, the 21,24% difference is represented by the physical persons and Authorized Physical Persons.

Table 3:The structure of leasing contracts

Object of contract		**% of total 2006**	**% of total 2005**
Auto vehicles :		93,14	91,2
	Cars	79,74	65,6
	Auto utilities	13,4	25,6
	Commercial Vehicles		
	Buses		
Industrial equipments		3,73	6,1
Agriculture equipments		0,25	
Airplanes /boats		-	-
Rail train		-	-
Other (biotic , medical technique)		1,44	2,3
Real estate- office		0,59	0,4
Real estate- residential		0,85	

In the total of all leasing contracts signed at association level, we can distinguish between the types of acquisition: leasing with imported goods and domestic leasing. Hereby, from the total of 47.965 contracts

signed in 2006 and being unrolled at the end of the year, about 56.5% are contracts with external suppliers and 43,5% with internal suppliers.

The duration of contracts for the movable or immovable goods, the biggest part, 40,2% of the goods value are signed for a period 3 years, 26,9% for 4 years , 12,56% for 5 years, 16,28% for 5 to 8 years and 4,06% for 1 to 2 years.

The contracts for real estate leasing are made usually for 5 years, from the goods value.

The structure of leasing contracts (at ASLR level), concerning the contract object, is shown in the above table:

From the analysis of the information given by ASLR members resulted that the most important segment of the leasing market continue to be represented by the auto vehicle leasing. This level was achieved in 2006 93,14%, increasing comparing with 2005, when for the same period it was 91,2%, so an increase of 2,08%.

Concerning the level of financing by leasing for the industrial and agriculture equipments recorded a level of 3,98%, decreasing from 2005 with 35%.

The real estate leasing is situated at a higher level as part of the total financing comparing with 2005, recording a percent of 1,44%, from which at real estate-commercial leasing recorded a level of 0,59%.

Although there is a substantial and constant evolution of the leasing market in Romania, the leasing companies are confronting a series of aspects from which we mention:

- the legal cadre is deficient structured: in this period there have been discussions about modifications to the law 441/2006, the law that bring changes to the law 31/1990-the law of companies, and the methodological norms of the ordinance 28/2006, law regarding the non-banking financial companies (IFN) activities;
- the manifestation of a lack of information for the potential clients about the leasing operation (where we include the psychological preference of the property on the good in
- detriment of a leasing contract in which the right of property on the good passes on the user only after the integral payment made by him);
- the actual level of national economic development;
- the low level of foreign investment in Romania;

One modality to resolve the aspects mentioned up is represented by the continuous activity of ASLR to promote the leasing industry and the companies who are present on this market.

ASLR has initiated and continued the effort to modify the legislative cadre in tight connection with all the decisional factors from the market, efforts that will become real in the next period at legislative level. In present ASLR makes conjugated efforts with the business environment to modify the law 441/2006, which thorough the changes brought to the law 31/1990, brings big loses for the commercial companies.

Also, ASLR manifests the availability to continue the debates and the necessary dialogues for creating the adequate legislative cadre for the unrolling of leasing operations of all kinds of leasing companies, regardless the appurtenance of those at an certain category of stakeholder, in conditions of transparency, real competition and honor.

ASLR develop a sustained campaign to attract new members in the association from the category of leasing companies unaffiliated to any association.

Application regarding which financing method is more advantageous: leasing or bank credit

In order to do that, we will simulate the acquisition of an asset through either method. The asset that is to be financed both through leasing and credit is Dacia Logan for the price of 6500 Euro, without VAT. The financing period is of 60 months.

●Leasing contract through BRD Sogelease IFN S.A

Within BRD Sogelease , the step to be followed for leasing are :

- down payment between 15 and 50% of the CIP price of the good, to which will added the VAT;
- management commission;
- registration taxes;
- CASCO insurance;
- royalties, comprising: capital share, interest and VAT only for the capital share;
- residual value of 20% to which will be paid the customs taxes valid at the end of the contract.

The general financing conditions offered by BRD Sogelease Leasing are summarized in the table no.1

***Table 4: General financing conditions for the leasing contract offered by* BRD Sogelease**

Avans	15%-50%
Financing period	a) minimum 1 year-maximum 5 years, legal persons(excepting the cars)
	b) a) minimum 1 year-maximum 4 years, natural persons
Residual value	20% for the imported goods
	1-5% for the goods of internal production
Method of payment	Monthly
Currency in which financing is granted	EURO, USD, RON
Financial conditions	a) administration commission b) leasing interest is established function of the financed good, duration of the contract, and the structure financing
Exchange rate for the payments	BNR exchange rate+0,5%
Insurance services	Full casco-zero franchise

Source:www.brd.ro

The conditions for the leasing contract concluded with BRD Sogelease for the acquisition of an car Dacia Logan are presented in the table below:

Table 5: Conditions for the leasing contract concluded with BRD Sogelease

Period of the leasing contract-months	4 years(48 months)
Price without VAT	6500
Advance(15%)	975
Financed value	5525
Interest	6,8 %
Residual value	1300
Leasing installment	124,67
Management commission(2%)	130
Value of the contract EUR	7089,16
Currency	EURO

Source: BRD Sogelease

●Banking credit from B.R.D.

This financing option, a credit from B.R.D., proposes the following conditions:

The bank loan is given for 80% of the total value of the automobile: 80% x 7089=5671,2 EUR. The advance is of 20% of the same value.The number of approved credit installments is of 48 monthly installments and the annual interest rate is 7,5 %.There is also a management commission of 2,5 %.

There are two possible methods to calculate the monthly amount: equal monthly payments and equal monthly installments.

Table 6: Equal total monthly payments

	Equal total monthly payment		
	Total installment	**Credit installment**	**Interest**
1	145	90	55
2	145	91	54
3	145	92	53

Table 7: : Equal monthly installments

	Equal total monthly payment		
	Total installment	**Credit installment**	**Interest**
1	170	115	55
2	169	115	54
3	168	115	53

Conclusions

With the leasing contract, the advance payment is of 975 Euro, while for the bank loan this one is significantly higher, amounting to 1417,8 Euro.The leasing financing system is more suitable if the client does not want to pay a high advance or does not have enough money .

The leasing installment (124,67) Euro is higher than the credit installment in any of its two possible calculations.

As a conclusion, in case the buyer has the money for the advance payment for a bank credit, it is more advantageous for him to finance the purchase through a bank credit.

When comparing the leasing and credit alternatives, we must mention that leasing implies money which the leasing company usually borrows from banks and thus the total cost of a leasing contract is in general higher than total cost of a bank credit.

However, the advantages of a leasing contract are:

- there is no need for many guarantees;
- the financial resources of the lessee are not blocked for the period of the contract;
- the fiscal deductibility of the expenses generated by the leasing contract;
- the payment is usually done a small advance.

Despite the advantages and disadvantages of each of the financing methods, it cannot be said that inavriably one of them is superior to the others.It all depends of the needs of the client and of the goods purchased.

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Conf. univ. dr. Mihaela Herciu
Lucian Blaga University of Sibiu, Romania

FINANCIAL MANAGEMENT OF INTERNATIONAL BUSINESS – FROM MULTINATIONAL CAPITAL BUDGETING TO SENSITIVITY ANALYSIS

Abstract:*In a international business, investment, financing, and money management decisions are complicated by different currencies, tax regimes, regulations concerning the flow of capital across borders, norms regarding the financing of business activities, levels of economic and political risk. Financial managers must consider all these factors when deciding which activities to finance, how best to finance those activities, how best to manage the firm's financial resources, and how best to protect the firm from political and economic risk.*
In this context, capital budgeting quantifies the benefits, costs, and risk of an investment. Multinational capital budgeting, like traditional domestic capital budgeting, focuses on the cash inflows and outflows associated with prospective long-term investment projects.

Keywords: *financial management, international business, capital budgeting, risk management, sensitivity analysis*

JEL Classification: *F23, F37, G31*

When considering its options for financing, an *international business* must consider ***three factors***. The first is how the foreign investment will be financed. If external financing is required, the firm must decide whether to tap the global capital market for funds, or borrow from sources in the host country. The second factor is how financial structure of the foreign affiliate should be configured. The last factor emphasizes the nature of the global capital market and how that has affected financing decisions (See Hill, Charles, *International Business. Competing in the Global Marketplace*, McGraw-Hill International Edition, 2007, pp. 673).

Multinational companies undertake their capital budgeting decisions within a harsh environment of volatile exchange rates and political risks as well as other factors. This paper develops a capital budgeting framework, by applying a geometric Brownian motion process to model the exchange rate behavior and a Poisson process to reflect the arrival of an expropriation by a hostile government. A practical example of the stochastic model is given in this paper. The solution to the stochastic model could be used by multinational managers as a decision tool, especially for those companies where expropriation risk is a cause for concern.

Multinational capital budgeting decisions are more sophisticated than within a purely domestic situation because of factors such as the volatility of exchange rates, differences between countries' interest rates, political risks and the effects of international taxation systems. There are several papers in the research literature which have sought to incorporate exchange rate and political risk into the international investment decisions of multinationals. None of the models produced have been successful in integrating both the effects of a volatile exchange rate and political risk. It is therefore the aim of this paper to show how exchange rate volatility and political uncertainty may be incorporated into the capital budgeting processes of multinationals; using a stochastic calculus approach since these types of models best capture random effects. More specifically, this paper derives the value of a project given an exchange rate which follows a geometric Brownian motion process and the arrival of an expropriation by a host country following a Poisson distribution (See John Pointon, *Exchange Rate and Expropriation Risk in Multinational Capital Budgeting: A Stochastic Calculus Approach***,** Published in *International Journal of Business Studies*, Vol. 3, No.2, pp. 81-88, December 1995).

According to Mandura, Jeff and Fox, Roland (*International Financial Management*, Thomson Learning, 2007, pp. 491-502) the factors to consider in multinational capital budgeting are:

- ***Exchange rate fluctuation.***

Using the past to predict the future requires that we look at past values of the exchange rate. Rather than take the actual rate, we detrend the data by taking the changes in the rates. Taking the past year as typical of future behavior, it is a simple matter to work out the standard deviation of daily changes in the exchange rate. If the past year was not typical then representative period has to be found.

- ***Inflation.***

Capital budgeting analysis may either *include* or *exclude* inflation in the calculations. When inflation is significant, calculations can appear confusing as the numbers are unrecognizably high. So it can be helpful

to work with inflation adjusted estimates instead. If *inflation is to be included* in the revenues and costs must be estimates of the actual costs and revenues that the firm expects to pay and receive at the time. If *inflation is to be excluded*, than the revenues and costs ate in today's values and will be more familiar to managers. The current exchange rate should be used and predictions should not include a trend element caused by inflation differences between the countries (Also see Ross, Stephan, Westerfield, Randolph, Jaffe, Jeffrey, Jordan, Bradford, *Modern Financial Management*, McGraw-Hill Irwin, 2008, pp. 206-208).

- ***Financing arrangement.***

Many foreign projects are partially financed by foreign subsidiaries. To illustrate how this foreign financing can influence the feasibility of the projects, consider the following revisions: subsidiary financing and parent financing. One reason that the subsidiary financing is more feasible than complete parent financing is that the financing rate on the loan is lower than the parent's required rate of return on funds provided to the subsidiary. If local loans had a relatively high interest rate, however, the use of local financing would likely not be as attractive.

- ***Blocked funds.***

In some cases, the host country may block funds that the subsidiary attempts to send to the parent. Some countries require that earning generated by the subsidiary be reinvested locally for at least three years before they can be remitted. Such restrictions can affect the accept/reject decision on a project. If the foreign subsidiary has a loan outstanding, it may be able to better utilize the blocked funds by repaying the local loan.

- ***Uncertain salvage value***.

The salvage value of an MNC`s project typically has a significant impact on the project's Net Present Value (NPV). When the salvage value is uncertain, the MNC may incorporate various possible outcomes for the salvage value and re-estimate the NPV based on each possible outcome. If may even estimate the break-even salvage value, which is the salvage value necessary to achieve a zero NPV for the project. If the actual salvage value is expected to equal or exceed the break-even salvage value, the project is feasible. The break-even salvage value can be determined by setting NPV equal to zero and rearranging the capital budgeting equation.

- ***Impact of project on prevailing cash flows.***

Thus far we have assumed that the new project has no impact on prevailing cask flows, but, in reality, there may often be an impact: favorable or negative.

- ***Host government incentives.***

Foreign projects proposed by MNC`s may have a favorable impact on economic conditions in the host country and are therefore encouraged by the host government. Any incentive offered by the host government must be incorporated into the capital budgeting analysis. For example, a low-rate host government loan or a reduced tax rate offered to the subsidiary will enhance periodic cash flows. If the government subsidized the initial establishment of the subsidiary, the MNC`s initial investment will be reduced.

- ***Real options.***

Some capital budgeting projects contain real options, in that they may allow for additional business opportunities. Since these opportunities can generate cask flows, they can enhance the value of a project. The value of real option within a project is primarily influenced by two factors: the probability that the real option will be exercised and the NPV that will result from exercising the real option.

Financial management is concerned with the decisions taken by a firm's executive officer, which relate to cash flows. In general, depending upon the level and nature of its business activities a firms cash flow may represent the sales revenue which the firm receives from sales of its products or services; it may constitute the capital it raises on foreign and domestic capital markets to finance its current activities or support its plans for expansion; or it may involve the funds held by the firm as a hedge against possible fluctuations in international exchange rates and interest rates.

An executive must consider all the aspects of international financial management when taking the decision to invest abroad. First, a firm needs to consider the financial feasibility of the investment (also known as capital budgeting). Second, an executive must assess the balance of debt capital and equity capital, which will be required for the funding of the investment (i.e. the capital structure). Thirdly, the executive must consider methods of raising long-term capital and its sources. Finally, an executive should determine the method of managing its cash flows during the period of the investment. In assessing the risks faced by a firm when embarking upon international activities, difficulties associated with fluctuations in exchange rates are probably the most serious problem to resolve (See Chandra Sekhar Yalamanchili, Hitesh Shah, Madhuri

Ananth, Ina Susatya, Venkata Seshayya Vallabhaneni, *Key Focus Areas for Executives in Globalization of Business*, Jason Hill, Texas A&M University-Commerce).

Sensitivity analysis – as a method to reduce risk management at the firm level – is used to determine how "sensitive" a model is to changes in the value of the parameters of the model and to changes in the structure of the model. Parameter sensitivity is usually performed as a series of tests in which the modeler sets different parameter values to see how a change in the parameter causes a change in the dynamic behavior of the stocks. By showing how the model behavior responds to changes in parameter values, sensitivity analysis is a useful tool in model building as well as in model evaluation (See *An introduction to sensitivity analysis*, Lucia Breierova, Mark Choudhari, Massachusetts Institute of Technology, 2001).

Many decision makers feel more uncomfortable about the necessary to guess probabilities for unfamiliar political and foreign exchange events than they do about guessing their own more familiar business or financial risks. Therefore it is more common to test sensitivity to political and foreign exchange risk by simulating what would happened to net present value and payback period under optimists/pessimists scenarios (See Eiteman, David, Stonehill, Arthur, Moffett, Michael, *Multinational Business Finance*, Pearson Education, 2007, pp. 593).

In these scenarios we will take in consideration many factors that influenced the business risk of the firm, like (See Moyer, Charles, McGuigan, James, Rao, Ramesh, *Fundamentals of Contemporary Financial Management*, Thomson South-Western, 2007, pp. 392):

- The variability of sales volumes over the business cycle;
- The variability of variable costs;
- Fixed costs;
- Depreciation;
- Earning before tax;
- Net earning;
- Net cash flows;
- Actualized cash flows;

How can the firm get the net present value technique to live up its potential? One approach is even ***sensitivity analysis***, which examines how sensitive a particular NPV calculation is to changes in underlying assumptions. Sensitivity analysis is also known as what-if analysis and bop (best, optimistic, and pessimistic) analysis (See Ross, Stephan, Westerfield, Randolph, Jaffe, Jeffrey, Jordan, Bradford, *Modern Financial Management*, McGraw-Hill Irwin, 2008, pp. 229).

For example:

Basic scenario

Indicators	**Year 0**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Initial investment	80000					
Sales		80000	80800	81608	82424	83248
Variable costs (55% din CA)		44000	44440	44884	45333	45787
Fixed costs (1500)		1500	1500	1500	1500	1500
Depreciation		16000	16000	16000	16000	16000
Earning before tax		18500	18860	19224	19591	19962
Tax - 16%		2960	3018	3076	3135	3194
Net Earning		15540	15842	16148	16456	16768
Net cash flows	-80000	31540	31842	32148	32456	32768
Actualized factor/investment opportunity	10%					
Actualized cash flows		28673	26316,033	24153,136	22168,091	20346,2663
NET PRESENT VALUE						**41656**
PAYBACK PERIOD	**without actualization 2 years and 186 days (906 days)**					
	with actualization 3 years and 14 days (1094 days)					

In the optimist scenario sales will increase with 10% up to basic scenario and in pessimist scenario sales will decrease with 10% up to basic scenario.

Sales in optimist scenario

Indicators	**Year 0**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Initial investment	80000					
Sales		88000	88880	89769	90666	91573
Variable costs (55% din CA)		48400	48884	49373	49867	50365
Fixed costs (1500)		1500	1500	1500	1500	1500
Depreciation		16000	16000	16000	16000	16000
Earning before tax		22100	22496	22896	23300	23708
Tax - 16%		3536	3599	3663	3728	3793
Net earning		18564	18897	19233	19572	19915
Net cash flows	-80000	34564	34897	35233	35572	35915
Actualized factor/investment opportunity	10%					
Actualized cash flows		31422	28840,198	26470,779	24296,109	22300,1731
NET PRESENT VALUE						**53329**
PAYBACK PERIOD	**without actualization 2 years and 108 days (828 days)**					
	with actualization 2 years and 268 days (988 days)					

For analyze the sensitivity we calculate the elasticity coefficient, using the formula:

$e_{NPV/Sales} = (\Delta NPV/NPV_{bs}) / (\Delta S/S_{sb})$

ΔNPV – NPV in optimist scenario (NPV_{os}) – NPV in basic scenario (NPV_{bs})

ΔS – Sales in optimist scenario (S_{os}) – Sales in basic scenario (S_{bs})

$e_{NPV/Sales} = ((53329-41656)/41656)) / 10\% = 2.80$

In conclusion, increase the sales with 1% drive to increase the NPV with 2.80%.

$e_{PP/Sales} = - (\Delta PP/PP_{bs}) / (\Delta S/S_{sb})$

ΔPP – PP in optimist scenario (PP_{os}) – PP in basic scenario (PP_{bs})

ΔS – Sales in optimist scenario (S_{os}) – Sales in basic scenario (S_{bs})

$e_{PP/Sales} = - ((828-906)/906)) / 10\% = 0.86$

In conclusion, increase of sales with 1% drive to decrease of PP with 0.86%.

$e_{PP/Sales} = - (\Delta PP/PP_{bs}) / (\Delta S/S_{sb})$

ΔPP – PP in optimist scenario (PP_{os}) – PP in basic scenario (PP_{bs})

ΔS – Sales in optimist scenario (S_{os}) – Sales in basic scenario (S_{bs})

$e_{PP/Sales} = - ((988-1094)/1094)) / 10\% = 0.96$

In conclusion, increase of sales with 1% drive to decrease of PP actualized with 0.96%.

Sales in pessimist scenario

Indicators	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Initial investment	80000					
Sales		72000	72720	73447	74182	74923
Variable costs (55% din CA)		39600	39996	40396	40800	41208
Fixed costs (1500)		1500	1500	1500	1500	1500
Depreciation		16000	16000	16000	16000	16000
Earning before tax		14900	15224	15551	15882	16215
Tax - 16%		2384	2436	2488	2541	2594
Net earning		12516	12788	13063	13341	13621
Net cash flows	-80000	28516	28788	29063	29341	29621
Actualized factor/investment opportunity	10%					
Actualized cash flows		25924	23791,868	21835,493	20040,055	18392,2916
NET PRESENT VALUE						29983
PAYBACK PERIOD	without actualization 2 years and 281 days (1001 days)					
	with actualization 3 years and 151 days (1231 days)					

$e_{NPV/Sales} = (\Delta NPV/NPV_{bs}) / (\Delta S/S_{sb})$

ΔNPV – NPV in pessimist scenario (NPV_{ps}) – NPV in basic scenario (NPV_{bs})
ΔS – Sales in pessimist scenario (S_{ps}) – Sales in basic scenario (S_{bs})
$e_{NPV/Sales}$ = ((29983-41656)/41656)) / (-10%) = 2.80
$e_{PP/Sales} = - (\Delta PP/PP_{bs}) / (\Delta S/S_{sb})$
ΔPP – PP in pessimist scenario (PP_{ps}) – PP in basic scenario (PP_{bs})
ΔS – Sales in pessimist scenario (S_{ps}) – Sales in basic scenario (S_{bs})
$e_{PP/Sales}$ = - ((1001-906)/906)) / (-10%) = 1.048
$e_{PP/Sales} = - (\Delta PP/PP_{bs}) / (\Delta S/S_{sb})$
ΔPP – PP in pessimist scenario (PP_{ps}) – PP in basic scenario (PP_{bs})
ΔS – Sales in pessimist scenario (S_{ps}) – Sales in basic scenario (S_{bs})
$e_{PP/Sales}$ = - ((1231-1094)/1094)) / (-10%) = 1.25
In conclusion:
Decrease of sales with 1% drive to decrease of NPV with 2.80%.
Decrease of sales with 1% drive to increase of PP with 1.048%.
Decrease of sales with 1% drive to increase of PP actualized with 1.25%.

Sensitivity analysis treats each variable in isolation when, in reality, the different variable are likely to be related. If ineffective management allows costs to get out of control, it is likely that variable costs, fixed costs, and investment will all rise above expectation at the same time. If the market is not receptive to a solar plane engine, both market share and price should decline together. Managers frequently perform scenario analysis to minimize this problem.

In conclusion, risk evaluation and risk management instruments are difficult to use and monitor. Understanding them often requires a good grasp of mathematics and statistics. It is, consequently, not clear that audit-committee members without specialized training would be up to monitoring the in-and-outs of coverage and even speculations presented to them, often in rapid and very summary fashion.

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Lecturer phd candidate Ioana Monica Horja
"Dimitrie Cantemir" University of Targu Mures, Roamania

ASPECTS OF COMPANIES INSOLVABILITY

Abstract : *Gearing a trader in the complex and continuous relations with suppliers and creditors, on a part, and with customers and the other side implies the continuous functioning of cashing and payments mechanism with these. If this mechanism is blocked because of scarcity of liquidities on this circuit's link, the activity of many customers connected by successive operations is threatened.*

Maintaining on the continuous mechanism of payments in commercial activity is realized sometimes with the price of removing from the circuit of these who, most of increasing the losses, can't continue the payments.

These customers removing who cannot pay their debts are made by a procedure named insolvability which can be reorganization or bankruptcy, both organized and leaded by juridical rules.

This paper tries to point a few aspects of insolvency procedure which is analyzed by juridical, accounting and taxation point of view. In the paper are treated the main steps in companies insolvency.

Key words*: debtor, creditors, insolvency, reorganization, bankruptcy*

JEL Classification: *K35*

The companies, as legal persons, are formed, consolidated, developed or reduced their activity or are dissolved or even liquidated by the economical conjuncture, convenient or inconvenient.

The dissolution and the liquidation of companies are notions which refer of the same economical process, ceasing the company activity.

The company dissolution is the juridical abolish of this and is ended by the erasure of company by trade registry.

The company liquidation is a mix of operations for turning to the company patrimony which is in incapacity to pay the debts in order to pay the creditors and to distribute the rest to shareholders.

A company can have difficulties because of internal and external causes.

Among the external causes can be enumerated:

- Product/market profitability (a new product which cannot reach the target, the diminishing of market, the wrong choice of communication sectors or of the distribution ways of a product);
- Technical causes (ecological impediments, concurrent products with new technologies and lower costs);
- Monetary causes (fluctuation of coins, wrong previsions about the inflation ratio);
- Legislative and fiscal causes;
- Loss of customers.

The internal causes can be:

- Defectively management;
- Unsuitable organization of the production or administration sector;
- Too many outgoings

All these causes can result in a crisis for the company, in a lack of poise. The company crisis can be considered the final stage of an undesirable process in which the company potential of obtaining profit and its liquidity are going to a wrong direction who threatens the company existence.

The emphasize of these lack of poise situations can get to incapacity of pay, which is a situation of financial lack of poise characterized by changing the liquidity and solvency level.

The solvency supposes the financial state of a company that is able to pay all debts as they fall due by the assets.

The liquidity shows that the company has financial resources to pay its debts as they fall due, so it has solvency.

Seeing this crisis on time can get the remediation of the situation by measures of reorganization or restructuring.

If these situations can't be remediate or the taken measures strand, such as juridical reorganization or all this goes to entering into bankruptcy.

Dissolution and liquidation are operations which refer to the same economic process, bringing to an end the activity of a company. Ending the activity of a company needs a few steps with the result not only the erasing a company and also the liquidation of assets and liabilities of the company.

Companies liquidation can be made in two ways: through the initiative of the shareholders or through the initiative of the debtor or creditors.

Voluntary dissolution and liquidation are made by the initiative of the shareholders and juridical dissolution and liquidation takes place when the company is unsolvable, which goes to the insolvency procedure. The juridical dissolution and liquidation is determined by the debtor or by the creditors.

Voluntary liquidation is made according to Companies Law, republished and occurs when the members of the company resolve to voluntarily wind-up the affairs of the company and dissolve. Voluntary liquidation begins when the company passes the resolution, and the company will generally cease to carry on business at that time (if it has not done so already). If the company is solvent, and the members have made a statutory declaration of solvency, the liquidation will proceed as a members' voluntary winding-up. In such case, the general meeting will appoint the liquidator(s). If not, the liquidation will proceed as a creditor's voluntary winding-up, and a meeting of creditors will be called, to which the directors must report on the company's affairs. Where a voluntary liquidation proceeds by way of creditor's voluntary liquidation, a liquidation committee may be appointed.

Juridical liquidation is made according to Insolvency Law no 85/2006 through the petition of the debtor or the creditors or any other interested persons or institution. Juridical liquidation is determined by the court order of the syndic judge. The juridical liquidation is a complex procedure with two different steps: reorganization and bankruptcy and is made by the liquidator under the control of syndic judge and creditors. The reorganization is the recovery of the company and avoiding bankruptcy. In case of impossibility of reorganization the solution is bankruptcy.

Bankruptcy is the moment when the customer stops the payment of his debts.

Bankruptcy, the compulsory liquidation, is different by the voluntary liquidation, which is made by the company members.

In insolvency procedure are involved many bodies:

- **the court.** The competence court is the tribunal having jurisdiction over de debtor's registered seat, as recorded in the trade registry.
- **the syndic judge.**The syndic judge is nominated by the president of the tribunal, from the judges appointed as syndic judges. The procedure opening and closing judgment is passed by the syndic judge.
- **the liquidator.**The liquidator is nominated by the syndic judge. He will represent the company on the procedure development.
- **the creditors.**The creditors are natural or legal persons which have debts to the liquidated company.

Juridical reorganization is made through a reorganization plan in which the obligations can be payed during a period of three years.

If the obligations can1t be payed in reorganization or the company has no goods and nopossibility to pay its obligation, the syndic judge shall decide by minutes on the entering into bankruptcy.

The effects of entering into bankruptcy and the adequate measures are:

- the dissolution of the debtor company
- canceling the debtor's right of his administration and appointing a liquidator
- the handing over the estate administration from the debtor/administrator to the liquidator
- drawing up to the liquidator of a list comprising the creditors and all their claims at the entering into bankruptcy date and checking up of the claims
- notifying the entering into bankruptcy to the known creditors, to the debtor and the trade registry office.

The bankruptcy procedure has three main stages:

1. *Measures preceding the liquidation*

According to Law No 85/2006 the first measure is putting under seals the assets of the debtor's estate (the shops, warehouses, deposits, offices, commercial correspondence, archive, information storage and processing devices, agreements). There are not be put under seals the objects that have to be urgently realized in order to avoid their material deterioration or loss of value, bookkeeping registers, bills of exchange and other securities that are outstanding or are to shortly become outstanding, cash.

For all the assets of the debtor's estate the liquidator makes an inventory becoming their judicial trustee.

2. *The performance of liquidation*

The liquidation is performed by the liquidator under the syndic judge's control. The liquidation is performed by a few main rules:

- the assets are sold advantageous and rapidly,
- the assets may be sold in the lump or individually
- the assets are sold by direct negotiation or by auction.

The revenues obtained from the sale and from cashing up the claims are deposited by the liquidator in the account of the debtor's estate.

3. *The distribution of amounts achieved from the liquidation*

At each three months, calculated from the liquidation commencement date, the liquidator shall present to the syndic judge a report on the funds obtained from the liquidation and the collecting of claims and a plan of distribution among the creditors.

According to the law, the claims shall be paid in the following order:

- first the claims like taxes, stamps, other expenditures from selling the goods and garantated claims
- after, the claims are payd in the next order:
    a) taxes, stamps, the expenses necessary for the preservation and administration of the assets of the debtor's estate, the payment of the remunerations of the persons employed;
    b) claims arising from labor relations
    c) claims representing credits, with the related interests and expenses, granted by credit institutions after the procedure opening,
    d) budgetary claims,
    e) claims representing amounts due by the debtor to third parties on the basis of certain obligations of alimony, allowance for minors,
    f) claims representing the amounts established by the syndic judge as alimony for the debtor and his family, in case the debtor is a natural person,
    g) claims representing banking credits,
    h) other unsecured claims,
    i) subordinated claims,
    j) claims of the associates or shareholders of the debtor legal person.

After the liquidation of the assets of the debtor's estate, the liquidator shall subject to the syndic judge a final report with a general balance sheet. After the approval of the final report by the syndic judge, this closes the procedure and also dispose deregistration.

From the accounting point of view, the operations which are made in bankruptcy are reglementated by the M.P.F.O. No. 1752/2005 and there are the following:

a) putting under seals and preserving the assets of the debtor's estate
b) the inventory and the evaluation of the assets and liabilities
c) drawing up the financial statements for the companies which shall be liquidated

The start balance sheet is drawn up on the base of the last balance sheet drawn up by the company which is corrected:

- the results of inventory are registered, materialized in plus or minus to the inventory
- the annulment of the intangible assets which are considered without economical value by passing on the outgoings (constitution outgoings)
- the annulment of the assets of the next exercises because the company does continues the activity (prepaid expenses).

d) the sale of the assets that have to be urgently realized in order to avoid the depreciation
e) the sale of the important assets of the debtor's estate advantageous and rapidly with the creditors' approval
f) the deposit to a bank, in the debtor's account, of the amount obtained from the sale
g) establishing the liabilities

The liquidation generates a few debts: penalty of determination of a contract, prepaid rents, and the liquidator remuneration.

The final liquidation balance sheet includes to the assets, the cash from the account and to the liabilities the equity and the liquidation result.

h) the distribution of amounts achieved from the liquidation according to the distribution plan to the creditors, in the legislated order

The liquidation operations can ends with profit or loss. According to these situations the distribution operations can be like this:

1. *the liquidation result is a profit*

In this case the distribution is made like this: the share capital is distributed at the nominal value of shares, the legal reserves reduced with profit tax and dividend tax and the other elements of equity and the liquidation result reduced with dividend tax.

2. *the liquidation result is negative but the loss can be covered by the equity*

In this situation, to the shareholders is returned the share capital and the rest from the equity after the cover.

3. *the liquidation result is negative and the loss can't be covered by the equity*

In accordance with the juridical form of the company is proceeded like this: for unlimited company and joint-stock company in which the associates and the shareholders are responsible only by the share capital limit, the uncovered debts are cancelled; for partnership company, limited partnership company and joint-stock limited partner company in which the associates and the shareholders are responsible unlimited and together, the uncovered debts are supported by the associates or the shareholders by the enforcement of personal estate.

i) drawing up and the approval of the final report
j) drawing up the final financial statements.

The taxation of liquidation is made by the rules of Taxation code.

In voluntary liquidation according to article 12 of Taxation code, the incomes obtained in liquidation or dissolution of a Romanian legal person is incomes obtained in Romania and taxable incomes.

In the title which refers to income tax is a separate chapter "Reorganization, liquidation and other assets and shares transfers" which specifies that distribution of assets by a Romanian legal person through their shareholders, such as dividends or as the result of liquidation is a taxable transfer. The tax value is 16% of the income. The losses from uncollected debts are deductible expenses if the debtor is dissolved for limited companies or if the debtor is liquidated and there is not any successor. The benefit for the liquidation operations is taxable.

The decrease or cancel of any provision or reserve which was already deductible is included in taxable incomes.

The dividends of shareholders are taxes with dividend tax,

The liquidation incomes are investment incomes. According to article 66 of Taxation code, the taxable income for liquidation or dissolution without liquidation of a legal person is the surplus of distributions amount over the contribution of a person to equity. The tax is 16%.

For VAT, according to the taxation code any distribution of assets to the shareholders, including a distribution in case of liquidation or dissolution is taxable.

The fiscal treatment of insolvency companies is different such as the company is in observation, in reorganization or in bankruptcy.

a) The taxation in the observation period

In the observation period the activity of the debtor's company continues. In case that is a profitably activity, the benefit must be used for creditor's payment. All the payments are made only with the authorization of judicial manager named by the syndic judge. Is not allowed to pay the creditors claims even that they had been financed profitable activities. The benefit is calculated considering the undischarged debts.

The judicial manager has to check all the operations made by the debtor in the last three years before the opening of the insolvency procedure, and he can cancel operations which were made with the purpose of hiding assets or incomes for the creditors. In case of canceling operations, usually transfers of assets at minimal prices, the outcome has to be corrected and the taxable base after ajustation generates supplementary taxes, penalties and to claims increase.

For the claims before the insolvency opening the penalties are calculated until the opening date.

b) The taxation in the reorganization period

In case of approval of a reorganization plan, the company activity continues, claims are reduced by payments according to the payment plan. The decrease of debts is taxable incomes.

In the reorganization period are calculated interests, penalties for claims after the insolvency opening date, which are paid also according to the payment plan.

In the observation period and in the reorganization period the company must pay also the current debts.

c) The taxation of the bankruptcy

In bankruptcy, the incomes are obtained from selling the debtor's assets and from interests of the amounts held in banks. There are no expenditures like protocol or sponsorship. The publication expenditures are made only for selling the assets, is not necessary to calculate the depreciation because the depreciation expenditures are not made for obtained incomes.

About VAT tax, according to the taxation code at selling of assets are applied the simplificated measures according to article 160. So, on the invoices is written reverse taxation, without afferent tax.

The provisions are deductible 100% of customer's debts if the next conditions are fulfilled:

1. Are registered after 1.01.2007
2. The debt is against a legal person in bankruptcy
3. Are not secured bay other legal person
4. Are obligations of a person which is not affiliated?
5. Were included in taxable income.

Rules about the taxation treatment of liquidation are also in Taxation Procedure code. For unpaid administrative claims generated before or after insolvency opening are calculated interests and penalties until bankruptcy opening.[7]

The advantages of merger or division taxation is many times covered by taxation laws and by many institutes which forbidden some transactions with companies who wants not to pay taxes.

Many times the insolvency companies have administrative claims which can not be paid only through a reorganization plan. The advantage of a reorganization plan is the payment of claims step by step in the reorganization period. In case of bankruptcy the administrative claims are paid after secured claims and employees claims.

So, the bankrupty procedure is considered closed only after the distribution of amounts achieved from the liquidation. The procedure closing judgment is notified to all the participants to the procedure and also to the trade registry office.

The commercial relations are established by the presumption that every trader is capable to pay his debts on time. The trader who stops the payment is entered into bankruptcy[1]. Because of this the insolvency is major incident that gets problems on a company activity.

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[1] Art. 695 Commercial Code

Professor Phd Alexandra Horobet
Lecturer, PhD Cosmin Joldes
Teaching Assistant PhD candidate Sorin Dumitrescu
Academy of Economic Studies Bucharest, Romania

EXCHANGE RATE CONVERGENCE IN CENTRAL AND EASTERN EUROPE: A CLUSTER-BASED APPROACH

Abstract: *The enlargement of the European Union in May 2004, with the accession of ten Central and South-Eastern European countries, out of which eight are former-communist states (The Czech Republic, Hungary, Poland, Estonia, Lithuania, Latvia, Slovakia and Slovenia), followed by a second integration wave on January 1, 2007, when Romania and Bulgaria joined the EU, marks an economic and political experiment that is radically different from all previous EU adhesions. The integration process of in the European Union will impact directly their monetary and financial markets, considering their specific objective of adopting the Euro as common currency. The Euro adoption is by far the greatest challenge these states are facing at present, and the introduction of the Euro as common currency in Slovenia at the beginning of 2007 proves that fulfilling of convergence criteria imposed by the adoption of the European currency is feasible. Our paper analyses the degree of homogeneity degree of exchange rates evolutions in Central and Eastern European countries that joined EU in 2004, based on the hypothesis of eventual Euro adoption and by taking into account their participation in the Exchange Rate Mechanism II. The results indicate that from the exchange rate perspective, the eight countries have entered into a homogeneity and convergence process, the only exceptions being Hungary and Poland. The explanation for this homogeneous behaviour resides, in our opinion, in the macroeconomic convergence process that takes place in all these countries as a result of their accession to EU, as well as in the participation in ERMII for some of these countries' currencies and the preparation for the entrance in ERMII for the rest of them, as a pre-requisite for the eventual adoption of the common currency.*

Key words*: exchange rates, competitiveness, convergence, cluster analysis*

JEL Classification*: F15, F20, F31*

I. Introduction

The enlargement of the European Union in May 2004, with the accession of ten Central and South-Eastern European countries, out of which eight are former-communist states (The Czech Republic, Hungary, Poland, Estonia, Lithuania, Latvia, Slovakia and Slovenia), followed by a second integration wave on January 1, 2007, when Romania and Bulgaria joined the EU, marks an economic and political experiment that is radically different from all previous EU adhesions. The difference between these two integration processes results not only from the diversity of the countries, in terms of culture, population and territorial size, but also from regional macroeconomic particularities. It is obvious that the integration process of Romania and Bulgaria in the European Union will impact directly their monetary and financial markets, considering their specific objective of adopting the Euro as common currency. The adoption of the Euro is by far the greatest challenge these states are facing at present, and the introduction of the Euro as common currency in Slovenia at the beginning of 2007 proves that fulfilling of convergence criteria imposed by the adoption of the European currency is feasible.

The purpose of this research is to analyze the degree of homogeneity of exchange rate evolutions in the Central and Eastern European (CEE) countries that joined the European Union in 2004, starting from the premise that these countries will eventually adopt the common European currency and taking into account their participation in the Exchange Rate Mechanism II (ERMII).

The convergence analysis of exchange rates evolution in the eight former-communist countries that joined the EU in 2004 is based on the exchange rate regimes in force in these states, which are summarized in Table 1.

The diversity of exchange rate regimes in these countries could be explained, on the one hand, by the structural diversity of the group and, on the other hand, by their necessity to control inflation and exchange rates. To illustrate, we note that in the past 10 years, four of the CEE emerging economies transformed their monetary policies by adopting the inflation targeting regime: the Czech Republic in 1998, Poland in 1999, Hungary in 2001 and Romania in 2005. Adopting this monetary framework is strongly connected to the exchange rate regimes used in these countries: independent floating in Poland, managed floating in Czech

Republic and Romania and fixed exchange rate in Hungary. The objective pursued by all these countries is linked to the aspiration of higher stability of internal prices and, implicitly, of exchange rates.

Table 1. Exchange rate regimes in CEE countries

Country	*Currency*	*Exchange rate regime*	*ERMII integration*	*Estimated date for Euro adoption*
Czech Republic	Koruna (CZK)	Traditional administered floating	2007-2008 (E)	2010
Hungary	Forint (HUF)	Exchange rate varies with the Euro within ±15%	2007-2008 (E)	2010
Poland	Zloty (PLZ)	Independent floating	2008 (E)	2010
Slovenia	Tolar (SIT)	Euro	2004	Adopted since 2007
Slovakia	Koruna (SKK)	Managed floating	2006	2009
Latvia	Lats (LVL)	Exchange rate fixed to currency basket	2005	2008
Lithuania	Litas (LTL)	Monetary council	2004	2008
Estonia	Koruna (EEK)	Monetary council	2004	2008
Romania	Leu (RON)	Administered floating	2010-2012 (E)	2012-2014

Source: IMF, ING Romania, European Central Bank, Romanian National Bank

Nonetheless, all these countries will see their currencies replaced by the Euro, sooner or later, but not before their currencies perform for at least two years in the Exchange Rate Mechanism (ERMII). This multilateral exchange rate arrangement, similar to the mechanism which led to the introduction of the Euro (Exchange Rate Mechanism I), was put in place on January 1, 1999, with the purpose of insuring the convergence of the economies that were participating in the system and a smoother adoption of the Euro, by inducing higher stability of exchange rates against the Euro. Participation in ERMII is voluntary for the countries outside the Euro zone; however, because the 2-year minimum period requirement represents one of the convergence criteria imposed for Euro adoption, all countries wishing to replace their national currencies with the Euro are compelled to adhere to this system. Joining the ERMII presupposes the establishment of a fixed exchange rate of the respective currency against the Euro with a fluctuation margin of ±15%. The countries that are currently engaged in ERMII are Denmark (with a lower margin, of only ±2,5%) and Lithuania, Estonia, Latvia and Slovakia (all with a margin of ±15%). Slovenia was part of the system for two years before adopting the Euro on January 1, 2007. As shown in Table 1, a number of countries are expected to join the ERMII in 2008 (The Czech Republic, Hungary, Slovakia and Bulgaria), with Romania following between 2010 and 2012, according to estimates of the Romanian National Bank.

II. Data and research methodology

The convergence analysis is based upon the identification of homogeneous groups formed of the eight countries – Czech Republic, Hungary, Poland, Slovenia, Slovakia, Latvia, Lithuania and Estonia, according to the evolution of the nominal and real exchange rates of their currencies against the first 12 and 25 trading partners, respectively, before and after their accession to the European Union in May 2004. The time frame considered in our analysis covered the fourth quarter in 2000 until the fourth quarter in 2006, and we also split it into two sub-periods, aiming at better taking into account the before and after accession evolutions on the foreign exchange market, as follows: the first sub-period extended between the fourth quarter in 2000 and the first semester in 2004, while the second covered the time between the second semester in 2004 and the fourth semester in 2006. All data were collected from the EUROSTAT database, and we used monthly frequency for the nominal and real exchange rates.

The exchange rates are composite effective nominal and real rates. *The nominal effective exchange rate* (NEER) measures the change in the nominal value of a currency against the currencies of its main trading partners and is computed as a weighted arithmetic average of the bilateral exchange rates of the currency against the trading partners' currencies; the weights are given by the importance of the foreign trade between the country of reference and the respective trading partner in the total volume of the country's foreign trade. An increase of this exchange rate (in reality, it is measured as an index) signals an appreciation or a strengthening of the currency against all the others. The real effective exchange rate (REER) assesses the competitiveness of a country in terms of prices or costs against the competitiveness of its main competitors on foreign markets. The changes in competitiveness are identified by taking into account not only changes in the nominal exchange rate, but also changes at the level of costs and prices in the respective

countries. REER corresponds to NEER deflated by the nominal labour average costs (at economy level) and by the consumer prices (consumer price index/harmonized consumer price index HICP). An increase in REER indicates a decrease of country's competitiveness on foreign markets, while a decrease in REER points toward an increase of competitiveness. The exchange rates used in our analysis were: (1) NEER 12 and REER 12 – they take into account 12 European Union countries (Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, Holland, Austria, Portugal, Finland); (2) NEER 25 and REER 25 – they take into account the 12 above-mentioned countries, as well as Denmark, Sweden, United Kingdom and the 10 countries that joined EU in 2004 (Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia). Double weights in exports' level are used to compute NEER and REER, aiming at properly reflecting not only the competition on the internal markets of the various competitors, but also the competition on export markets.

The research methodology is represented by the cluster analysis, which offers a solution to the general issue of classifying entities (cases) in a number of groups called clusters, in such a manner as to find closer entities from the perspective of used attributes within the cluster, as compared to entities included in another cluster. The goal of such an analysis relies in identifying *natural* clusters depending on a specific internal criterion, without knowing a priori the fitting of entities in the formed clusters. The internal criterion considered in cluster analysis is based on a measure of similarity or closeness between studied entities, while the grouping of entities into clusters is made with respect to two conditions: (1) the similarity between the grouped entities, taking into account the variables considered and (2) the differentiation between the entities included in a cluster and the entities included in other clusters.

The effective use of cluster analysis raises, typically, two issues: the first one refers to the tool used to measure the distance between entities, while the second one refers to the algorithm employed for cluster identification. For what concerns the measurement of the distance between entities or groups of entities (we will denote the entities by *i* and *j*, with coordinates (X_{1i}, X_{2i}) and (X_{1j}, X_{2j}), respectively, depending on the attributes X_1 and X_2 considered in the analysis), cluster analysis use of the following tools: (1) *Euclidian distance* – it measures the distance between points *i* and *j* as the hypotenuses of a triangle they form, using the formula $D(i,j)=\sqrt{(X_{1i}-X_{1j})^2+(X_{2i}-X_{2j})^2}$; (2) *quadratic Euclidian distance* – it is defined as the square of the Euclidian distance, using the formula $D(i,j)=(X_{1i}-X_{1j})^2+(X_{2i}-X_{2j})^2$; and (3) *Manhattan distance* – defined as $D(i,j)=\left|X_{1i}-X_{1j}\right|+\left|X_{2i}-X_{2j}\right|$. Other measures of distance can be employed, such as Cebisev, Minkovski, Canberra, Mahalanobis, Person or Jambu. For all the three measures detailed above, an *i* observation is considered to be closer (more similar) to observation *j* if D(i,j) < D(i,k). Alternatively, weights can be considered, in order to reflect the importance of variables taken into account, with a weighted measure of distance being computed. All distance measures depend on the measurement units of variables X_1 and X_2 and are influenced by the characteristics or variables with high values. Due to this reason, the variables are standardized before starting the cluster analysis, which means data transformation by extracting the average from each value of the variable and dividing the result by the standard deviation of the variable.

For what concerns clustering algorithms, they can be divided in two main categories, depending on their hypotheses and the nature of results. As such, hierarchical and iterative algorithms can be employed – the hierarchical algorithms include aggregation clustering and division clustering, the best known being the single linkage method, the complete linkage method, the centroid method, the average linking method or Ward's method; the iterative clustering algorithms include the k-means method, CLARA algorithm or fuzzy algorithm.

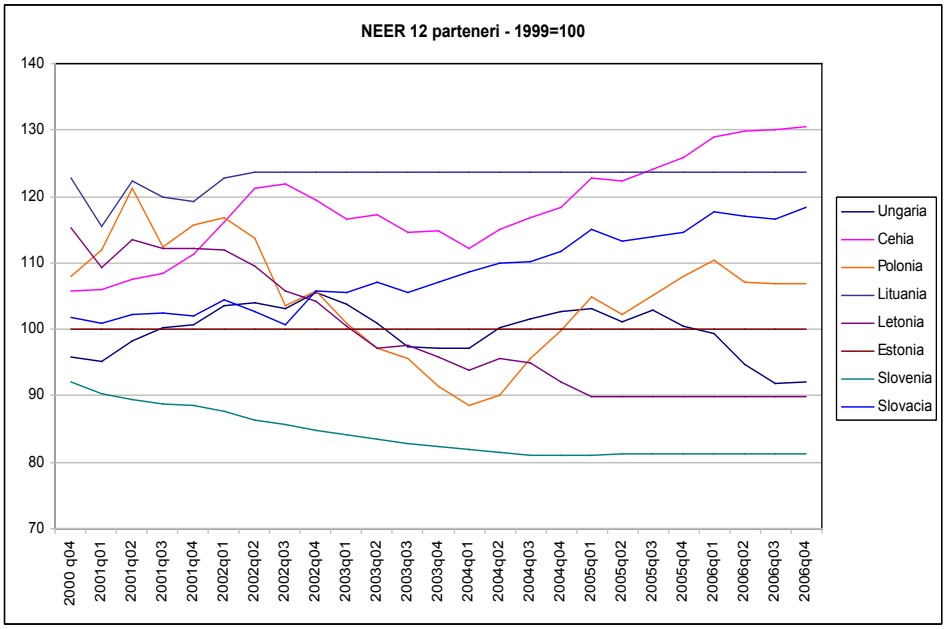
In our research, in order to identify the homogeneity or heterogeneity degree, the eight countries were successively grouped in clusters depending on their nominal and real exchange rates, afterwards. Before applying clustering algorithms, all variables were standardized. The amalgamation techniques used were of a hierarchical type: single linkage and Ward's method, while using Euclidian distances.

III. Nominal exchange rates convergence

The behaviour of the currencies in the panel differs significantly across countries, whether we compute the index in relation to the top 12 commercial partners, or in relation to the top 25 commercial partners. Thus, as shown in Figure 1, between 2000 and 2006, four countries recorded an appreciation of their currencies – The Czech Republic, Lithuania, Slovakia and Poland. The Czech koruna appreciated by 30% from the 1999 level, while the Slovak koruna experienced an 18% increase from 1999. The case of the Lithuanian currency is special, because it had appreciated constantly until Lithuania's accession to the ERMII, and afterwards the exchange rate has been stable, registering an overall appreciation of 23% from 1999. The Latvian currency remained unchanged in nominal terms from 1999, and the other three currencies,

overall, have depreciated, with a steeper decline for the Slovenian currency, which was priced in 2006 at 81,2% of its value in 1999. The evolutions are, by and large, the same, when we switch the referential basis to the fourth trimester of 2000: the Czech koruna and the Hungarian forint have been constantly appreciating, while the Slovenian tolar and the Estonian koruna have depreciated. The evolution of the Polish zloty had ups and downs: after the appreciation trend ended in mid-2002, a period of rapid depreciation followed, which ended in the first trimester of 2004 with the Polish currency reaching a level of 81% its value in Q4, 2000. The decline was followed by a gradual appreciation, and the zloty approached at the end of 2006 the value it had at end of 2000.

Figure 1. Nominal effective exchange rate (NEER 12), 2000-2006



Regarding the evolution of the currencies relative to the main 25 trading partners, the movements confirm, on the whole, the elements observed in our previous analysis, which took into account only the main 12 partners. Out of the eight countries under consideration, three saw their currencies appreciate considerably from 1999 – The Czech Republic by 30%, Slovakia by 16% and Lithuania by 25% - three saw their currencies depreciate from 1999 – Hungary by 9%, Latvia by 10% and Slovenia by approximately 20%. Estonia is the only country in the panel whose currency remained at the 1999 level. In addition, the evolution of the currencies of the eight countries with respect to another referential moment – Q4, year 2000, shows that four currencies appreciated – the Czech koruna, the Slovakian koruna, the Lithuanian litas and the Estonian koruna – and the other four depreciated – the Hungarian forint, the Slovenian tolar and the Polish zloty (the zloty registered a comeback from the second half of 2004, as noted earlier) and the Latvian lats.

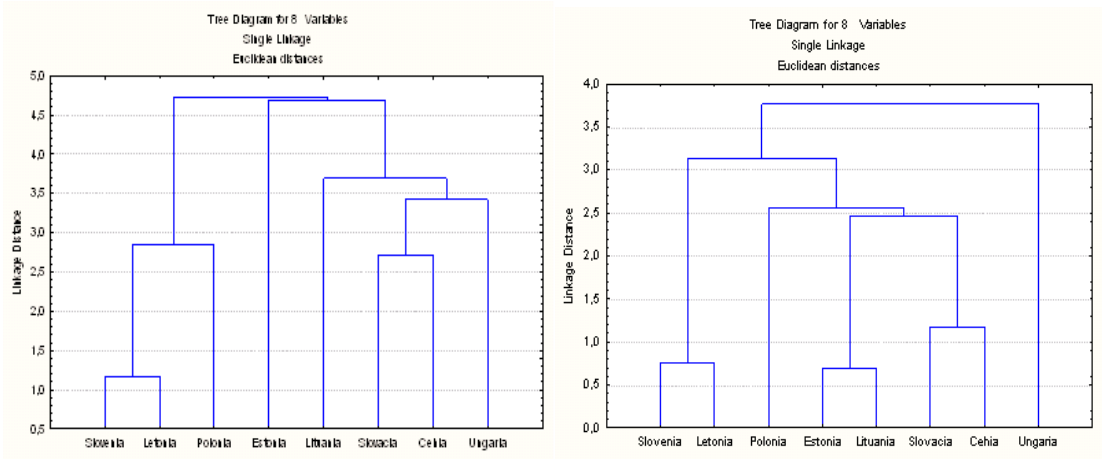
It is reasonable to believe that the evolutions on the foreign exchange market have been affected by the integration of the eight states in the European Union. The impact of the enlargement on the foreign exchange market can be observed by analyzing the homogeneity of the evolutions of these currencies after integration, in comparison with the pre-accession period. Thus, considering a higher homogeneity determined by the presence of strong convergence of the states under consideration after integration, our expectations, based on the results from the application of clustering algorithms, are as follows: we should observe a higher linkage distance between the variables analyzed after integration, as compared with the period before integration, on the one hand, and in forming more homogenous clusters after integration, as compared to the before integration period.

Considering the nominal exchange rate in relation to the first 12 partners (NEER 12), a first important observation is that our expectation regarding the diminishing of the linkage distances between variables is confirmed, irrespective of the aggregation method applied (simple linkage method or the Ward method). Studying the clusters formed by the simple linkage method (see Figure 2a-b), we observe that for the first sub-period (before integration), the minimum linkage distance, associated with the first cluster, equals 1.1728, and in the second sub-period the distance is only 0.6882. Moreover, the maximum linkage distances, where the last variable is added to the previously formed clusters, is 4.726 for the simple linkage method, and lower, only 3.7683, for the second sub-period. Another manner for emphasizing the increase of

homogeneity between the variables included requires the comparison of amplitudes between the two connection distances – maximum and minimum. Thus, for the first sub-period, the difference between the two distances is 3.5533, and in the second sub-period it is 3.0801. These results, obtained using the simple aggregation method, are also confirmed by the Ward method. Before integration, the minimum connection distance between variables is 1.1728, and the maximum distance is 15.3454, while after integration the minimum distance is 0.6882 and the maximum is 10.3683. In terms of differences between the maximum and the minimum distances, for the first sub-period the difference is 14.1727, and for the second sub-period it shrinks to 9.6801, which suggests a higher homogeneity of exchange rate evolutions among countries after integration.

Figure 2. Cluster aggregation using NEER 12, 2000-2006

a. Q4 2000 – Q1 2004 b. Q2 2004 – Q4 2006



Similarly, the homogeneity increase across countries is highlighted by the results dependent upon the nominal exchange rate against the top 25 partners (NEER 25). Thus, the minimum linkage distance from the application of the simple aggregation method is 1.3677 in the first sub-period and decreases to 0.6918 in the second sub-period, while the maximum distance diminishes from 4,9978 in the first sub-period to 4,3686 in the second sub-period. However, the amplitude between the two distances increases slightly from 3.6300 in the first sub-period to 3.6769 in the second sub-period. By applying the Ward method, the minimum linkage distance decreases from 1.3677 in the first sub-period to 0.6912 in the second sub-period, and the maximum linkage distance decreases from 18.0226 to 12.7249 in the second sub-period. The amplitude of the distance increases from 16.6549 to 12.0331, which confirms our previous results recorded for the NEER 12 case.

The formation of clusters before and after the accession reveals interesting facts for the exchange rates evolution homogeneity analysis. By observing the formation of clusters prior and subsequent to the integration dependent upon the NEER 12 and by applying the simple aggregation method, we detect the presence of a strong cluster between The Czech Republic and Slovakia, formed at the second iteration in the first sub-period and at the third iteration in the second sub-period, while the connection distance between the two variables becomes significantly shorter (from 2.7137 to 1.1737). The Ward method, better suited for determining the homogeneity degree between variables, identifies the same cluster formed by the Czech Republic and Slovakia in the two sub-periods: in the first sub-period it appears at the second iteration at a distance of 2.7137, and in the second sub-period it can be found at the third iteration, at a distance of 1.1737. These results indicate a similar evolution of the currencies of the two countries, which is unsurprising, considering their long common history and the identical exchange rate regime effective in both countries. The second cluster was detected using both aggregation methods. Comprising Slovenia and Latvia, it was formed before the integration time and persists to the end of the period. When using the simple linkage method, this cluster appears at the first iteration (with a distance of 1.1728) in the first sub-period and at the second iteration (with a distance of 0.7580) in the second sub-period. For the Ward method, the Slovenia-Latvia cluster occurs at the first iteration in the first sub-period (with a distance between variables of 1.1728) and at the second iteration in the second sub-period (with a distance of 0.7580). The reduction of the connection distance between Latvia and Slovenia implies an increase of homogeneity and a closer relationship of the two countries from an exchange rate perspective, which could be explained by the fact that the two currencies entered the ERMII only one year apart (the Slovenian tolar was included in the

ERMII in 2004, and the Latvian lats in 2005). The cluster identified in the second sub-period using both aggregation methods entails an accentuation of the foreign exchange convergence; this is the cluster formed by Lithuania and Estonia, which was the first one revealed. The explanation for this peculiar finding resides in the fact that the two currencies were pegged to the ERMII mechanism at the same time, in 2004, which led to a fixed exchange rate against the Euro with a low margin for both currencies, taking into account that the countries forming the Euro zone are the main trading partners of these two Baltic states. Besides the two clusters, the rest of the countries show diverse behaviors. Thus, Poland appears to lie closer to the Latvia-Slovenia cluster in the first sub-period, but in the second sub-period it appears to be more homogeneous with the Lithuania-Estonia cluster. Hungary displays the most divergent behavior, because it enters the cluster formation only at the fourth iteration in the first sub-period and at the sixth (by simple linkage method) or the seventh (by Ward method) iteration in the second sub-period. This implies, at least from a foreign exchange perspective, that Hungary has a long way to go in order to reach convergence, conclusion supported by the postponement of its ERMII accession. Another confirmation of the homogeneity increase across the countries under consideration could be observed in the structure of the groups formed in the first sub-period, which is altered in the second sub-period: in the first sub-period, using both aggregation methods, we can identify two strong clusters (Latvia-Slovenia and The Czech Republic-Slovakia), while in the second sub-period there are three such clusters (Lithuania-Estonia, Latvia-Slovenia and The Czech Republic-Slovakia).

Repeating the analysis by taking into consideration the NEER 25 leads to conclusions that are less evident from the perspective of foreign exchange market evolutions homogeneity. The key element appears to be the presence of a strong cluster, identified at the first iteration using both aggregation methods and in both sub-periods, which is formed by Latvia and Slovenia. Moreover, the linkage distance between the two variables is significantly diminished in the second period, from 1.3677 to 0.69182, which indicates a stronger convergence of these two countries from a foreign exchange market perspective. The second robust cluster formed in the first sub-period – Estonia-Slovakia –, identified using both aggregation methods at the second iteration, is destroyed in the second sub-period, Estonia being more homogenous with Lithuania after integration. This particularity could be explained by the adherence of both countries to the ERMII in 2004, when the Slovak koruna remained outside the exchange rate mechanism while Slovakia maintained its managed floating regime effective in the first sub-period. Another notable aspect is the nearing between The Czech Republic and Slovakia after integration, and also their preservation in the same, larger, cluster, with the same partners for the two sub-periods (Lithuania and Estonia).

IV. Real exchange rate convergence

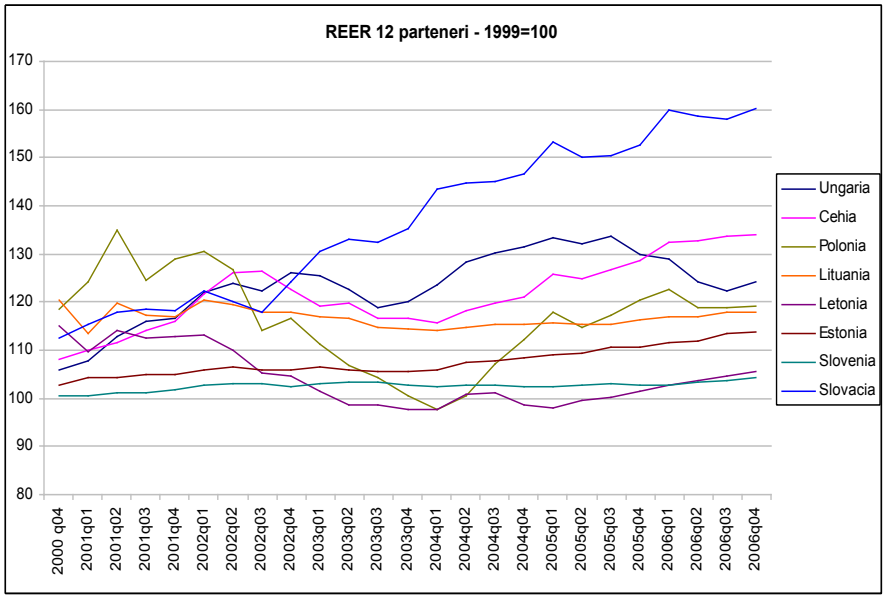
Analogous to concerns with the effects of inflation in the domestic setting on nominal versus real price levels, the effects of relative inflation rates between the home economy and the foreign economy matter for the exchange rate between the two countries. When the foreign inflation is higher and the home inflation does not change, the foreign currency would be expected to depreciate against home currency. Although the foreign currency will cost less now in home currency terms, this does not necessarily imply that the real value of goods and services purchases across borders decreased. The explanation resides in the fact that the increase in foreign prices foe goods and services has exactly offset the decline in the value of the foreign currency, given higher inflation rates abroad than at home. Another way of expressing this phenomenon is to say that purchasing power remains the same in the two countries. In this case, while the foreign currency has undergone a nominal depreciation, it has not undergone a real depreciation. Therefore, what eventually matters for purchasing power between any two countries is not the simple change in the nominal exchange rate, but the change in nominal rates after adjustments for the changes in the relative inflation rates between the two countries have been made. The *real exchange rate* can be defined as the nominal exchange rate that takes into account the inflation differentials among the countries. When a currency appreciates in real terms, its purchasing power abroad has increased; when it depreciates in real terms, its purchasing power abroad has decreased.

Taking into consideration the year 1999 and using the real composite exchange rate that takes into account the inflation rates of the first 12 commercial partners, we observe, in the next graph, that the currencies of all the eight countries analysed recorded real appreciations during the 2000-2006 period, the highest appreciation being in the case of the Slovak currency (approximately 60%) and the lowest in the case of the Slovenian currency (only 4%).

By changing the moment of reference – this time it is the last quarter of year 2000 – the evolutions of these eight currencies in real terms are different, in comparison with year 1999. In these circumstances, the currencies of Slovakia, Hungary, Czech Republic, Estonia and Slovenia have appreciated in real terms, in comparison with the end of 2000, while Latvia and Lithuania's currencies have depreciated in real terms.

Analyzing these evolutions from the competiveness point of view, it results that, within this period, Slovakia, Hungary, Czech Republic, Estonia and Slovenia have reduced slowly their competitiveness against the twelve trade partners, while Latvia and Lithuania have seen their competiveness increase. The evolution of Poland's currency within this period is an interesting one, and different than any other currency of the eight analyzed: the Polish currency depreciated in real terms by the beginning of 2004. After this moment the currency slowly started to appreciate in real terms. By the end of 2006, the real exchange rate had practically the same value as at the end of year 2000. This indicates that the Polish economy lost part of the gained competiveness till 2004, being closer and closer from other economies of the region.

Figure 3. Real effective exchange rates (REER12), 2000-2006



The real exchange risk analysis by taking into account 25 trade partners confirms the above conclusions. Under these circumstances, comparing with year 1999, all these eight considered currencies appreciated in real terms. This indicates a decrease of their competiveness degree. The higher appreciation, in real terms, was registered by the Slovak koruna, while the lower appreciation was recorded by the Slovenian currency. Comparing with the fourth quarter in 2000, the evolutions are similar: Latvia is the only country that succeeded to increase its competiveness. All the others, with currencies being within an obvious process of appreciation in real terms, were decreasing their competiveness on foreign markets[1].

The cluster analysis that takes into account the real exchange rate offers supplementary interesting indications, as far as the evolution of these eight economies is concerned. Taking into consideration REER 12 (see Figure 4a-b), we may observe a diminishment of the minimum and maximum linkage distances between cases before and after integration: the lowest distance is 1.6886 in the first sub-period and 0.9585 in the second sub period. After the application of the Ward method we may observe the reduction of the minimum linkage distance from 1.6886 to 0.9585 - from one sub-period to the other - and the reduction of the minimum linkage distance from 17.4296 to 9.1975. Consequently, the distance amplitude reduces from 3.9139 to 1.8144 when the simple linkage method is used and from 15.7410 to 8.2390 when the Ward method is applied. This indicates an increase of the homogeneity of foreign exchange evolutions, as a reflection of the competiveness in the region.

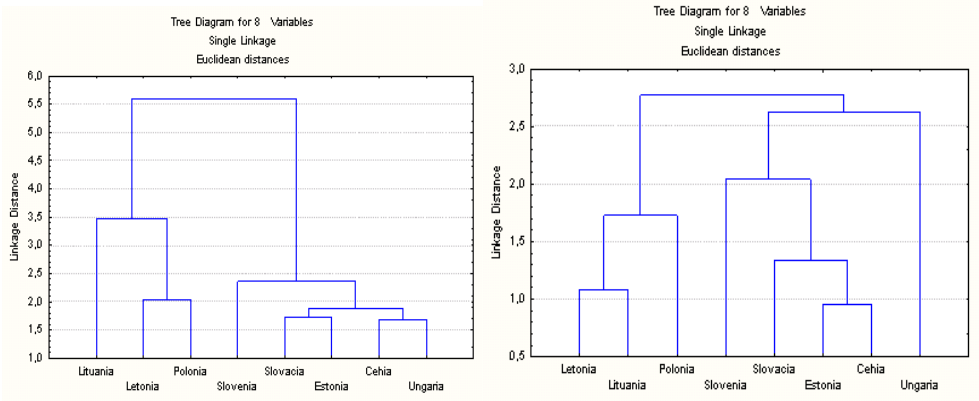
Concerning the formation of homogeneous groups of countries, both methods indicate the presence of two strong clusters before integration: at the first iteration the cluster of Hungary - Czech Republic is identified (with a linkage distance between its components of 1.6886 in the case of both methods), while at the second iteration the cluster Estonia – Slovakia is identified (with a linkage distance between its components of 1.7245 in the case of both methods). The Ward method also determines the presence of a third strong cluster, identified at the third iteration, and formed between Poland and Latvia (this is identified only in the case of the forth iteration when the simple linkage distance method is being used). None of the previous formed clusters exists after integration. In the after-integration period, the most homogeneous one is the cluster Czech Republic – Estonia (cluster indentified at the first iteration by both methods, with a

[1] Due to lack of data, Lithuania was not included in the analysis using REER25.

distance between components of 0.9585), followed by Lithuania and Latvia (cluster identified at the second iteration, with a distance of 1.0820 by both methods). The country that enters the latest in the clustering algorithm is Poland in the first sub-period, as indicated by the results of the single linkage method (at the fourth iteration) and Hungary in the first sub period by using the Ward method (at the fourth iteration), while both methods indicate Hungary as being the least homogeneous country after the integration.

Figure 4. Cluster aggregation using REER 12, 2000-2006

a. Q4 2000 – Q1 2004 b. Q2 2004 – Q4 2006



When REER 25 is used, the conclusions that we may draw are similar to the previously identified ones, as the homogeneity of these eight countries increases, being emphasized by the reduction of the minimum and the maximum linkage distances. In these circumstances, when the single linkage method is applied, the minimum linkage distance decreases from 1.3730 in the first sub-period to 0.97171 in the second sub-period, while the maximum linkage distance declines from 6.2286 to 2.9805 in the second sub period. The Ward method also indicates a decrease of both distances: the minimum from 1.3730 during the first sub-period to 0.9171 in the second sub-period, and the maximum from 16.4527 to 6.7985. As such, the distances range declines, which suggests an increase in the homogeneity between the considered countries and economies.

As in the case of REER12, the two methods indicate the presence of two strong cluster before integration: the first one is formed between Estonia and Slovakia (at the first iteration with a linkage distance of 1.3730 in both methods), and the second one involves Hungary and Czech Republic (at the second iteration in both methods, with a distance of 1.6528. Also similar to the previous results, these clusters are destroyed in the post-integration period, during this time the strongest clusters and, consequently, the closest countries from the exchange rate evolution perspective being Czech Republic and Estonia (first iteration), accompanied by Slovakia (second iteration). Poland and Hungary are, again, the most heterogeneous countries, in both sub-periods.

V. Concluding remarks

The objective of our research was to analyse the degree of homogeneity of the currencies evolutions in the case of 8 Central and Eastern countries that became part of the European Union in 2004 – Czech Republic, Hungary, Poland, Slovakia, Latvia, Lithuania and Estonia, taking into account their premises of adopting EURO and their participation in the European Exchange Mechanism II. The convergence analysis involved the identification of similar groups, as much as possible, formed by these eight countries according to the evolution of the nominal and real exchange rates of their currencies in comparison with the first 12 and 25 trade partners, respectively, before and after the moment of entering EU (May 2004). Our results reveal that from the exchange rate point of view, these eight countries entered in a process of homogenisation and convergence, Hungary and Poland, being, maybe, the only exceptions. The main explanation for this homogeneous behavior, in our opinion, is related to the macroeconomic convergence process that these countries are part of, as a result of the integration in the European Union. At the same time, the entrance of some of these currencies in ERMII, as a condition of a future EURO adoption, may provide a useful explanation for these evolutions. For what concerns the business environment risks, a higher similarity of foreign exchange evolutions indicates a decrease of the risk in the case of these countries, considered as a group, along with the diminishment of exchange rate risk, generated by the currencies adoption of a fixes exchange rate regime.

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Andreea Ignat
"Dimitrie Cantemir" University of Târgu Mureş, Romania

THE UTILIZATION OF THE BILL OF EXCHANGE AND THE PROMISSORY NOTE AS PART AS THE SPECIAL FORMS OF FINANCE: FORFETING, FACTORING, LEASING

Abstract: *Throught define the bill of exchange and the promissory note are titles of commercial credits. It is important to mention the fact that thay appeared in practice as instruments of commercial credits.*

Moreover, due the law number 83/1994, about the bill of exchange and the promissory note, these paper of value are besides titles of commercial credits, modality to guarantee the pay of internal and external price too, the guarantee being insured by the quality of these titles of credits to be the titles rightful executories. So due to 53, 54 and 57 article of law nr. 58/1934 about the bill of exchange and the promissory note reviset and completed by the law nr. 83/1994 these titles have the value of rightful executory titles for capital and accessories.

Due to this features, the operations about the bill of exchange and the promissory note are characterised throught an elevate degre of quarantee offered by the cambial device, fact for wich the most banks consider these titles as being the main titles of quarantee and use them also in special financing forms which do not stipulate in their technical force norms that contain the legal conditions for the scroll operations, the use of these instruments.

Key words: *bill of exchange, promissory note, special forms of finance, forfeting, factoring, leasing*

The selling of goods by credit is a primordial condition for the promotion of the exports, and the extension of the term of the credit a way to increase of the competitive the of selling goods.

The newest conditions for the promotion of exports can not be insured neither by the purveyors through their own forces, nor by the commercial banks, which cann't assure only the short-term financing, in order not to risk to reach to delicate financier situations. Indeed, by obteining the means for credit through mobilizationof the temporary free availabilities (the deposits made in principle at sight and can be retired anytime by the deponents), the commercial banks can not utilise them without bareback risks, only for the covering needs of money, all provisionally.

In order to avoid these dismissions, the practise of international commercial finantiation, has known a permanence growth, as, together with the commercial techniques of credit banking become "classic", have appeared and are freacvently utilized new techniques of finantiations such as: factoring, leasing, forfeiting, outwards frame checked up by states, unreeled by specialized financial societes and which have to the base technical norms in force, in which are stipulated the legally conditions for the scroll of operations.

Although in the technical norms of factoring and leasing are not stipulated the utilization of the bill of exchange and the promissory note, due to the fact that these titles of credits are through the law titles rightful executories both the commercial banks and the pecializated financial institutions, utilize them more frequently in quality of instruments of avouch.

In essence, the promissory note and the bill of exchange are commercial credit titles which offer the beneficiary the right to a sum of money, representing wares sold on credit. That's why they are included in trade effect category, promissory note and bill of exchange being "improved credit instruments, respectively, complete and formal credit titles".

It is important to mention the fact that they such have appeared in the practical, as instruments of commercial credits.

However, thanks to the fact that the operations with promissory notes and bill of exchanges are characterized in a high extent guarantee offered by the cambial mechanism, in Romania they are not used mainly in the quality for which they were created, but as instruments of avouch. More banks consider these titles as being mainly titles of guarantee.

According to the law no. 83/1994 concerning the promissory note and the bill of exchange, these valuable papers are guarantee modalities of internal and external price payment, beside the negotiable credit titles, the guarantee being assured by the quality of these credit titles, being the rightful executorial titles.

This means that the forced execution of the debtor does not need to be obtained by court ruling, but after the creditor's submission of his claim; without any further formalities, the debtor is executed by virtue of the title he has signed.

Besides this legal quality for promissory note and bill of exchange there were established a series of operations which increases their guarantee feature.

First of all, the drawer is obliged to accept the promissory note at presentation (if not, they will appeal to the unaccepted protest) and from the moment of acceptance the drawer becomes the main debtor of paying obligation.

Secondly, promissory note and bill to exchange can be bill guaranteed by a third person which may be an economical entity or a commercial bank with recognized bonity and which assumes the responsibility of paying instead of debtor at settling day, if this one doesn't pay.

In the case in which the payment obligation can not be realized in none of the ways previously presented situations it can be appealed the non- payment protest.

The bill of exchange can be described as a loan note under personal signature which connects two people: the subscriber/issuer and the user. The title is created by the subscriber, a legal or physical person who has the capacity of a debtor, who thus binds himself to pay a determined amount upon presentation or upon a certain term, to another person, called user, who has the capacity of creditor or at his order.

The promissory note can be defined as a credit title which connects three persons: drawer, shirred, beneficiary. The title is created by the drawer who is the issuer as a creditor of shirred and beneficiary's debtor.

The promissory note is an unconditioned written order given by creditor , named drawer, to his debtor , named shirred , to pay at sight or at a certain term the sum of money to drawer itself or to a third person , named beneficiary as well as to their order**.**

The promissory note and the bill of exchange make the guarantee of paying obligation , resulting from selling goods, in the mean time they represent the materialization of debtors money debts which becomes independent related to the obligation from the commercial contract.

Among the special forms of finance just one stipulate in her technical norms the utilization of the bill of exchange and the promissory note, namely the forfaiting.

Forfeiting consists in buying without the right of regress about sellers debts, before the settling day by the commercial banks or other commercial institution named lump, of the bill of exchanges and promissory note, emitted on mid or long-term hold by those, against on a tax of forfeiting which usually bases on tax offered by the Intern- Bank London (LIBOR) on the period of trust.

The term without regress means that all the risks bound to the encashment of debt on settling day will be assumed by the financier.

Forfait financing is the operation through which an exporter or an executor of services to extern sell his debts in foreign currency materialized in draft or payable bill to order resulted from a buying-selling international contract, which he has with a client or a beneficiary from abroad, to a banking society or specialized financial institution, named forfeited versus a forfeited cost, before getting these to the settling day, but not less than 30 days before the term. The value of a transaction can not be less than 50.000euro or 50.000$. Forfait financing is a financial form of invested goods, for a long term, usually for 5 years, period which is established by economics life period of the financed goods.

But due to the long settling day, brokers don't make one's option for this form of finances, but many times they appeal for factoring.

The factoring is the operation which assures the financing, the administration of debt materialized in invoices and/or the collection of debt to term and/or the protection taken against failure to pay, performed by a bank or a financial institution specialized, named factor, based on contract finished with a part named adhesive part, purveyor of goods or performer of services.

In comparison with the forfeiting which is a unconventionally form of finance, newer and more modern, which appeared recently due to the necessity that the purveyors to offer credits for longer periods and in grater amounts.

In our days the factoring services entered in almoust evry bank offer from Romania.

In the case contracts of trust, can appear the risk of his insolvability or the risk of trust. At this form of risk is submissive the anchor ring, when the customer after receiving the goods can't or doesn't want to pay it at the settling day. For prevention and avoiding the risk of insolvability the exporter can transfer this risk about the factoring society.

Through the factoring operation the adherent submit the factors, with the title of selling or real mobiliar guaranty, the debts appeared from selling of goods or performing of services.

With other words, the factoring is the selling operation of factors by a society supplying goods or performing services, named forwards adhesive, to a banking company or financier institution, named factor.

The factor finances the adhesive on the strength of the invoices received from this, against of an Agio, following that at the term to retrieve the debts from the adherent's customers.

Buying the debts by the factor generated by the invoices is performed to the nominal value from which is diminished an interest named Agio equal with the interest named LIBOR+ p.p. on year proportional with the period until the encashment of debts.

Opposed to the forfeiting which is actually a discounting operation without recourse of the bills of exchange and the promissory notes on middle –term , the factoring is "an instrument of mobilizes of commercial debts on short term which contrary to discount doesn't require the issue of bills of exchange or promissory notes"[1].

Although both in the uniform rules used-up internationally and in the technical targets in force emitted by the commercial banks, in which are stipulated the legal conditions for the scroll operations of factoring are not foresight the utilization the slip to order, in the practice of many Romanian commercial banks, an adherent can not solicit a credit of factoring without bareback avouch through the issuance of a slip to order.

Această măsură este impusă de bancă pentru a avea o mai marea siguranță în recuperarea creanței la scadență, deoarece comparativ cu facturile care sunt niște simple documente ce atestă vânzarea, biletul la ordin este un titlu executoriu de drept. Aceasta înseamnă că, nu trebuie obținut pe cale judecătorească dreptul de executare silită a debitorului, ci după înaintarea protestului de către creditor, fără formalități complicate, se trece la executarea silită a debitorului chiar pe baza titlului semnat de el.

This measure is taxed by the bank in order to have more safety in the recovery of the book debt to term, because comparatively with the invoices that are some simple documents that certify the sale, the bill of exchange and the promissory note is a right of execution. This means that the forced execution of the debtor does not need to be obtained by court ruling, but after the creditor's submission of his claim; without any further formalities, the debtor is executed by virtue of the title he has signed.

The issue of a slip to order with the nominal value equal with the value of the book debt mobilized by factor, we haven't yet verified if it is compulsory in the practice of all commercial banks from Romania which scrolls factoring operations, but it is a condition required by the B.C.R, branch Mures.

While the trust can offer only financing, the factoring presupposes an ensemble of services[2].

- Financing. The financed sum by BCR Mures can be max. 90% of the nominal value of invoices and up to 100% with the bill of "Directiei Afaceri Documentare Finantarea Comertului" from which the factors commissions are substracted, the rest of sum being issued in the moment of encashment of invoices by factor.
- The max. period of financing is 180days , depending on the remained time.
- Pursuit and administration. All debts are made evident in bookkeeping , the service of Administration supposes the financial administration taken over by the factoring , the separate reflection invoices which surpass the ceiling if risked of failure to pay, reporting invoices founded out in clearance sale to end of each month
- The collection of debt at selling day , the report in written form on adhesive about each case of refusal of flat of a debtor , the caveat which debtors don't respect the selling day.
- The protection against the risk of failure to pay through covering by the factor the equivalent of 10% remaining of uncashed , in term of 120 days from the selling day of debt, in case of risk appearance.

This multiple advantages which permit merchants to focus on what they know better to do :promotion and selling of products.

An another special form of finance which doesn't stipulate in its mechanism of the utilization of the bill of exchange and the slip to order, but in which, in practice these instruments are frequently founded, is the leasing.

Many more leasing companies require from their customers the issuance of the bills of exchange or the promissory notes as instruments of payment or of avouch.

The leasing is the operation by which a part, respectively a leasing company named lessor or landlord, remit to the other part named lessee or tenant, against a periodical pay, named installments of leasing, the right of possession and use of a good whose owner is, for a determinate period of time.

1 D. Putz, Le factoring, service complet ou partiel, Etudes economiques, nr. 147/148, 1970, pag. 283

2 Ilie Mihai, (2003), Tehnica şi managementul operațiunilor bancare, Editura Expert, pag. 156

For this purpose, the owner is called the lessor or landlord, and the other person is called the lessee or tenant, and the rights to possess and control the land are exchanged for some payment (called consideration in legal English), usually a monthly rent.

The bills of exchange and the promissory notes represent a way of payment by which the monger bank is desemnated to put at the disposal to the leasing society a **fonduri banesti** with a certain value.

Therefore, in the case in which in the lesee refuses the pay, the society of leasing, could demande from his bank to raise and to put at command from the account of the user, the value of the payment through these instruments.

So, the rights of the lessor debts will be generated by a cambial comercial book debt, folowing to receive the payment of installments at term of paying of the promissory notes and the bill of exchange and the obligation of lessee to pay the rent in time will create a cambial comercial debt.

In the practice of a leasing companies in the frame of avouch of granted the leasing, the companies of leasing can ask to his lessee to guaranty the payment of installments, interests and commissions through the issuarance of some bills of exchange or the promissory notes too, having the terms for the usances of the rent, titles which by-pathes endorsement in the favour of the lessor and which are kaped as gage.

The titles will be used by the lessor just in case of non payment of a rent in time. Other companies use bills of exchange or the promissory notes only if they were not payed during a period of three month the afferent rent and only for the remained difference of the pay.

From our practice we observed that some leasing companies make their choice just for the utilization of the bills of exchange, while others require just promissory notes.

As I mentioned before, the lessor can demand the lessee to avouch the rents of leasing and residual value through slips to order. The number of the slips to order will be the number of rents in the established quantum in the term level plus an additional bill of exchange in proportions of 10% from the initial value that represents the sum of the accessories obligations (incident to interests book debts and finicality, interests to the interest, penalitys for the latest, provizioane, taxes, speze and expenditures).

The terms written down in the bills of exchange will be established according to the paying day established in the term level plan to which a period of 21 working days is added term starting with the next day from the day which represents the term pay established in the term level plan.

In the case of finance of more categories of good, the sum written down in each bill of exchange will be If the lessee honours in time the payment of installment of leasing for which was emited one of the bill of exchange, the lessor will give back the bill of exchange emited for stipendiary rate.

If the lessee honours in time the payment of rate of leasing for which was emitted one of the bill of exchange, the lessor will give back the bill of exchange emitted for stipendiary rate.

The lessee aknowledges and understands that the bills of exchange are emitted just for the guarantee for the pay of the rates of leasing to whole value and to the adequate terms in the contract and that the recovery in this way by the locator of the equivalent value of the rates of leasing debts doesn't absolve the lesseer to fulfil the other contractual bonds assumed.

The lessor will hand out the bill of exchange to the roomer, to his solicitation, but not earlier 30 days after cessation of the contract. The additional bill of exchange foreseed will be freed only after the achievement of all the bonds of the user which result from this contract. The falling book debts should be compensated by the roomer only when the book debt to compensate the user is considerated sure, is recognized or isn't contested by the lessor.

If the locator finished more contracts with the same roomers and one or more contracts expires ahead of schedule, the locator has the right to compensate the possible established surplus with the remanent book debts.

Although the bill of exchange is not so used-up in Romania, there are leasing societies which made their choice for using this instrument of credit, of pay and of avouch.

For example, the „MAIB-Leasing" S.A.Company in its activity operates only with bill of exchange in their quality as instruments of paying.

The companionship emits bills of exchange for the payment jobs granted and goods obtained. For the development in better conditions of the process of issue, circulation and pay of the bills of exchange by the company, this regulated its own Regulation about the bills of exchange, approved by the Council of the Society at 13. 06. 2006 used alongside the law about the bill of exchange and thepromissory note.

At the solicitation of the holder beneficiary of the bill of exchange to receive the payment of the bill of exchange before the leakage of the circulation term established in it, the Company is compeled in the established conditions by the regulation mentioned before, to receive the bills of exchange toward payment and to pay them.

Sequence in-sequence their, the companies of leasing, respectively the locators need sources of finance for obtaining the goods that follow to be rented then in system of leasing. Due to penetration on the community sale, the Romanian transportators were obliged to renew and to enlarge the self park to outfaced the continuously growth of the volume of the merchandise and travels, reason for which practical took with assaults the companies of leasing.

In order to outfaced to all the growing demands, the companies of leasing need to have access as quick as possible and in more flexible conditions to finance and therefore appeal mainly to the commercial banks then to shareholders, to the funds of investments and to the broadcast of debentures in order of the attraction of funds.

In order to help the leasing companies, two Romanian banks created and developed special products fated to support the activity of leasing. These are BCR and CHECK.

As methods of avouch, BCR solicits the setting-up of mortgages about goods which do the object of the contracts of leasing finances by the bank, to assignment the insurance policies of these and after case, can constitute assignments of book debt about the laws of cash resulted from the contracts of leasing. Besides the methods of avouch demanded by BCR, the CHECKS solicits in plus from the companies of leasing the issuance of bill of exchange in favour of bank for whole value of the trust.

We can draw the conclusion that in Romania the bill of exchange and the promissory note are not use mostly in the quality for which were created namely as the titles of commercial trusts. They are emitted to ensure the most varied forms of credit and of finance of the internal and external trade.

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Professor Ph.D Livia Ilie
Lecturer Ph.D. student Lucian Belaşcu
„Lucian Blaga" University of Sibiu, Romania

FUNDAMENTALS AND EMOTIONS IN CAPITAL MARKETS

Abstract: *Economists often talk about capital markets' efficiency. They refer to the fact that investors have access to information and that relevant information is already reflected in the stock prices. Financial securities are fairly evaluated in efficient capital markets and offer sufficient returns to compensate for the risk investors bear. No institution created by human beings is perfect and no financial market is perfect. But financial managers must assume the Efficient Market Hypothesis and then look to find the inefficiencies and imperfections in the market in order to create valuable financing strategies. This paper aims to present the rational and irrational components of capital market behavior.*

Key words: *rational expectations, market efficiency, behaviorism, market anomalies*

JEL Classification: *D53, D8, G14*

1. About The Theory of Rational Expectations

Evaluating the stock prices depends on people's expectations, mostly in what concerns the cash flows. It is difficult to imagine an economic activity in which expectations are not playing an important role. That's why this paper starts by examining how expectations are formed? The Theory of Rational Expectations is the most used theory to describe how expectations are formed in an economy.

In the '50s and '60s economists were considering that expectations are formed only based on experience. This perspective on expectations, known as *adaptive expectations*, says that changes in expectations are appearing slowly over time, as past information is changed. But people are forming their expectations not only based on past information.

John Muth[1] developed an alternate theory of expectations, known as the ***theory of rational expectations***, that can be formulated as follows: **expectations are identical with the optimal forecasts (the best approximation of the future) using all available information**. Even if a rational expectation is equal to the optimal forecast using all the available information, a prediction based on it is not always perfect.

There are two reasons that explain why an expectation may be not rational:

1. People can be conscious of the existence of all information, but to find it there is need for too much effort in order to make the best approximation using their expectations.
2. People may be not conscious about some relevant information, so that their approximation about the future is not perfect.

It is important to recognize that, if an additional factor is important, but the information related to it is not available, the expectations that are not taking into account this factor may be still rational.

In financial markets there is a strong motivation to equal expectations with the optimal predictions on the future. In these markets, those that have better predictions on the future are becoming rich.

The application of the theory of rational expectations to financial markets is very useful and is known as the Efficient Market Hypothesis or the Efficient Capital Markets.

The theory of rational expectations is directing us at two common sense implications in what concerns the formation of expectations, very important in analyzing the economy as a whole:

- If there is a change in the way a variable is modified, then there will be a change also in the way in which expectations regarding that variable are formed.
- Errors in forecasting expectations are in average zero and can not be predicted in advance.

As the monetary economists developed the theory of efficient expectations, the financial economists developed a parallel theory of how expectations are created in financial markets. The conclusion is the same: expectations in financial markets are equal to the optimal forecasts using all available information. Even if the financial economists gave a different name to the theory – Efficient Market Hypothesis – it is the application of the theory of rational expectations to stock valuation.

[1] Muth, J., *Rational Expectations and the Theory of Price Movements*, Econometrica 29, 1961

2. The Efficient Market Hypothesis

The efficient capital markets are those in which the current market prices incorporate the available information that means that current prices reflect the present value of securities and is impossible to obtain excess profits having only public information.

This concept has profound implications for the financial management while efficient markets wash out many of the company's strategies that can create value. In an efficient market, financial managers can not time their security issues, the issue of additional shares will not depress the price, and the price of securities will be not influenced by the accounting methods.

The theory of efficient market directs to the idea that managers can not create value by cheating investors. This is very important because managers should create value using other methods, maybe more difficult. The efficient market hypothesis has implications also for the investors. Because the information is reflected immediately in the price, investors should not expect abnormal returns. Obtaining the information only in the moment when it becomes public brings no advantage to the investor. The price is adjusted immediately, and the investor has no possibility to use the information in his advantage.

Some are trying their entire carrier to select those securities that will outperform the market average. There is an impressive amount of information to analyze a company and the way their shares performed: the evolution of dividends and stock prices, profits, debts, taxes, market share, new investments, a.s.o. If somebody knows more than anybody else in the market the situation of a company, than this person can benefit by investing when there are good news or by selling when there are bad news. More, such a person can use the information by selling it.

The consequence of all the analysis of the available information studied and used in order to obtain profit by transacting on the capital market is that the capital market becomes more efficient.

A market is efficient when stock prices incorporate information. In an efficient market, any information can be incorporated in the price immediately: the price is adjusted immediately at fair value. If there are necessary several days to have the price that reflects fairly the information, the market is inefficient and investors may gain abnormal returns by speculating any delay. In reality some information may affect the price sooner or later.

Researchers classify information in three categories: information related to past prices and volumes, public information and all information (public and private). The effect of these three categories of information over the stock prices is reflected in the three levels of market efficiency:

- *Weak-form efficient market*. A capital market is considered to be weak-form efficient when stock prices incorporate the past information. If this form is present, technical analysis is useless. This is the weakest form that we expect from a capital market. It is useless to analyze past prices and volumes to predict the future. This information is already reflected in the stock price.
- *Semi strong-form efficient market*. A semi strong-form efficient market is one in which prices reflect the available public information. In this case, fundamental analysis is useless. It is impossible to obtain abnormal returns using only public information.
- *Strong-form efficient market*. Prices reflect all public and private information. Neither the persons that have inside information can use it to transact on the capital market and to make abnormal returns. In functional markets there are laws that forbid to insiders to transact before announcing their intention.

The empirical evidence proves the existence of semi strong form of market efficiency. What the efficient market hypothesis states is that, **in average**, managers are not capable to obtain abnormal returns, in excess of the market returns.

3. Evidence and anomalies of the Efficient Market Hypothesis

At the beginning evidence was favorable to the efficient capital market hypothesis, but in the last years a more profound analysis suggests that the hypothesis is not always correct. In this respect, here is some **evidence in favor of market efficiency**:

- **Performance of investment analysts and mutual funds**. An implication of the efficient market hypothesis is that we cannot expect abnormal returns (above the equilibrium market return) by buying and selling securities. One cannot beat the market! By analyzing the performance of investment analysts and mutual funds we can identify the consistence of efficient market hypothesis. The fact that someone obtained a very good performance in the past is not certifying that he/she will have a similar one in the future. Some are lucky, some not. Being lucky doesn't mean that a forecaster is able to beat the market.
- **Is stock price reflecting the available public information?** The efficient market hypothesis says yes. If the information is already public, a positive announcement about a company will no more increase its stock price. The information is already reflected in the price. Early empirical evidence confirmed also

this conclusion. Announcements of favorable earnings are not determining, in average, the increase of the stock price.

- **Technical analysis.** The efficient market hypothesis suggests that technical analysis is useless. Past information related to stock prices cannot predict future changes. Technical analysis that is based on such information cannot anticipate successfully changes in stock prices.
- **Random walk behavior of stock prices.** The efficient market hypothesis implies that stock prices should follow a random walk, so future changes in the stock prices should be unpredictable. And this is what the market is proving day by day.

All early evidences in favor of the efficient market hypothesis were overwhelming, so that the well known financial economist Eugene Fama declared that evidences that confirm the hypothesis are extensive and contradictory evidence is rare. Still, in the last years the hypothesis started to present some anomalies and empirical evidence indicate that the hypothesis is not always applicable. Here are some of the **anomalies** of the EMH:

- **Small firm effect.** Many empirical studies showed that small firms obtained abnormal returns over long period of times even when higher risk associated with these companies was taken into account. There are several theories that explain this anomaly, suggesting that it is the effect of rebalancing the portfolios of institutional investors or of low liquidity of small firms' securities, of the high information cost to value small firms, or an inappropriate measurement of the risk.
- **January effect.** Over long period of times the stock prices have a tendency to produce an increase in price above a normal level from December to January. These are predictable but inconsistent with the random walk behavior of stock prices. The so-called January effect seems to be reduced in the last years for large firms, but it is still observable for the small firms' stocks. A cause is considered to be taxes. Investors are stimulated to sell stocks before the end of the year because capital losses reduce the taxable income. Afterwards, in January investors repurchase the stocks in the market generating the rise in the price and producing abnormal returns.
- **Market overreaction.** Recent research suggests that stock prices may overreact at new announcements, and errors will be corrected in time. This is contrary to the efficient market hypothesis, investors being able to gain abnormal returns.
- **Volatility in excess.** Volatility in excess is a phenomenon related to market overreaction: stock prices volatility may be higher than the one taken into account by fundamental analysis.
- **New information is not always incorporated in stock prices.** Recent evidence suggests that stock prices are not adjusted immediately to the announcement of profits, which is inconsistent with the efficient market hypothesis. In average, stock prices continue to grow a period of time after the announcement of unexpected profits and continue to decline after the announcement of unexpected lower profits.

The debate related to the efficient market hypothesis is not over yet. Evidence suggests that this hypothesis is a good starting point to evaluate behavior in capital markets. Still we can identify violations of this hypothesis that suggest that EMH can not be generalized for the entire market behavior.

4. Capital markets: fundamental analysis or emotions

Over four decades the theory according to which capital markets are reflecting the intrinsic value of shares was unbeatable. Lately, a new point of view came to live: investors may change the market trend fundamentally through irrational decisions.

Behaviorists that still have in mind the artificial increase of IT stocks and also the crash of the'90s have an easier task to promote a theory according to which markets can be sometimes less efficient in incorporating new information and investors being driven by emotions may make the markets incorrect. Some are even considering that capital markets have their distinctive lives that have no connection with the economic growth and profitability. They argue that markets are not efficient, do not reflect economic fundamentals. In consequence, in the market significant and long lasting deviations from the intrinsic stock value may appear.

Behavioral finance offer a valuable perspective sustaining the idea that markets are not always correct due to the fact that rational investors can not always correct the mispricing of irrational investors.

But for managers, the important question is how often deviations appear and if these are frequent enough to be taken into account in the decision making process. Significant deviations from the intrinsic value are however rare and markets succeed rapidly to revert to prices that reflect fundamental value.

Behavioral finance theory sustain that markets may fail in reflecting economic fundamentals under three conditions. When all these conditions apply, the theory predicts that prices biases in capital markets can be significant and persistent.

- **Irrational behavior.** Investors behave irrational when they are not analyzing fairly all the available information while forming expectations related to future performances of companies. Some investors are putting too much emphasis on recent events and this may create errors by overvaluing some companies with good recent performances. In contrast, some investors are excessively conservative and undervalue the companies that provide positive information.
- **Systematic behavior.** Even if investors decide to buy or sell without performing a fundamental analysis the impact on stock prices is limited. But if this irrational behavior is systematic (large groups of investors have the same behavior), persistent deviations of stock prices may appear.
- **Arbitrage limits in capital markets.** Arbitrage means that investors that consider a stock to be overvalued to sell it determining the price to decrease to its intrinsic value and viceversa. Due to costs involved, complexity and risks to be assumed, this type of arbitrage doesn't occur always so that it is possible that prices will not return to fundamental value.

However, experts consider that capital markets reflect intrinsic values. At the end of '70s and '90s major stock price deviations were present. At the end of '70s when investors were obsessed by high short term inflation rates, market was probably undervalued. The other well-know market deviation was at the end of '90s when the market reached P/E ratios of 30 that were not justified by the increase of 3% in real GDP and 13% return on equity.

When such deviations took place the capital market reverted to fundamental levels in a period of approximately 3 years. Even if the market was incorrect from time to time it still reverted to intrinsic values. This makes us believe that, for managers, it becomes even more important to understand the stock intrinsic value because it permits them to explore any deviation and to take them into account when they design and implement the company strategies. For example, managers may obtain advantages:

- by issuing additional stock when the market overvalues the firm's stocks compared to the intrinsic value;
- by repurchasing shares when the market is undervaluing the shares;
- by paying acquisitions with shares not with cash when the market overvalues shares.

Taking into account that on the long run the stock price reverts to its fundamental value, managers should make decisions based on the present value of cash flows. Significant is the behavior of stock prices on the long term and not the overvaluation or undervaluation at one moment in time. For strategic decisions, evidences suggest without doubt that the market reflects the fundamental (intrinsic) value.

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Lect. univ. drd. Dorel Ilincuța
"Spiru Haret" University, Romania

THE PRIMARY ACCOUNTING OF THE EVALUATION AFTER THE RECOGNIZING THE CORPORAL IMMOBILIZATION[1] - THE REVALUATION MODEL –

Abstract: *At the ulterior evaluation after the initial recognized, an enterprise can opts for a determining model of the cost or for the revaluation model.*

Keywords: *evaluation; revaluation; the revaluation differences.*

JEL Classification: *B21; C81; F15; L14; M41*

In concordance with IAS 16 The corporal immobilizations, an element of the corporal immobilization whose right value can be credibly evaluated will be recorded at a revaluation value, this is its right value at the revaluation time minus any next accumulated amortization and accumulated losses from the depreciation.

At the revaluation of the corporal immobilization, any cumulated amortization at the revaluation time is treated in one of the following ways:

- Proportional recalculated with changing in the accounting gross value of the asset so that the accounting value of the asset, after the revaluation to be equal with its revaluation value. This method is used when the asset is revaluation with application of an index at the amortized replacement cost;
- Elimination from the gross accounting value of the asset and the net value recalculated at the revaluation value of the asset. This method is, as a rule, used for buildings.

For the revaluation difference, IAS 16 - The corporal immobilizations presents the next solutions:

- if the accounting value of the asset is increased because the revaluation, this increasing will be registered directly in the credit account of the proper capital entitled the difference from revaluation. Anyway, the majority determined from revaluation will be recognized in the profit or loss, according as a decreasing compensates from the same asset revaluation, previous recognized in the profit or loss;
- if an asset accounting value is reduced like a result of a revaluation, this reduction will be recognize in the profit or loss. Anyway, this reduction resulted from the revaluation will be directly subtract from the real estate at the revaluation chapter at the same asset in concordance with the existence of the credit balance in the revaluation excess for that asset.

The revaluation excess included in the proper capitals for an element of the corporal immobilization can be transferred direct in the reported result when the asset is recognized.

This can involves the entire excess when the asset is taken away or retrocedes. Anyway, a part of the excess can be transferred according as the asset is using by the entity.

So, the value of the transferred excess is the difference between the amortization calculated on the revaluation accounting value and the amortization value calculated on the initial cost of the asset.

Transferring from the revaluation excess in the reported result doesn't do through the profit and loss account.

Registering in the primary accounting of a revaluation differences is done in concordance with the used method for the reflection of the input revaluation accounting value, thus:

- **the method of the gross value:** the concomitant revaluation of the immobilization gross value and the accumulated amortization which are used when it is appealed at the cost of replacing because it can't determined the right value on the market;
- **the method of the net value**: revaluation only for net accounting value which is used when it can determine a right value on the market for the revaluation asset.

[1] Ilincuța Lucian-Dorel, *Informația degajată de contabilitatea primară şi situațiile financiare privind imobilizările corporale*, Referatul 3-doctorat, ASE, Bucuresti, 2007

When is used *the method of the gross value* or *of an index*, how it is known, the input gross value is actualised and the accumulated amortization on *the actualization index* base. This is, as a rule, *the index for the prices general increasing* in a period of time.

Example:

The input value (the historical cost) of a building is 500,000 lei. The utile life duration is 25 years; the consummated duration is 15 years. The actualization index is 130% or 1.3. Using the method of linear amortization.

Calculation:

→ the input value 500,000 lei
→ the amortization value 300,000 lei (500,000 lei/25 years × 15 years)
→ the net value 200,000 lei (500,000 lei – 300,000 lei)
→ the input actualized value 650,000 lei (500,000 lei × 1.3)
→ the cumulated amortization actualized value 390,000 lei (300,000 lei × 1.3)
→ difference between the revaluation input value and the input value (the historical cost) 150,000 lei (650,000 lei – 500,000 lei)
→ difference between the revaluation cumulated amortization and the cumulated ones 90,000 lei (390,000 lei – 300,000 lei)
→ difference between the extra value of the building and the amortization extra value 60,000 lei (150,000 lei – 90,000 lei)

Recognizing in the primary bookkeeping:

212	=	%	150,000 lei
		105	60,000 lei
		2812	90,000 lei

• When it is used *the method of the net value* is annulated the cumulated amortization until the revaluation and is accounted difference resulted from the net value revaluation.

Example:

The input value (the historical cost) of a building is 500,000 lei. The utile life duration is 25 years; the consummated duration is 15 years. The building must be revaluated and it was fixed a right value at 260,000 lei.

Calculation:

→ the input value 500,000 lei
→ the amortization value 300,000 lei (500,000 lei/25 years × 15 years)
→ the net value 200,000 lei (500,000 lei – 300,000 lei)
→ the right value (by the market) 260,000 lei
→ the difference of the revaluation (excess) 60,000 lei (260,000 lei – 200,000 lei)

Recognizing in the primary bookkeeping:

a) annulment of the cumulated amortization:

2812	=	212	300,000 lei

b) registering the positive difference from the revaluation:

212	=	105	60,000 lei

During the existing of the corporal immobilization economical in a concurrency business where the technological progress registers a continuous increasing, as a rule, the difference between the revaluation is negative, so, it is registered a loss from the depreciation. But, many times, the etalon for measuring the value – money loses its "power" what means an "insidious evaluation" in the historical account.

If an economy registers the inflation or hyperinflation periods, during the utile life duration can appear more revaluation, especially for the corporal immobilization with life duration longer than 5 years.

Example[1]

A commercial society has got a transport mean evaluated at the entrance (beginning of N year) at a value by 100,000 lei, having utile life duration by 10 years, being amortized after the linear method.

The 1st Case. At the end of the third function year is the first revaluation of the asset and fixes the right value by 87,500 lei. Using the *method of the net value*, we have:

- The accounting net value at the end of the N + 2 year before the revaluation = 70,000 lei;

[1] Example adapted from Mihai Ristea (coord.), *Contabilitatea financiară a întreprinderii*, Ed. Universitară, Bucureşti, 2005, p. 147 and next.

- Difference from the positive revaluation in sum of 17,500 lei (87,500 lei – 70,000 lei) is registered in 105 account *Reserves from the revaluation*, through its credit.

At December, 31st N + 3 there are registered the next operations:

a) annulations the cumulated amortization until the revaluation time:

2813	=	2133	30,000 lei

b) correction of the accounting net value:

2133	=	105	17,500 lei

***Observation**:* It will be calculated the amortization begins from a new accounting value (87,500 lei) and from the last period for using (7 years). The annual amortization recalculated = 87,500 lei/7 year = 12,500 lei.

At December, 31st N + 3 there are registered the next operations:

c) the amortization for the N + 3 year:

6811	=	2813	12,500 lei

d) transferring the revaluation reserved at the reported result during the amortization:
the amortization difference of the revaluation is 12,500 lei – 10,000 lei = 2,500 lei.

105	=	1065	2,500 lei

and concomitant:

1065	=	1171	2,500 lei

Observation: These registering are repeated and the end at the N + 4 year.

The 2nd Case. The second revaluation of the transport mean is effectuated after 2 years from the first one of the asset, fixes a right value at 40,000 lei. Using the *method of the net value* at the 31st of December N+ 4, we have:

- the cumulated amortization in 2813 account *The installation amortization, the transport mean, animals and plantations* is by 25,000 lei (12,500 lei/an x 2 years);
- the correction of the net accounting value:

The net accounting value, at the end of the year N + 4, before the revaluation, is 62,500 lei (87,500 lei – 25,000 lei). The difference from the negative value, in sum of 22,500 lei (40,000 lei – 62,500 lei) is registered with the debit of account - 105. *The reserves from the revaluation* with 12,500 lei and 681 - *The exploitation expenditure regard as amortizations, provisions and adjusters for depreciation* with 10,000 lei.

The bookkeeping registrations are:

a) annulations the cumulated amortization until the revaluation moment is registered thus:

2813	=	2133	25,000 lei

b) correction of the net accounting value:

%	=	2133	22,500 lei
105			12,500 lei
681			10,000 lei

***Observation no. 1**:* At the end of the year N + 4, the 105 account is like:

D	105	C
(31.12 N + 3) 2.500		
(31.12 N + 4) 2.500	17,500 (31.12 N + 2)	
SFC (31.12 N + 4) 12.500	12.500 (31.12 N + 4)	

***Observation no. 2**:* It will be recalculated the amortization begins from the new accounting value (40,000 lei) and from the last period for using (5 years). The annual amortization recalculated = 40,500 lei/5 years = 8,000 lei.

At December, 31st N + 5, N + 6 and N + 7 there are registered the annual amortization:

6811	=	2813	8,000 lei

Because the 105 account balance is zero, there aren't registered the transfer of the *reserve from the revaluation* to the *reported result.*

The 3rd Case. The third revaluation of the transport mean is effectuated after 3 years from the second one of the asset, fixes a right value at 28,000 lei. Using the *method of the net value* at the 31st of December N+ 7, we have:

- the cumulated amortization in 2813 account is 24,000 lei (8,000 lei/an x 3 years);
- the correction of the net accounting value:

The net accounting value, at the end of the year N + 7, before the revaluation, is 16,000 lei (40,000 lei – 24,000 lei). The revaluation difference is positive, in sum of 12,000 lei (28,000 lei – 16,000 lei) and it is

recognized with the credited 781 for 10,000 lei for annulated the known expenditures at the previous revaluation and of the 105 account with 2,000 lei.

The bookkeeping registrations are:

c) annulations the cumulated amortization until the revaluation moment:

2813	=	2133	24,000 lei

d) correction of the net accounting value:

2133	=	%	12,000 lei
		105	2,000 lei
		781	10,000 lei

Observation: It will be recalculated the amortization begins from the new accounting value (28,000 lei) and from the last period for using (2 years). The annual amortization recalculated = 28,000 lei/5 year = 14,000 lei.

At December, 31st N + 8 and N + 9 there are registered the annual amortization:

6811	=	2813	14,000 lei

In the same time, it is transferred the reserve from the reported revaluation for the difference of the amortization by 4,000 lei (14,000 lei – 10,000 lei). Because this exceeds the 105 account balance it will transferred the entire sum of 2,000 lei.

105	=	1065	2,000 lei

and concomitant:

1065	=	1171	2,000 lei

Notes: In concordance with the IAS 16 *The corporal immobilization* the reserve transfers from the revaluation at the reported result it will be done according as the asset realisation. The asset realisation means or its amortization, or its extraction from the business (selling, cassation).

In the presented example it was transferred the reserve from the revaluation at the reported result according as the asset amortization. If the transfer is done at the extraction from the business it is necessary to proceed like:

At December, 31st N + 2:

- The net accounting value is 70,000 lei (100,000 lei – 3 years x 10,000 lei/year);
- The right value on the market is 87,500 lei;
- The difference from the revaluation is 17,500 lei (87,500 lei – 70,000 lei) and it is recognized through the 105 account lending.

At December, 31st N + 4:

- The net accounting value is 62,500 lei (87,500 lei – 2 years x 12,500 lei/year);
- The right value on the market is 40,000 lei;
- The difference from the revaluation is -22,500 lei (40,000 lei – 62,500 lei);
- The 105 account balance is zero, owed the conversion with the 17,500 lei;
- There are recognized the exploitation expenditures of the amortization and provisions by 5,000 lei (22,500 lei – 17,500 lei).

At December, 31st N + 7:

- The net accounting value is 16,000 lei (40,000 lei – 3 years x 8,000 lei/year);
- The right value is 28,000 lei;
- The difference from the revaluation is 12,000 lei (28,000 lei – 16,000 lei);
- The 105 account balance is 7,000 lei and is the difference between 12,000 lei and 5,000 lei (the exploitation expenditures of the amortization and provisions recognized at the previous revaluation).

At the extraction from the business (December, 31st N + 9) the 105 account balance is 7,000 lei. This sum is transferred at the reported result thus:

105	=	1065	7,000 lei

and concomitant:

1065	=	1171	7,000 lei

In PCG from O.M.F.P. no. 1750/2005 it was introduced the 1065 account - *The reserves for the excess realised from the revaluation reserves.* In these conditions, the part of the revaluation reserves transferred at the reported result conveys first this account.

Transferring at the reported result can be done or according as the amortization or to extinction the asset from the entity business thus:

105	=	1065

And concomitant and ulterior:

1065 = 1171

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Associate Professor Adrian Mihai Inceu
Associate Professor Dan Tudor Lazăr
Bogdan Andrei Moldovan
Alexandru Pavel
Paul Zai
"Babeş-Bolyai" University of Cluj Napoca, Romania

COMPARATIVE ANALYSIS OF HEALTH FINANCING SYSTEMS

Abstract: *This paper analyzes the main health financing systems from a general point of view, concentrating countries, particularly Central and Western EU countries.*

Key words*: financing systems, health, EU, National Health Service, Social health insurance system, Private health insurance system, Community-based health insurance system, Out-of-pocket payments system*

JEL Classification*: H51, H75, I18*

Every year the Governments spend an important percentage of the public money for the health system. In 2005, the average share of GDP that OECD[1] countries devoted to health spending reached 9%. This share varied considerably across OECD countries, ranging from around 6% in Korea, Poland and Mexico up to 15.3% of GDP in the case of the United States.

Governments must assess the most appropriate mechanisms to pool health risks and provide financial protection to their populations. But macroeconomic, demographic, and fiscal constraints limit the extent to which governments can simply allocate more public revenues for health[2]. In this paper we will try to present the general types of health financing systems and few functional models in developed countries.

The four core functions of the health system are: stewardship (oversight), creating resources (investment and training), delivering services (provision) and health systems financing. The aim of the financing function is to make funding available and to set the right financial incentives so that all individuals have access (financially and geographically) to effective public health and personal health care (World Health Organization, 2000)[3]. In order to do this, it should meet the following targets:

- generate sufficient and sustainable resources for health
- use these resources optimally (by modifying incentives and through appropriate use of these resources)
- ensure that everyone has financial accessibility of health services

The policy makers must examine the context and determine which method constitutes the best means for developing a strong health financing system in terms of equity, efficiency, and sustainability. It is important to be pragmatic and ensure that the mechanisms chosen are aligned with country-specific economic, institutional, and cultural characteristics.

To attain these goals, five main health insurance mechanisms are used to pool health risks, promote prepayment, raise revenues, and purchase services[4]:

- state-funded systems through ministries of health or national health service (NHS) - compulsory universal coverage, national general revenue financing, and national ownership of health sector inputs

[1] Organisation for Economic Co-Operation and Development (OECD) – Health Data 2007, available on http://stats.oecd.org/wbos/default.aspx?DatasetCode=HEALTH
[2] Regional Committee for Europe Fifty-sixth session - *Approaching health financing policy in the WHO European Region* - Copenhagen, 11–14 September 2006
[3] Jorine Muiser - *The new Dutch health insurance scheme: challenges and opportunities for better performance in health financing* – World Health Organization, Geneva 2007
[4] Pablo Gottret, George Schieber - *Health Financing Revisited - A Practioner's Guide* - **ISBN:** 0-8213-6585-1, World Bank Publications, March 2006, available on http://www.healtheconomics.org/books/2006/03/30/health-financing-revisite.html

- social health insurance - compulsory universal coverage under a social security (publicly mandated) system financed by employee and employer contributions to non-profit insurance funds with public and private ownership of sector inputs
- private or voluntary health insurance: employer-based or individual purchase of private health insurance and private ownership of health sector inputs
- direct or out-of-pocket payments
- community-based health insurance

While the features of each financing mechanism differ significantly, we cannot say that one method is better than another. The key health policy issues are not whether a government uses general revenues or payroll taxes, but the amounts of revenues raised and the extent to which they are raised in an efficient, equitable, and sustainable manner. Similarly, nothing is intrinsically good or bad about public versus private ownership and provision. The important issue is whether the systems in place ensure access, equity, and efficiency.[1]

A) State-funded system or National Health Service (NHS)

The NHS is committed to providing quality care that meets the needs of everyone, is free at the point of need, and is based on a patient's clinical need, not their ability to pay. The NHS will not exclude people because of their health status or ability to pay[2].

This system is based on a system of revenue collection through a broad-based tax (general revenues). All or a portion of this tax may be dedicated to the health care system (although this is generally just an accounting convention). General revenues may be raised at the federal, provincial/state, or local levels. Some the " National Health Service" label as inappropriate because the health care systems have been largely decentralized beyond the national level most of the countries.

General revenues are used to finance a portion of the health care system almost everywhere. In countries that rely primarily on social insurance, general revenue funds are often used to cover the costs of non-workers. General revenue financing usually refers to a **pay-as-you-go arrangement**, where current revenues are used to finance current expenditures.

In the case of this type of health care system, taxpayers who choose to pay for private healthcare must nonetheless still contribute to the NHS via taxation, and in effect, they "pay twice", although the vast majority of emergency medical treatment is carried out by the NHS. This is not a specific effect of the NHS, and occurs whenever a choice between a publicly-funded and privately-funded service exists - for instance in private education.

The NHS is required to break even at the financial year-end, the service should in theory never be in deficit, but these conditions have been consistently, and increasingly, breached.

Most industrialized countries, and many developing countries, operate some form of publicly-funded health care with the goal of universal coverage. The United States is the only wealthy, industrialized nation that does not provide universal health care and statistical data shows that lack of health insurance causes roughly 18,000 unnecessary deaths every year in the United States[3].

B) Social health insurance system (SHI)

SHI have been implemented for the first time by Otto von Bismarck in Germany. There is no clear definition of social insurance financing. Generally the term refers to a system in which some group of people, usually workers, is mandated to make contributions to a health care financing (or, for example, retirement) program[4]. Thus, social health insurance (SHI) is a method for financing health care costs through a social insurance program based on the collection of funds contributed by individuals, employers, and sometimes government subsidies.

Social insurance contributions are usually either regressive (a flat per capita mandate) or proportional (a flat payroll tax rate). Social insurance financing based on payroll taxation faces the problem that the tax base, which excludes non-labour income, may be narrower than under broader scope general revenue financing[5].

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[1] George Schieber, Cristian Baeza, Daniel Kress, and Margaret Maier, "Financing Health Systems in the 21st Century." 2006. *Disease Control Priorities in Developing Countries (2nd Edition),ed.* , 225-242. New York: Oxford University Press. DOI: 10.1596/978-0-821-36179-5, available on http://www.dcp2.org/pubs/DCP/12

[2] http://www.nhs.uk/aboutnhs/CorePrinciples/Pages/NHSCorePrinciples.aspx

[3] Institute of Medicine of the National Academies - *Insuring America's Health: Principles and Recommendations* - The National Academies Press, Washington, D.C., 2004, http://books.nap.edu/openbook.php?isbn=0309091055

[4] Sherry A. Glied – *Health care financing, efficiency, and equity* - NBER Working Paper No. 13881 JEL No. H42,H51,I18, March 2008, available on http://www.nber.org/papers/w13881.pdf?new_window=1

[5] Amelung and Glied, 2003, apud Sherry A. Glied – *Health care financing, efficiency, and equity*

Contributions to the social insurance system should finance the full insured cost of the health program or a pre-specified proportion of that cost, the contribution level being tied to the cost of providing health insurance. The payment of social insurance payments may vary with the choice of plan in a multi-plan system (as in Germany) or they may be fixed (as in the US Medicare program).

SHI systems are characterized by the presence of sickness funds which usually receive a proportional contribution of their members' wages. With these insurance contributions these funds pay medical costs of their members, to the extent that the services are included in the, sometimes nationally defined, benefit package. Usually, there are user fees for several health care services to inhibit usage and to keep social health insurance affordable.

Countries with SHI systems include Austria, Belgium, Germany, France, and Luxembourg. Generally, their per capita health expenditures are higher than in countries with National Health Systems.

Depending on the country, 63 per cent (the Netherlands) to 100 per cent (France, Israel, Switzerland) of the population are covered by the statutory sickness fund system. In countries with less than 100 per cent mandatory participation (USA, Netherlands, Belgium, Germany) certain categories of people are excluded from the public health insurance system, having to purchase private insurance (small exceptions exist for illegal immigrants, for people with objections by principle and for civil servants. In the Netherlands, for example, this applies to persons who in 2004 were earning more than 32.600 Euros/year (meaning 28% the population). In Germany this option applies to persons who in 2003 were earning more than 45.900 Euros/year (meaning 9% of the German population). In USA, where the public coverage through Medicare and Medicaid is restricted to the elderly, disabled and certain poor groups, 72% of the population has some form of private health insurance.

Funding for all members is equalized either within national state-run pools (Netherlands); within regional government (Austria) or foundation-based (Switzerland) pools; through mandatory risk-adjustment mechanisms (Belgium, Germany, Netherlands)[1].

C) Private health insurance system

The term health insurance is generally used to describe a form of insurance that pays for medical expenses. Private health insurance is a source of primary coverage for population groups without access to public health cover or supplements public systems by financing goods and services that are excluded from public coverage. It is an alternative or additional source of funding for publicly financed health systems, especially when these budgets are stretched to capacity. The private health care sector could serve as a safety valve and fill in when public system falls short and waiting lists grow too long.[2]

In private health insurance system, the financing may be individual or operated through employers (a firm to cover its employees) or other purchasing organizations. In each case, the covered groups or individuals pay premiums or taxes to help protect themselves from high or unexpected healthcare expenses. With some exceptions (highly regulated contexts or in employer-sponsored groups) the price of coverage is related to expected health expenditures – older, sicker people pay more for coverage and premiums rise as health expenditures rise. Under private coverage, people choose both how much to purchase and, by extension, how much to pay as a share of their income. Even in a situation without health insurance, however, health care utilization rises less than proportionately with income[3].

The benefit is administered by a central organization, most often either a government agency or a private or not-for-profit entity operating a health plan[4] and it may be provided through a government-sponsored social insurance program, or from private insurance companies.

In many countries private health insurance supplements public systems by financing goods and services that are excluded from public coverage. Thus, private health insurance is purchased by 65% of the population in Canada, where the supplementary role is the sole permitted function of private health insurance in most provinces, while in the Netherlands nearly all of the population with social health insurance

[1] Richard B. Saltman, Reinhard Busse, Josep Figueras - *Social health insurance systems in western Europe* – Open University Press, (ISBN 0 335 21363 4), 2004, available on http://www.euro.who.int/document/E84968.pdf

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[4] Gary Claxton - *How Private Insurance Works* - Institution for Health Care Research and Policy, Georgetown University, April 2002, available on http://www.kff.org/insurance/upload/How-Private-Insurance-Works-A-Primer-Report.pdf

purchases supplementary insurance. In Switzerland, 80% of the population supplements basic mandatory health coverage with a voluntary private health insurance policy[1].

Anyway, private health insurance, if any, is extremely limited because of people's inability to pay and institutional constraints to the industry's development, including the lack of well developed financial markets and regulatory environments[2].

Health insurance policy

The health insurance policy (the contract between an insurance company and an individual) can be renewable annually or monthly. The type and amount of health care costs that will be covered by the health plan are specified in advance, in the member contract or Evidence of Coverage booklet. The individual policy-holder's payment obligations can be[3]:

- Premium - the amount the policy-holder pays to the health plan each month to purchase health coverage;
- Deductible - the amount that the policy-holder must pay out-of-pocket before the health plan pays its share.
- Co-payment - the amount that the policy-holder must pay out of pocket before the health plan pays for a particular visit or service. a co-payment must be paid each time a particular service is obtained;
- Coinsurance - instead of paying a fixed amount up front (a co-payment), the policy-holder must pay a percentage of the total cost.
- Exclusions - not all services are covered; the policy-holder is generally expected to pay the full cost of non-covered services out of their own pocket;
- Coverage limits: - some health plans only pay for health care up to a certain money amount; the policy-holder may be expected to pay any charges in excess of the health plan's maximum payment for a specific service.
- Out-of-pocket maximums - similar to coverage limits, except that in this case, the member's payment obligation ends when they reach the out-of-pocket maximum, and the health plan pays all further covered costs; Out-of-pocket maximums can be limited to a specific benefit category (such as prescription drugs) or can apply to all coverage provided during a specific benefit year.

Also, the private health insurance can be[4]:

- *Primary principal*: Covers the medical care of persons who do not have legal access to the public system.
- *Primary substitute*: Covers the medical care of persons who have the choice of substituting private insurance for public coverage.
- *Duplicate*: Covers the medical care of persons who continue to have access to the public system (and who are obliged to contribute to it through taxes) but who wish to be treated in a parallel private sector.
- *Complementary:* Covers the portion under the responsibility of the insured person (co-payments or coinsurance) in the public health insurance system.
- *Supplementary*: Covers extras or services not insured by the public system.

Regarding the impact of private health insurance over the quality of care, studies show that it has been a minimal one in the countries where it is implemented, because private insurers have not usually engaged in significant efforts to influence the quality of the services they finance. In the same time, regarding the efficiency, even if private health insurance is often viewed as a tool to enhance efficiency, the evidence shows it has made only a small contribution so far. The main reasons are: high administrative costs,

[1] *Private Health Insurance in OECD Countries* - OECD, 2004 (ISBN: 9264015639), available on http://www.oecd.org/dataoecd/42/6/33820355.pdf

[2] George Schieber, Cristian Baeza, Daniel Kress, and Margaret Maier, "Financing Health Systems in the 21st Century." 2006. *Disease Control Priorities in Developing Countries (2nd Edition),ed.* , 225-242. New York: Oxford University Press. DOI: 10.1596/978-0-821-36179-5/Chpt-12, available at http://www.dcp2.org/pubs/DCP/12

[3] *Question and Answers About Health Insurance: A Consumer Guide*, available at http://www.ahrq.gov/consumer/insuranceqa/

[4] *Private health insurance in OECD countries* - OECD Observer, Nov.2004, http://www.oecd.org/dataoecd/42/6/33820355.pdf.

lack of incentives to manage care cost-effectively, limited competitive pressures, little consumer mobility across insurers, the lack of "vibrant" price and quality competition among providers[1].

Concluding, the private insurance can be a way of increasing the overall resources devoted to health care and, eventually, of reducing waiting times. OECD study confirms that the greater the resources (public and private) the shorter waiting times generally become[2].

D) Out-of-pocket payments system

Out-of-pocket payments are those payments into the health care system that are made directly at the point of service. In this category can be included full payments (pharmaceuticals or nursing home care for those without insurance coverage) as well as co-payments and deductibles. A system with only out-of-pocket payment would finance health care regressively, since health service use rises less than proportionately with income.[3]

Private and out-of-pocket spending accounts for almost half of total health spending in low income countries. Out-of-pocket payments became a major source of funding for health care systems in Asia[4] and Africa and generally in low income countries. In the country where this health care system represents the main system, the search for sufficient or alternative sources of public funding, however, has been unsuccessful; consequently, wages are not paid and hospitals run out of essential supplies.

Three categories of out-of-pocket payments can be defined:

- Health providers (government or private) charge official fees.
- Semi-official charges made for consumables such as drugs and medical supplies.
- Patients make under-the-table payments to health care providers, either as a so-called gift or increasingly as a precondition for service.

Also, Out-of-pocket payments can take three broad forms[5]:

Form	Definition
Direct payments	payments for goods or services obtained from the private sector in "pure private" transactions – for goods or services not covered by any form of pre-payment or insurance
Cost sharing/user charges	require the individual covered to pay part of the cost of care received
Informal payments	unofficial payments for goods or services that should be fully funded from pooled revenue; sometimes referred to as envelope or under-the-table payments

E) Community-based health insurance system

Community-based health insurance (CBHI) is an umbrella term for the various types of community financing arrangements that have emerged because of high out-of-pocket spending, uncertainty surrounding anticipated financial flows from donors, and large and unregulated private sectors. It refers to prepayment plans that attempt to pool risks to reduce the financial risk an individual faces because of illness[6]. It is a relatively new system which tries to address health care challenges faced in particular by the rural poor.

These CBHIs can be divided into two broad categories – one that provide ambulatory care only and the other that provides both ambulatory and inpatient category. Among the latter, there are 3 basic models[7]:

- *The provider model*, where a provider (usually a NGO hospital) provides health insurance for the community around.
- *The insurer model*, where an NGO takes the role of the insurer, collects money from the community and purchases health care for its members.

[1] *Private Health Insurance in OECD Countries* – Policy Brief, OECD, 2004, available on http://www.oecd.org/dataoecd/42/6/33820355.pdf

[2] Luigi Siciliani and Jeremy Hurst - *Explaining Waiting Times Variations for Elective Surgery across OECD Countries* - OECD Health Working Papers, No. 7, 2003; //www.oecd.org/dataoecd/31/10/17256025.pdf.

[3] Sherry A. Glied – *Health care financing, efficiency, and equity* - NBER Working Paper No. 13881 JEL No. H42,H51,I18, March 2008, available on http://www.nber.org/papers/w13881.pdf?new_window=1

[4] http://www.euro.who.int/document/OBS/Informalpayments.pdf

[5] http://www.euro.who.int/HEN/Syntheses/hcfunding/20040704_4

[6] Atim and others 1998; Bennett, Creese, and Monash 1998; Bennett, Kelley, and Silvers 2004, apud George Schieber, Cristian Baeza, Daniel Kress, and Margaret Maier, "Financing Health Systems in the 21st Century." 2006.

[7] Devadasan N. MBBS, MPH - *The feasibility of a Community Based Health Insurance (CBHI) at Wayanad, Kerala* - Institute of Tropical Medicine Antwerp, Belgium AND Achutha Menon Centre for Health Science Studies, SCTIMST, Trivandrum, Kerala available on http://www.srtt.org/downloads/healthfinancingforpoor-report.pdf

- *The linked model*, where the NGO collects the premium, but passes it onto a formal insurance company. This company then takes the risk of running the insurance.

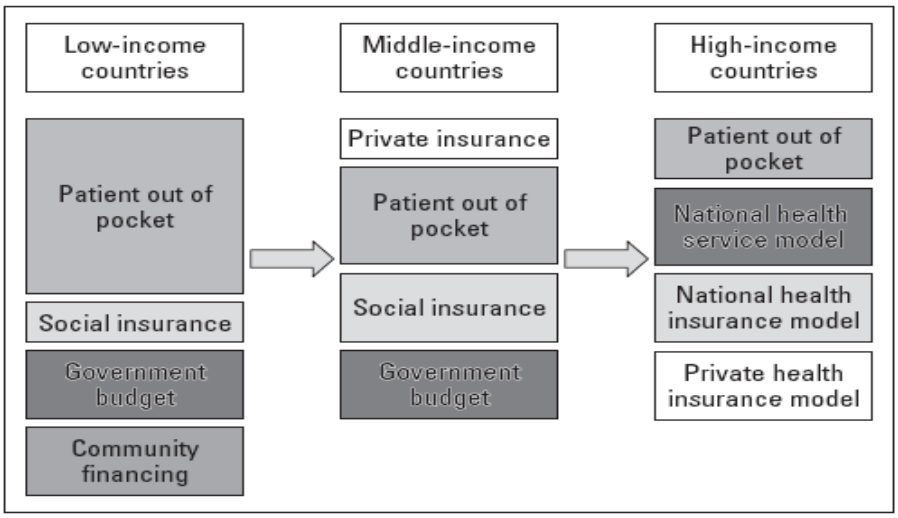
CBHI is based on a partnership between the community and health care providers. The CBHI schemes can develop their organizational structures including general assemblies, board of directors, surveillance committees and executive bureaus to regulate contractual relations between members and the mutual organization. Participation in the CBHI scheme is voluntary and is based on a membership contract between the CBHI scheme and the member. In addition, CBHI schemes develop contractual relations with health care provider organizations (health centers, hospitals) for the purchasing of health care[1].

Community-based health insurance can provide some financial protection by reducing out-of-pocket spending. There is weak or no evidence that schemes have an effect on the quality of care or the efficiency with which care is produced. In absolute terms, the effects are small and schemes serve only a limited section of the population. This type of community financing arrangement is, at best, complementary to other more effective systems of health financing.

Composition of health spending

There are major differences in the composition of health spending between the low-income countries, middle-income countries and high-income countries: as incomes increase, both private and out-of-pocket shares of total health spending decrease; as countries move up the income scale, public spending predominates and both out-of-pocket spending and external assistance decrease drastically[2] (fig1):

Fig. 1 Health Care Financing System Trends by Country Income Level



Source: Maeda 1998.

In low income countries, almost half of health spending is private, usually all out of pocket. The Government here provides only basic public health and other services, including some tertiary-level hospital care, generally in major urban areas, to the entire population within an extremely limited budget. In general, because of the small size of formal sector employment, social insurance is limited, except perhaps for government employees. Community- based health insurance may be available to varying degrees but is unlikely to play a major role. Private health insurance, if any, is extremely limited because of people's inability to pay and institutional constraints to the industry's development, including the lack of well developed financial markets and regulatory environments[3].

As countries' economies improve, government revenues tend to increase because of the expansion of the more readily taxable formal sector. Although private spending still accounts for some 40 percent of all health spending in MICs, the out-of-pocket share declines as private health insurance markets develop.

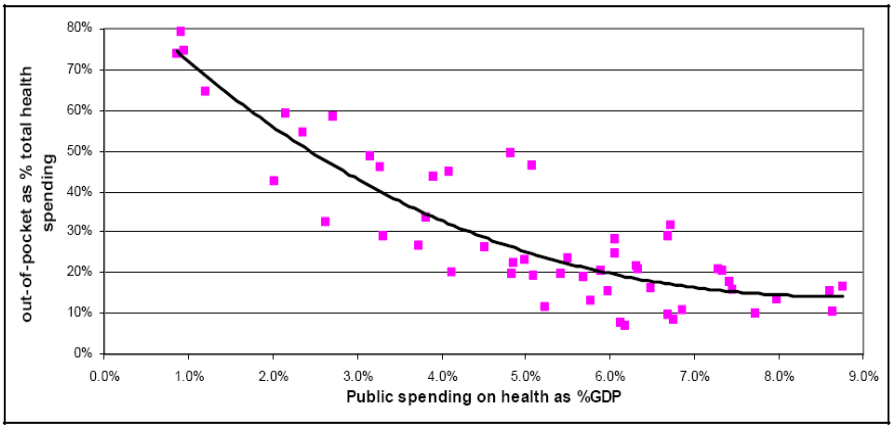
[1] Ibidem
[1] http://www.ncbi.nlm.nih.gov/pubmed/15310661
[2] George Schieber, Cristian Baeza, Daniel Kress, and Margaret Maier - *Financing Health Systems in the 21st Century* – 2006. *Disease Control Priorities in Developing Countries (2nd Edition),ed.* , 225-242. New York: Oxford University Press. http://www.dcp2.org/pubs/DCP/12
[3] Ibidem

Countries move into the high-income group with improved institutions, more efficient governments, and greater revenue raising capacity and spend a relatively small share on basic public health. With few exceptions, publicly financed universal coverage—or, in some cases, publicly mandated private coverage—becomes the goal.

Data analyses and conclusions

Analysis of health spending data of World Health Organization from European Region illustrate the strong inverse relation between government spending on health as a percentage of GDP, and the share of total health system spending coming in the form of out-of-pocket payments (fig 2). In other words, the more governments spend on health, the fewer patients pay at the time they use services, with consequent implications for the objectives of financial protection, equity in finance, and equity in the use of services.

Fig 2.
Relation between the level of government health spending and the share of total spending coming from out-of-pocket payments,



Member States in the European Region, 2003
Source: World Health Organization

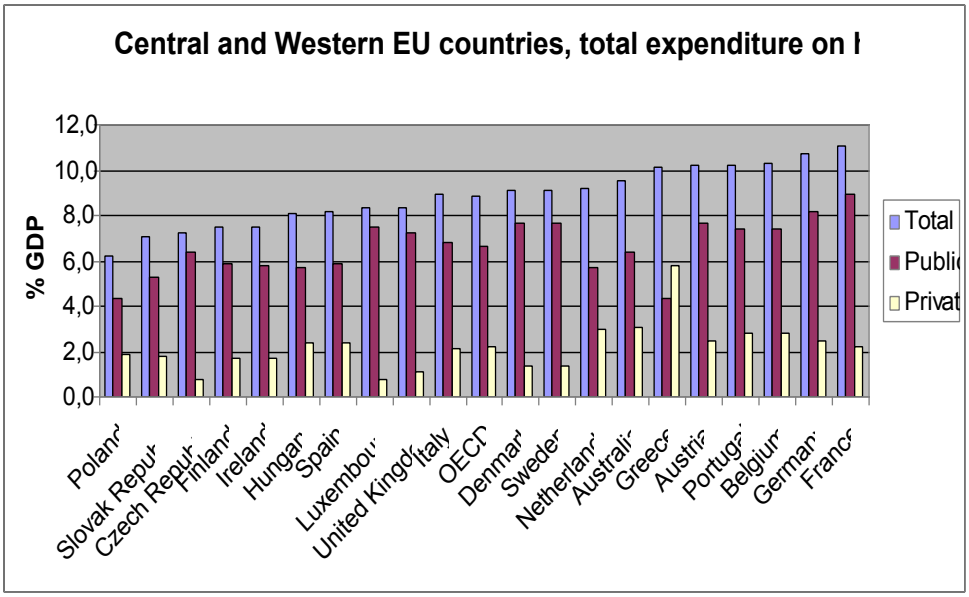
In OECD countries the health systems continue to be predominantly financed from public sources, which account, on average, for 72% of total health expenditure, compared to 6.3% for private health insurance and 19% for out-of-pocket payments. Only in the United States[1] does private health insurance exceed a third of total health expenditure, at 35%, while it goes above 10% only in the Netherlands, Canada, France, Germany and Switzerland. Countries that have multiple sources of primary coverage, including those with significant private health insurance market size, tend to be those with the highest total health spending levels per capita, such as the United States, Switzerland, Germany and France[2].

As shown in the next figure (fig 3 and 4), this share, reflecting the priority that governments accord to the health sector, varies widely across the region:

In many Western European countries, health care is the fastest growing segment of government spending. Over the past forty years there has been a significant increase in health-care spending. According to the OECD, in 2003 Western European countries spend between 7.3 and 11.5% of their gross domestic product on health care. Ten years ago it was between 6.9 and 9.9%. In 1960 it was only around 4%. There are only two ways to keep the present government-run European health-care systems going. One can either drastically increase the financial burden on those at the paying end of the system – the young and healthy of today – or one can drastically limit the quality and the availability of health care for those at the receiving end – the sick and the elderly[3].

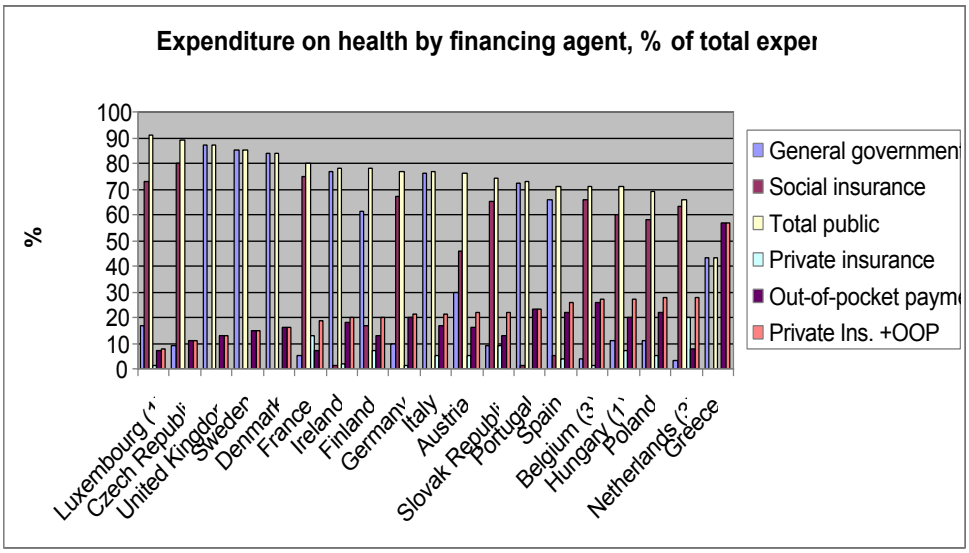
Fig. 3

[1] According to the Institute of Medicine, in USA an estimated 18,000 people die each year because they do not have health insurance, source http://www.usatoday.com/news/health/healthcare/2002-05-22-insurance-deaths.htm
[2] OECD- *Private Health Insurance in OECD Countries* – Policy Brief, OECD, 2004, available on http://www.oecd.org/dataoecd/42/6/33820355.pdf
[3] Paul Belien - Health Care Cuts in Europe, 2005, http://www.canadafreepress.com/2005/brussels112305.htm



Source: *OECD Health Data 2007*.

Fig. 4



Source: *OECD Health Data 2007*

Beyond fiscal concerns that are relevant in all countries, other contextual factor (beyond government control) which can affect health financing policy in Western Europe is demographic structure and projections. The current and projected future demographic structure of a country has important implications for health financing policy. There are two dimensions to this. First, older populations tend to need and demand more health services, pressuring on system costs as a result. Second, where populations are aging and fertility is low, the size of the productive workforce declines relative to the rest of the population, unless the gap left by falling fertility is filled by immigrant labour[1]. Another important cause of rising expenditure, however, is the advancement of better and newer – but more expensive – medical technology.

As the share of the working-age population shrinks in relation to the total population, it will become essential to diversify public funding sources to provide coverage for the no contributors. Anyway, in most west European countries with social health insurance schemes, public funding does not come solely from

[1] Regional Committee for Europe Fifty-sixth session - *Approaching health financing policy in the WHO European Region* - Copenhagen, September 2006

wage-based taxation. Only Germany and the Netherlands cover more than 60% of total health spending in this way. In Austria, Luxembourg and Belgium, less than half of total spending is funded from payroll taxes[1].

Conclusions

The higher and the more developed a society becomes, the more its citizens are willing to spend on keeping healthy. Modern technology makes everything cheaper except the highest quality of medical care, which is constantly improving[2]. Fiscal sustainability and increasing the level of government health spending are not the objectives of health financing policy, but health systems must give increased attention to improving the *efficiency* of resource use. It must to attempt to get the most from the public resources that are spent. While there will never be enough funds to satisfy all the needs of a health system, making better use of the resources that are available is the principal means to lessen the severity of sustainability tradeoffs.

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Paul Gabriel Miclaus
Ana Bobirca
Radu Lupu
Stefan Ungureanu
Academy of Economic Studies, Bucharest, Romania

A GARCH DYNAMIC CONDITIONAL CORRELATION MODEL FOR THE COMPUTATION OF DYNAMIC VAR ON THE ROMANIAN CAPITAL MARKET

Abstract: *Basel II Recommendations concerning internal rating based models approach for financial institutions and the success of RiskMetrics made Value-at-Risk (VaR) the most important risk measurement instrument at international level. The objective of this paper is to address the problem of adapting this method to the statistical properties of the returns for the Romanian Capital Market. We analyze the properties of the SIFs returns and present possible calculations for a VaR that takes into account the presented features.*

Key words*: Dynamic VaR, GARCH, GARCH Dynamic Conditional Correlations, Romanian Capital Market*

JEL Classification*: C13, C32, C51, G11*

Value-at-Risk - VaR

VaR has the objective to determine the total risk of a portfolio of financial assets by aggregating it in a single figure. This indicator gained practical importance since it started to be used by the treasurers in both financial and non-financial institutions, by the managers of mutual and closed-end funds as well as by the policy decision makers in government institutions.

The VaR approach represents a methodology of risk measurement. The concept is relatively new. In fact, many financial institutions all over the world have been using similar procedures (money at risk or dollars at risk, as they used to be called previously). However, the systemic approach of the VaR concept has been brought under the attention of financial world by the Group of Thirty (G30) in the paper în lucrarea *Recommendations for Derivatives Practices and Principles*, published in July 1993.

Nowadays VaRAşa has the purpose to measure the market risk, although proposals were issued to implement the same concept in order to measure the operatoinal risk.

Briefly, VaR is a statistical estimate according to a confidence level (usually between 90 and 99%, but most often 95%), meant to measure the value, expressed in a certain currency, that a portfolio or organization can lose within a certain period of time (for instance 10 days) due to changes at the market price of the assets taken into account. The time horizon can be set for a day for most of the trading positions, a month or more for the portfolio investments.

VaR gained in popularity because it represents the first common effort of the market participants to create a standardized approach to risk measurement, no matter if it is for a certain asset, a portfolio or the entire balance sheet of the organization. However, it is important to highlight the fact that VaR is merely a statistic estimate, based on the historic distribution of the returns. The mathematical model is used for risk management because it makes distributional estimates (interval estimates) and not point estimates or signaling factors (as opposed to the so-called *chartist* analysis, which seeks for „patterns" in the evolution of prices in order to identify buying or selling signals). Value at Risk is an instrument that makes uses of the statistical estimates in order to provide an estimated probability for the possible negative returns.

The performance of the VaR method

Cont (2001) identifies many general statistical properties of the financial assets' returns, trying to highlight their non-normal features: lack of autocorrelations, increased probabilities for extreme events, distribution asymmetries, large standard deviation with respect to mean (virtually zero daily returns), high autocorrelation for the series of volatilities (dependence of actual volatility on the past volatilities).

In the light of these features of the returns' distribution and of the new models built in order to determine more realistic prices, the analysis of the performance of the VaR principle of evaluation is a very important issue. If the returns develop as in the past and the distribution is not normal, then the application of the parametric method can drive toward the underestimation of the VaR statistic. Hence, there is need for

either the use of methods for the evolution of returns that can respond to the statistical properties of returns or the employment of parametric methods able to use the information provided by the history of returns.

Methodology – Modeling conditional covariances and correlations

The purpose of our paper is to present a model for the movement in the correlations for a hypothetical portfolio composed of 3 of the financial investment companies listed at the Bucharest Stock Exchange (SIF). We will compute the movement of the VaR computed by using a Dynamic Conditional Correlation model, in which each of the financial assets is modeled under a GARCH framework and the movement of the relations between the respective assets is modeled by using an "GARCH-like" model for the standardized covariances of one of the companies in our portofolio and the relations of this company with the other two stocks.

Starting from the benefits of the exponential smoother volatility model for the standard deviations of the returns proposed by RiskMetrics, the GARCH has the benefit of allowing for a long-term unconditional average volatility, which the series of returns tend to return to. The standard equation for the movement in the covariances of the financial assets taken into account is the following:

$$\sigma_{ij,t+1} = \omega_{ij} + \alpha R_{i,t} R_{j,t} + \beta \sigma_{ij,t}$$

which will tend to revert to its long run average covariance which equals:

$$\sigma_{ij} = \frac{\omega_{ij}}{(1 \quad \alpha \quad \beta)}$$

The use of the same coefficients α and β for all the matrix of covariances (for all the instruments in the portfolio) is needed in order to achieve the positive definiteness of this matrix, which allows for the volatility to be positive. It is well known that these two coefficients allow for the possibility of persistence, so, keeping them the same for all the assets in the portfolio is an important constraint.

The need to relax this constraint made room for the modeling of the correlations rather than the covariances. The main argument in support of this approach to modeling is founded by the fact that correlations are easily interpreted as they fall in the interval from minus one to one. Covariances on the other hand are a confluence of correlation and variance. For instance, the covariance between two assets could be time-varying even though the correlation is constant, simply because the variances are time-varying. There is ample empirical evidence that correlations increase during financial turmoil and thereby increase risk even further, therefore, modeling correlation dynamics is important for the risk manager.

We notice that, if we consider the volatilities of each asset to already having been estimated through a GARCH model, by standardizing the returns using its respective dynamic standard deviation,

$$z_{i,t} = R_{i,t}/\sigma_{i,t}, \text{ for all } i$$

we notice that the conditional covariance of the raw returns (not standardized) is equal to the conditional correlation of the standardized returns:

$$\rho_{ij,t+1} = \frac{E_t(z_{i,t+1} z_{j,t+1})}{\sqrt{E_t(z_{i,t+1}^2) E_t(z_{j,t+1}^2)}}$$

where, E_t is the expectation at moment t (conditional expectation).

Considering a "GARCH-like" smoother, we could model the correlations of returns by defining standardized covariances of the form

$$q_{ij,t+1} = \bar{\rho}_{ij} + \alpha(z_{i,t} z_{j,t} - \bar{\rho}_{ij}) + \beta(q_{ij,t} - \bar{\rho}_{ij})$$

so that the correlations may be computed by

$$\rho_{ij,t+1} = \frac{q_{ij,t+1}}{\sqrt{q_{ii,t+1} q_{jj,t+1}}}$$

The most important thing is that the correlation persistence parameters α and β are common across i and j. Thus the model implies that the persistence of the correlation between any two assets in the portfolio is the same. It does not, however, imply that the level of the correlations at any time is the same across pairs of assets. It does also not imply that the persistence in correlation is the same as the persistence in volatility. The persistence in volatility can vary from asset to asset and it can vary from the persistence in correlation between the assets. But the model does not imply that the persistence in correlation is constant across assets.

Data and Results

In order to apply the calculation of VaR for a portfolio composed of SIFs, worked with data for the SIF Banat Crişana, SIF Muntenia and SIF Oltenia from 2nd of March 2003 until the 10th of April 2008. We computed the log-returns for each of the assets and looked at the distributional properties with respect to the normal distribution. The software packages used for these computations were Matlab and Microsoft Excel. The results for the returns minus their means are presented next.

Figure 1 – Frequency distribution for the returns of SIF Banat Crişana

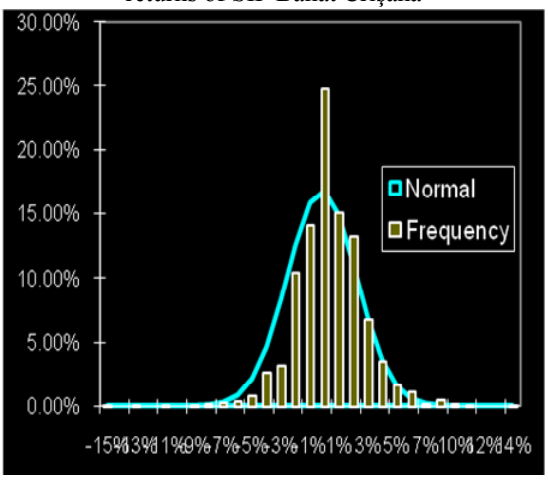
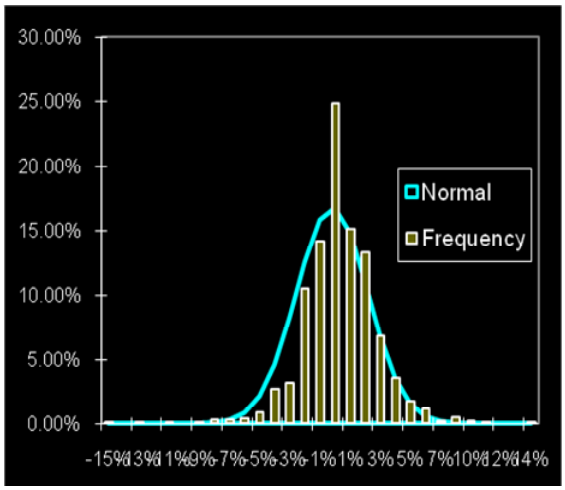
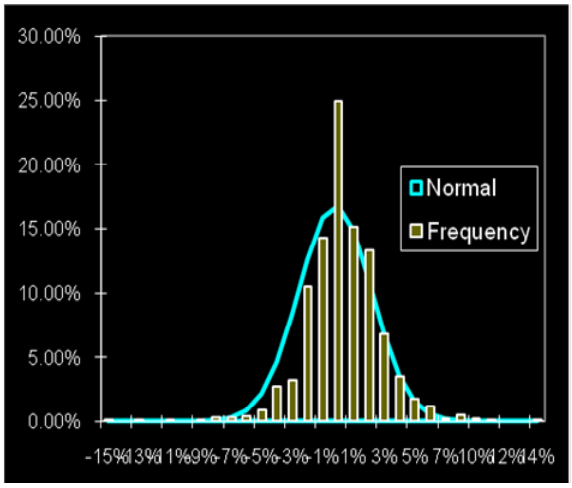


Figure 2 – Frequency distribution for the returns of SIF Muntenia



We notice that the distributions have all high kurtosis, with large tails and increased frequency around the mean, as well as negative skewness for the period we took into account. This means that the approach of computing a VaR using the parametric model (assumption that we know the distribution of returns) will lack the empirical properties of the returns by the proportion that we can observe by comparing the red curves in the previous graphs with the maps of frequencies.

Figure 3 – Frequency distribution for the returns of SIF Oltenia



The VaR should be computed by using a model that takes into account at least these two factors observed in the graphs. Previous studies showed that the use of a GARCH model might grasp the empirical properties of the returns, especially the fat-tails property. This is why the following step in our analysis consists in developing GARCH models for the three series of returns. We used for all of them the simple GARCH (1,1). The following results were obtained:

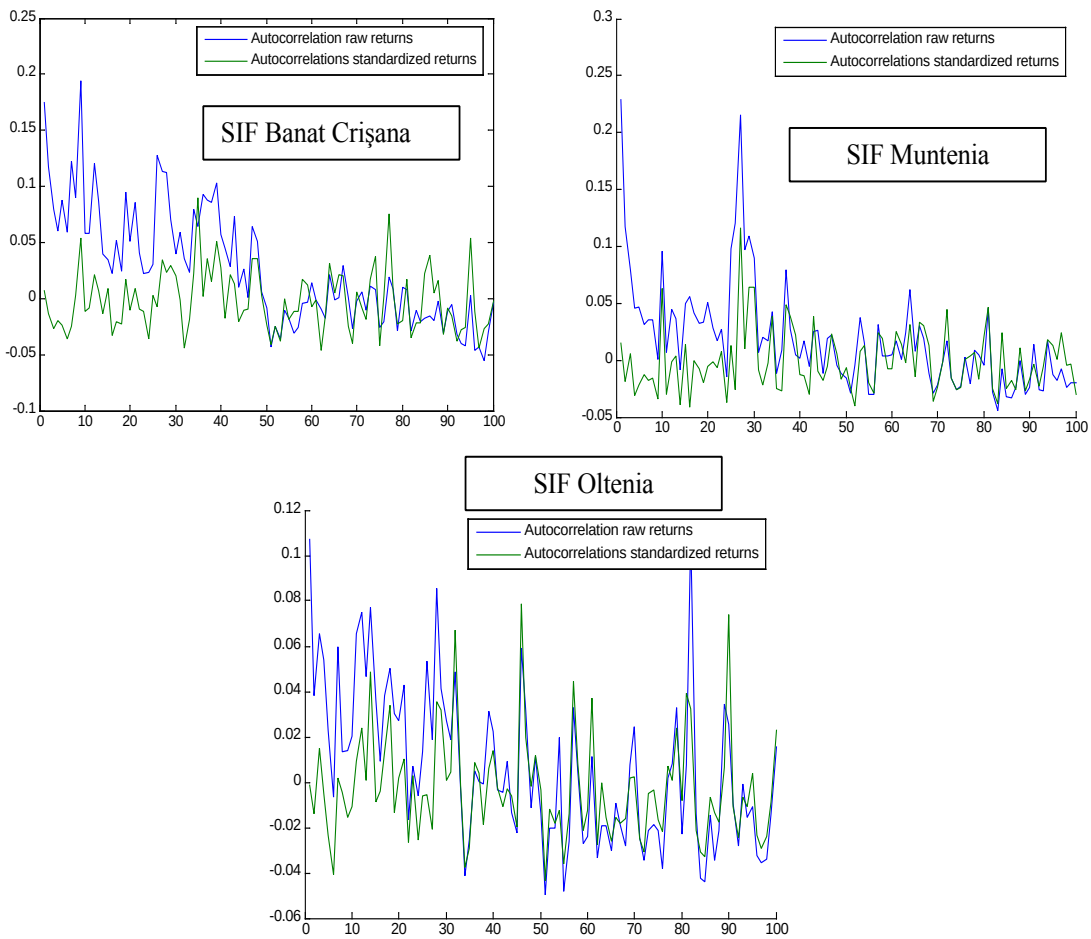
Figure 4 shows that after the use of a GARCH (1,1) model, the squared returns do not seem to show a very important pattern in their autocorrelations up to 100 lags. We used the squared returns as proxies for the daily variances and we observe that before using the GARCH as a filter, the raw returns show important patterns in their autocorrelations at a small number of paths. Our model succeeded to capture this pattern as

the autocorrelations of the standardized squared returns do not show any significant pattern. This means that the standardized returns for all the three financial instruments we took into account are "more normal" after using the model. Hence, a part of the deterministic nature of the data was capture by our model – the rest behaves very much according to a normal distribution, which is good news for the VaR computation using the parametric approach.

Table 1 – Results from the calibration of GARCH(1,1)

GARCH parameters	SIF Banat Crişana	SIF Muntenia	SIF Oltenia
α	0.192	0.14971	0.10616
β	0.76446	0.79027	0.80473
ω	3.2288e-005	4.1876e-005	5.6507e-005
$\alpha+\beta$	0.9565	0.93998	0.91089
Maximul Likelihood	3003.2	2950.9	2912.8

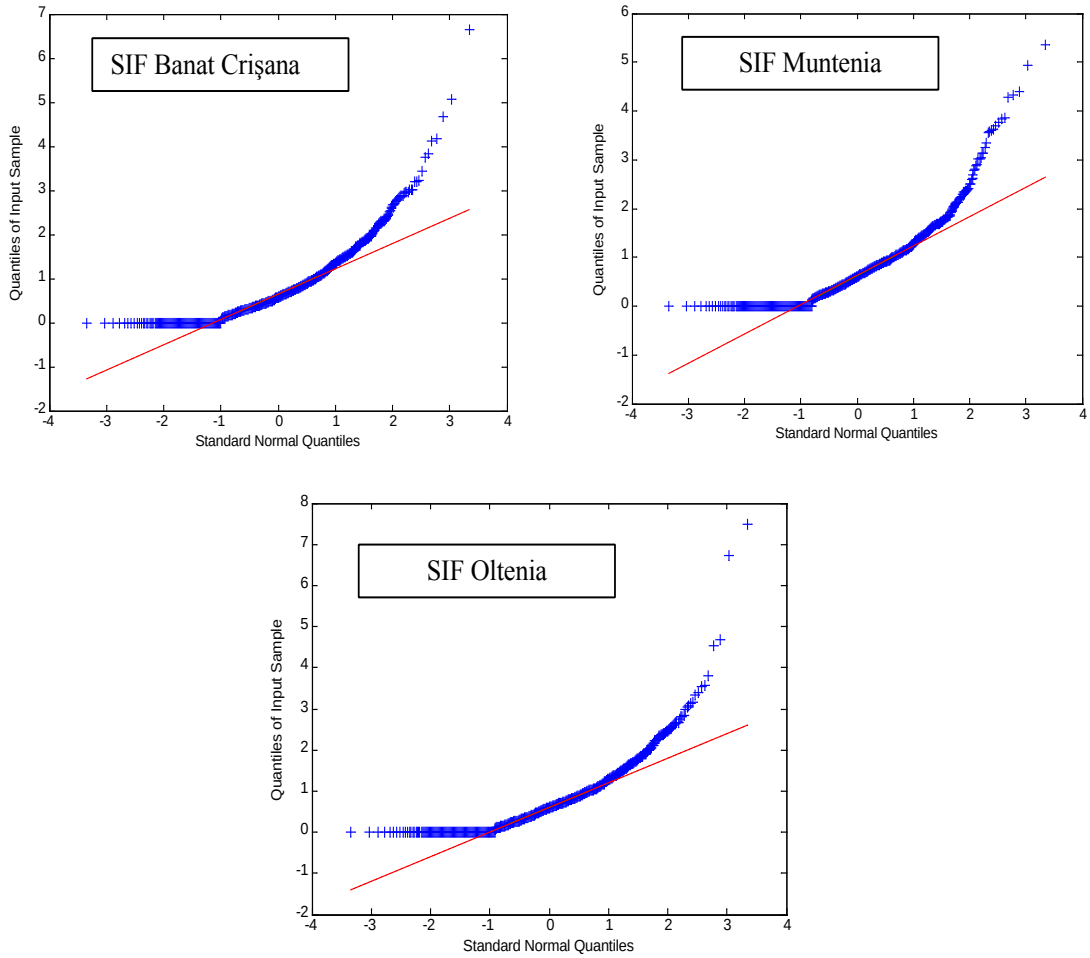
Figure 4 – Autocorrelations of Raw and GARCH (1,1) Standardized Returns



We could say more about the random features of our standardized returns by comparing them with the normal distribution.

Besides running the proper test for the normality of a time series the QQ plots perform a graphic analysis of the empirical quantiles for the series at hand and the quantiles of a theoretical distribution, like the normal distribution in our case. A horizontal line would mean that the quantiles of the time series for which we are realizing the analysis are exactly the same as the quantiles of the normal distribution. This has direct implications for a risk manager trying to employ the Value-at-Risk principle, as this statistic is merely a quantile for the distribution we are assuming.

Figure 5 – Quantile to Quantile plot for the standardized returns and the normal distribution



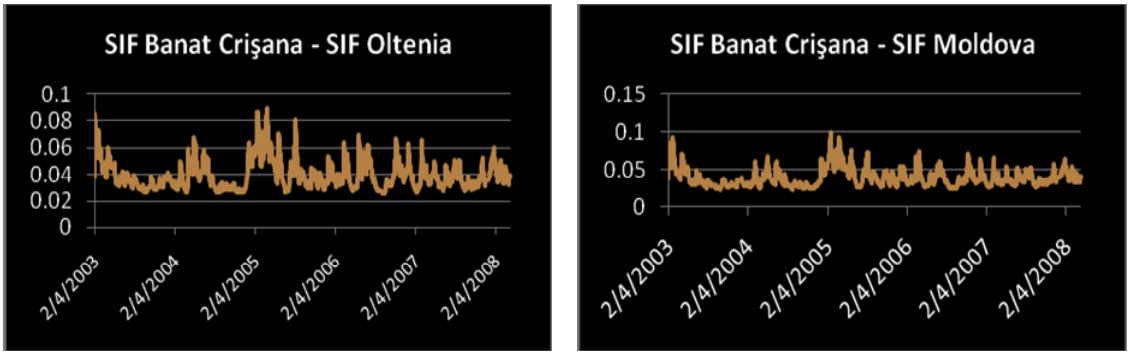
We can observe that neither the raw returns (as shown in figure 4) nor the standardized ones behave in a normal manner. They show important deviations from the normal especially in the tail region, meaning that the tails are much heavier than the normal. The increased kurtosis phenomenon was not totally eliminated by the power of the GARCH model. However, we will try to obtain more information for a portfolio risk management approach by taking into account the relations that appear among the assets in the hypothetical portfolio. This is why the next step consists in the calibration of the GARCH Dynamic Conditional Correlation model for the SIF Banat Crişana and each of the other two financial instruments from our analysis.

The authors realized the computations writing a code in Matlab and defining specific optimization functions for the estimation of the parameters in the GARCH (1,1) estimation for the univariate models and the Dynamic Conditional Correlation model. The results are presented in the following table. The coefficients were estimated by the use of the Quasi Maximum Likelihood principle, according to which the assets are assumed to move under the GARCH DCC model so that the residuals (standardized returns) follow the normal distribution eventually (after an important number of observations).

Table 2 – Parameters estimates for the Dynamic Conditional Correlation model

	SIF Banat Crişana and SIF Oltenia	SIF Banat Crişana and SIF Muntenia
α	0.2578	0.10219
β	0.7422	0.89781
Maximum Likelihood	616.84	568.13

Figure 6 – The VaR coefficients over the whole period for the hypothetical portfolios



The two portfolios considered for our analysis consisted in 50% investment in SIF Banat Crişana and 50% in each of the other two instruments. The model provides a method for the computation of VaR in a dynamic way. As seen in the graphs, the VaR is changing according to the movement in both the correlation and the variance of the two assets in our sample. The method presented in this paper can be extended further to include other assets. The model allows for movements in the matrix of correlations for the financial instruments in the portfolio – at each moment in time the correlations are changing in a deterministic manner. The empirical analysis provides evidence for the appropriateness of this model, especially under crisis events.

Conclusions

Our paper presents the methodology for the computation of dynamic VaR considering the evidence provided by empirical studies, according to which the distribution of the financial assets returns do not follow an unconditional normal distribution. We present the properties of some of the most traded assets at the Bucharest Stock Exchange – the SIF Banat Crişana, SIF Moldova and SIF Oltenia, considering that the analysis could be extended to other assets too. The first analysis proved that the returns show non-normal distributional properties, especially by looking at the asymmetry and the fat-tails effect.

We showed that the simple GARCH (1,1) model is able to extract part of the deterministic nature of the financial returns but the residuals are still keeping some non-normal features, which means that a GARCH based VaR measurement of the risk should take into account these issues.

In the end we built a GARCH Dynamic Conditional Correlation model that allows for heteroskedasticity in the univariate series of financial returns and for movements in correlations. This model was used for the computation of VaR in hypothetical portfolios composed of the three financial instruments listed on the Bucharest Stock Exchange. The dynamics of the correlations were evidenced in many papers on instruments listed on the developed markets, so the Romanian financial risk managers should take into account the proposed methodology.

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Associate Professor Adrian Mihai Inceu
Associate Professor Dan Tudor Lazăr
Bogdan Andrei Moldovan
Alexandru Pavel
Paul Zai
"Babeş-Bolyai" University of Cluj Napoca, Romania

FINANCING HIGHER EDUCATION ACROSS EUROPE

Abstract: *This paper analyzes the higher education funding mechanism from a general point of view, concentrating on European funding of tertiary education, particularly in EU countries.*

Key words: *financing systems, health, EU, National Health Service, Social health insurance system, Private health insurance system, Community-based health insurance system, Out-of-pocket payments system*

JEL Classification: *H52, H75, I22,*

The development of education is realized according to the needs of different stages of socio-economic development and of the equalization of the training and education conditions of all members of our society. The education is asked to contribute to the wide progress of society. The development and modernization of education has led to the increase of the resource allocated to it, in all countries, developing as well as developed ones[1].

In the first part of the paper we take a look at the institutional framework regarding the importance of higher education in the European Union. Then, we will analyze and shortly describe the different sources of financing - public and private. After that we will take a look at the key figures of higher education financing in the European Union like total expenditures of member countries and contribution per student as well as alternative financing sources.

In March 2000, the European Council, in Lisbon stated The European Union main goal for 2010 so that: "The Union must become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion", ("The Lisbon Strategy" - European Council, Lisbon).

In order to achieve its goal, the strategy identifies education and training as crucial factors for the development of Europe's long-term potential for competitiveness and social cohesion. This strategy involves a whole set of policy areas, from research and education to environment and employment.[2]

To achieve this ambitious goal, heads of States and Government asked for "not only a radical transformation of the European economy, but also a challenging programme for the modernisation of social welfare and education systems". In 2002, they went on to say that by 2010, Europe should be the world leader in terms of the quality of its education and training systems.

Making this happen will mean a fundamental transformation of education and training throughout Europe. This process of change should be carried out in each country according to national contexts and traditions and should be driven forward by cooperation between Member States at European level, through the sharing of experiences, working towards common goals and learning from what works best elsewhere (the "open method of co-ordination").

To ensure their contribution to the Lisbon strategy, Ministers of Education adopted in 2001 a report on the future objectives of education and training systems, agreeing for the first time on shared objectives to be achieved by 2010. A year later, the Education Council and the Commission endorsed a 10-year work programme to be implemented through the open method of coordination. Approved by the European Council, these agreements constitute the Community strategic framework of co-operation in the fields of education and training.

Ministers of education agreed on three major goals to be achieved by 2010 for the benefit of the citizens and the EU as a whole[1]:

[1] Văcărel, I; etc., - *Finanţe publice* – Bucureşti, Editura Didactică şi Pedagogică, Bucureşti, 2004 ISBN 9730-30-2635-2
[2] http://ec.europa.eu/growthandjobs/key/index_en.htm

- to improve the quality and effectiveness of EU education and training systems;
- to ensure that they are accessible to all;
- to open up education and training to the wider world.

In order to achieve the goals the European Commission urged its member states to continue to expand their investments at all levels of education and especially in tertiary education. In a communication on universities, the Commission recommends that the EU should aim, within the next ten years, to dedicate at least 2 per cent of GDP to tertiary education.

Higher education plays a central role in the development of both human beings and modern societies as it enhances social, cultural and economic development, active citizenship and ethical values. At European level, education in general and higher education in particular are not subjects of a ”common European policy ”, the competence for the content and the organisation of studies remains at national level. However according to article 149 of the Treaty of Nice, the Community ”shall contribute to the development of quality education by encouraging cooperation between Member States”, through a wide range of actions[2].

At this time, most European universities are not competitive on a global scale with the universities of Europe’s major competitors; neither in access for European students’ population, nor in attractiveness for third country students, nor in excellence of education and research. The necessary reforms cannot be accomplished within the current levels and patterns of investment. The funding gap between European universities and the universities of the key competitors should be bridged to overcome this[3].

Figure 1

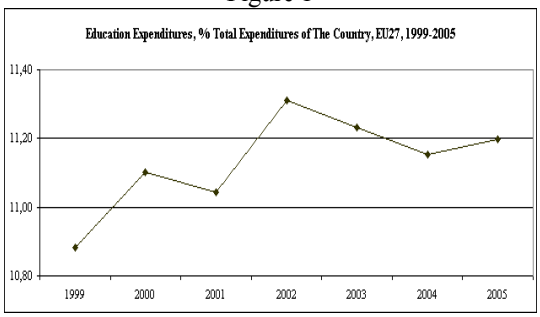


Figure 2

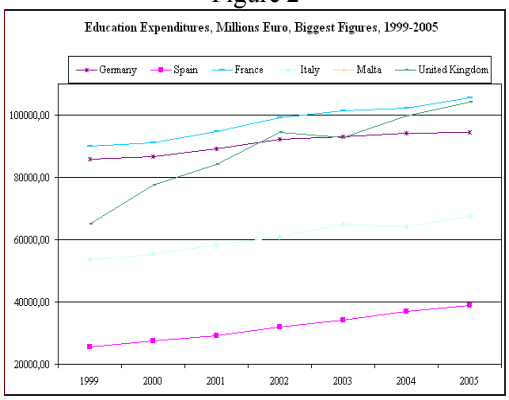


Figure 3

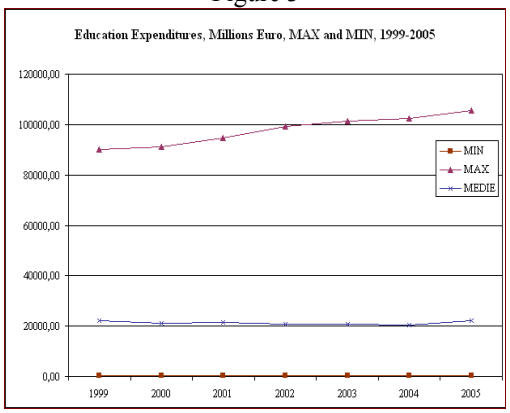
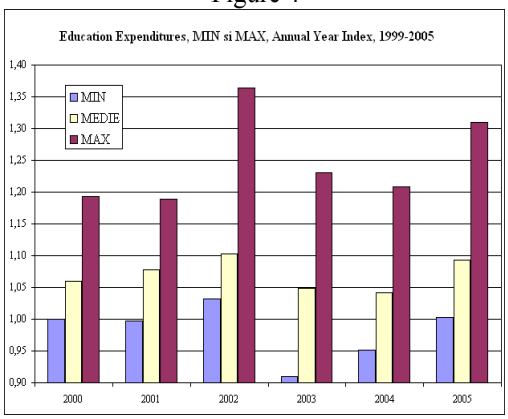


Figure 4



There is a difference in the origin of the funding-sources between European and Non European countries. Private resources are higher in countries like Japan, Australia, Canada, US and Korea. Under-funding and dependence on state funding do not only lead to the relative poverty of the higher education

[1] http://ec.europa.eu/education/policies/2010/et_2010_en.html
[2] http://ec.europa.eu/education/policies/educ/higher/higher_en.html
[3] CEGES - Centre for the Study of Higher Education Management - *Rates of return and funding models in Europe*. Final report to the Directorate-General for Education and Culture of the European Commission, Valencia University of Technology, Ed. NEXUS, 1 Pl., Valencia, 2007, p.136 - http://ec.europa.eu/education/doc/reports

sector. Consequences vary from low enrolment rates and failure to prepare students for the European labour market to difficulties in attracting and retaining top talent. The biggest funding deficit in European education and training is the comparatively low contribution from private sources (companies and individuals) in addition to (not as substitute for) the public funding[1].

The development of higher education in the European countries during the last three-four decades modified the main role of universities, transforming them into institutions that are especially oriented towards satisfying the needs of the productive system and the society in general. The state seized to be the main, unique and direct beneficiary of the higher education system. The private entities benefits from the services and product of higher education. Here are some arguments in favour of this assumption[2]:

- The general university education reduces the period of training when new technologies are implemented
- The higher productivity of educated individuals is transferred to the others employees and has an important effect on companies
- An important part of the external benefits produced by graduates is absorbed not only by the society in general (which justifies the public funding) but also by enterprises.
- The enterprises are the direct beneficiaries of the technical and scientific progress that is realized especially in universities.
-

Types of financing

The higher education level knows two main sources of financing: public and private.

Although their paper is not specifically on education finance, Epple and Romano (1996), examine three regimes for the provision of a good: market provision only, government provision only, and government provision supplemented by the private market system[3].

In virtually all developed countries the government is engaged in higher education. A commonly used argument is that private markets are unable to provide higher education up to an efficient amount. Positive externalities and capital market imperfections figure most prominently in the list of arguments claiming that investments in higher education regulated by private markets are too low[4].

In our opinion, alternative sources must be fount, more and more resources should be provided by private sources but there is room for increasing public investment in higher education, especially when the target set by the European Commission was at least 2% of a member GDP.

The reason for the existence of alternative source of financing, besides the public one is simple: public funding cannot keep the pace with the growing of higher education. Second of all, it would be fairer from a social point of view a higher private participation in higher education funding. Most important, a higher private share will probably increase the effectiveness and efficiency of the education system.

The public resources come from central, regional and local authorities while private funding comes from students, households and nongovernmental.

The relative importance of each type of financing source , either public or private varies significantly from one state to another, going from fully subsidized education in countries like Denmark, Finland and Sweden to states where the costs are supported by students trough tuitions.

For the non-UE member states, the education's financing system may be caracterized by large dependency on private sector - for example in the United States only half of the total funds for higher education comes from public sources[1].

[1] Idem

[2] Dincă, G. - *Schimbări în sistemul de finanțare în învățământul superior*,MECT Conferința Națională a Învățământului Superior, Bucureşti 2003- www.almamater.ro/schi_finante.pdf

[3] Epple, D. and R. Romano, "Ends Against the Middle: Determining Public Service Provision When There are Private Alternatives," Journal of Public Economics 62 (1996a), 297-325 *apud* Fernández, R; Rogerson, R - *Equity and resources:an analysis of education finance systems*. Working Paper 7111, National Bureau of Economic Research, Cambridge, 1999 - http://www.nber.org/papers/w71 11

[4] Wigger, B. , Von Weizsäcker, R - *Risk, Resources, and Education: Public Versus Private Financing of Higher Education* , International Monetary Fund - IMF Staff Papers Vol. 48, No. 3, 2001, p.3 - http://www.imf.org/external/pubs/ft/wp/1999/wp99174.pdf

Figure 5

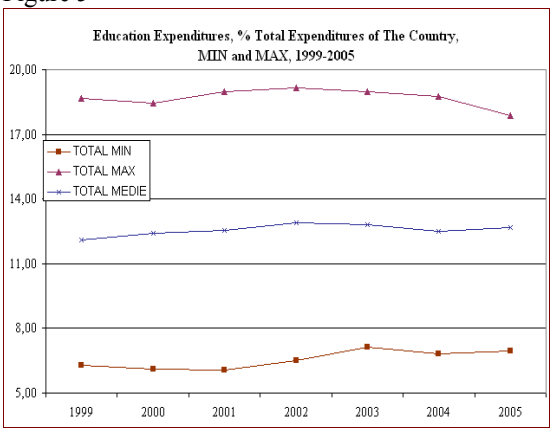


Figure 6

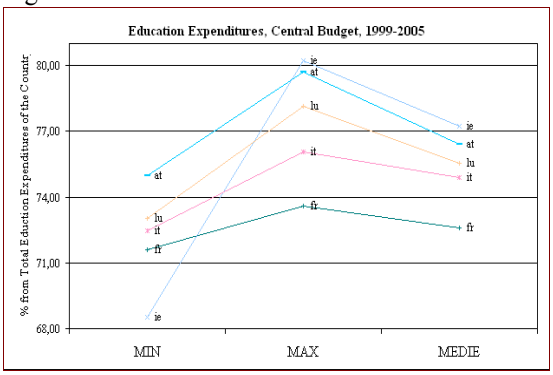
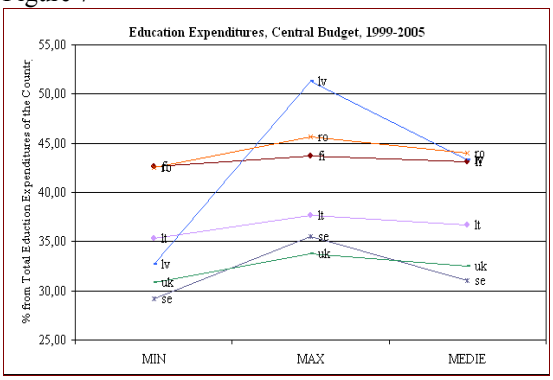


Figure 7



Public funds must be granted to higher education institution in such a way that effectiveness, efficiency and quality are promoted. In this sense, funding tools that have been experimented in some countries are the following[2]:

- *Formula base funding*. In many countries public funds are delivered to institutions as a sum based on a set of variables related to costs but also to basic outcomes. These experiences have shown a positive effect on institutions and on their results.
- *Performance funding*. Performance funding is the generalized way for funding research but it is less usual for funding teaching activities. In some countries a portion of the funds granted to higher education institutions are linked to the achievement of certain standards which were previously agreed between public authorities and institutions. The results of these experiences are also very positive.
- *Competitive and targeted funds*. In spite of research in Europe is under-financed comparatively with the US, indicators of research outputs show that the gap is lower in results than in funds. This indicates that efficiency of European basic research is relatively good. One of the explanations may be the way of financing research. Generally speaking, research is financed under criteria of competition among institution, departments, research groups or individuals. In addition, most research programmes previously set targets and objectives. There is another reason explaining the relative success of European research: the European funds for research. European research programmes have remarkably increased the competence among research teams and they have opened the research systems from a national market to a more global one. Financing targeted teaching activities or setting up programmes for financing educational activities in a competitive way among institutions must be explored. In this case, the possibility of establishing a broad European programme, similar to the research framework programmes, for developing quality and competition among European institutions for developing excellence should be considered.

[1] Consiliul Concurenței – *Ghid privind finanțarea sistemului de învățământ din România,comparativ cu unele state membre ale U. E., din perspectiva legislației ajutorului de stat* - http://www.competition.ro/Publicatii/Nota%20invatamant%2060606.pdf

[2] Rates of return and funding models in Europe – p.8

Figure 8

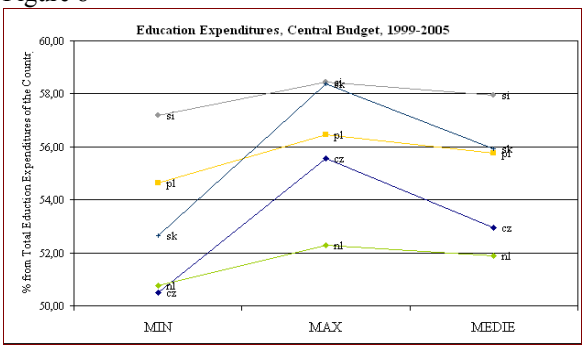


Figure 9

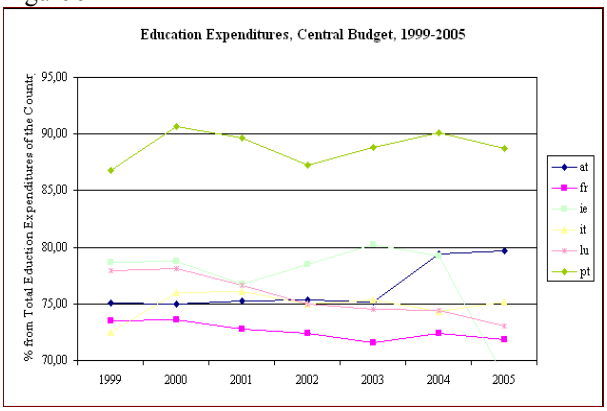
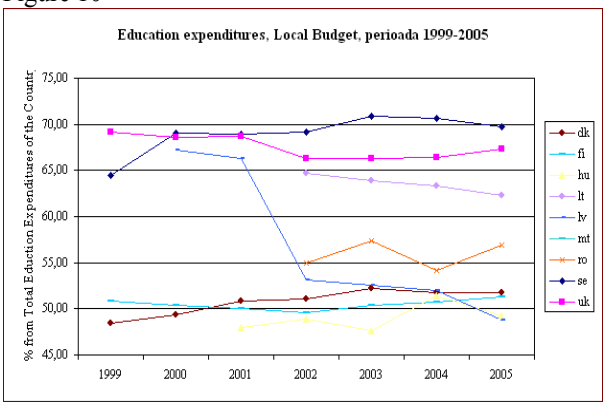


Figure 10



There are two ways that public sector uses to finance higher education:

- direct funding to institutions
- indirect funding trough financial support to students and transfers to firms and not-for-profit organisation

Regarding the **private funding** there are five possible types of funding for the high education institutions:

- Private investment through contribution to the basic costs of tuition - establishing or increasing tuition fees is a topic currently being debated in many countries. Charging or increasing tuition fees, however, has proved to be a very difficult policy from a political standpoint since it challenges many of the fundamental precepts of egalitarianism and could raise conflicts with students. On the other hand, the different levels of taxation in European countries produce different approaches to this question
- The systems of investment and support that lead to the creation of private universities;
- General contribution that some individuals make in exchange for the personal benefits to themselves or their families which accrue from university education – what is generally called alumni support;
- Research and service contracts - the contribution that organisations such as industrial companies make in exchange for direct benefits that accrue to them through research outcomes – private research support;
- Fund raising, philanthropic support - the contributions that philanthropic individuals, charitable foundations or other entities make to promote broad social benefits that universities can provide to societies[1]. With some exceptions, most European universities have not seriously sought voluntary support.

Financing in European high education, key figures

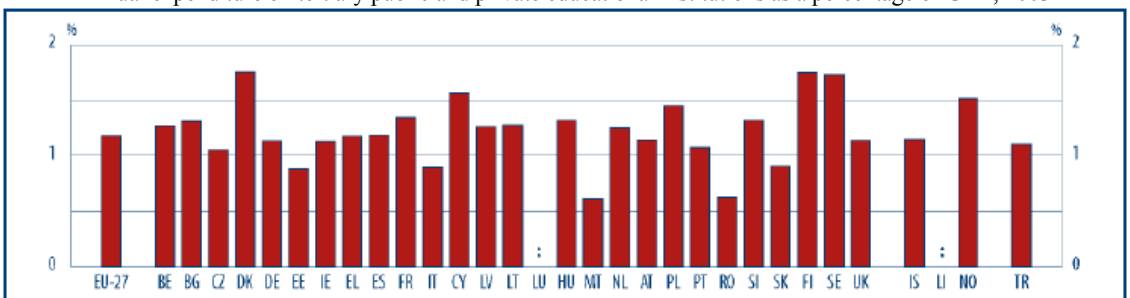
In most European countries, higher education systems were originally developed on the principles of free university education for all, the underlying rationale being that fees may discourage students from modest socio-economic backgrounds. Hence, free or low-cost entry has traditionally been seen as a means of equalising access to higher education[2].

These days the situation is changing, more and more countries taking into consideration alternative financing sources in order to cover the growing needs of higher education.

[1] Hume, W - *University Funding Models, Private Investment and Governance*,.; The University of New South Wales, German-Australian Conference on, Higher Education Financing, Berlin 24-25 october 2003

[2] Asplund, R.; Abdelkarim, O; Skalli, A. - *An equity perspective on access to, enrolment in and finance of tertiary education.* Helsinki: ETLA, Elinkeinoelämän Tutkimuslaitos, The Research Institute of the Finnish Economy, 2007, Keskusteluaiheita, Discussion Papers, ISSN 0781-6847; No. 1098

Figure11:
Annual expenditure on tertiary public and private educational institutions as a percentage of GDP, 2003



EU-27	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK	IS	LI	NO	TR
1.18	1.28	1.31	1.05	1.75	1.13	0.88	1.13	1.18	1.19	1.35	0.90	1.57	1.26	1.28	:	1.32	0.61	1.25	1.14	1.45	1.08	0.63	1.32	0.90	1.75	1.73	1.14	1.15	:	1.52	1.11

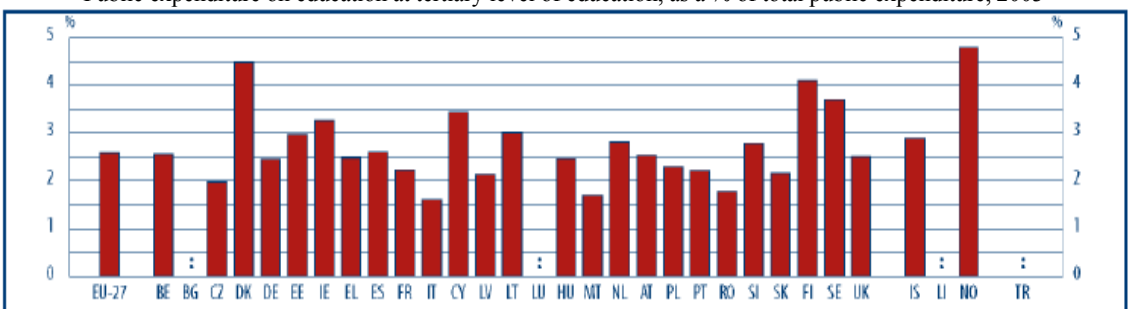
Data source: Key data on higher education in Europe – European Commision, 2007[1]

In the European Union – 27, the total expenditure either public, private or international on tertiary education institutions accounts for 1.18 % of Gross Domestic Product (GDP). The available data shows us that the Union was, in 2003 far from it's stated objective of 2%.(See Figure 11)

The figures shows us that the Nordic countries (Denmark, Finland, Sweden and Norway[2]) and Cyprus are the countries with the hihest level of expenditures on higher education, exceeding 1,5%. The proportion is lower than 1 % of GDP in Italy (0.9 %), Malta (0.61 %) and Slovakia (0.9 %). Estonia and Romania also spend less than 1 % of GDP but certain expenditure categories are not included (the payments by households to institutions) so the percentage is an underestimate[3].

The total public expenditure on tertiary education represented over 1 % of the GDP of each country. We can easily see that in almost all European countries, the public source is by far the main source of funding at this level. Public expenditure on tertiary education is over 2 % of GDP in four Nordic countries, namely Denmark, Finland, Sweden and Norway. In these countries, the public level it is higher than that of the EU-27 by at least 0.9 of a percentage point of GDP.

Figure 12 :
Public expenditure on education at tertiary level of education, as a % of total public expenditure, 2003



EU-27	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK	IS	LI	NO	TR
2.58	2.57	:	1.98	4.49	2.46	2.96	3.27	2.48	2.60	2.23	1.61	3.44	2.13	3.01	:	2.47	1.70	2.82	2.53	2.30	2.21	1.78	2.80	2.17	4.10	3.71	2.51	2.89	:	4.78	:

Data source: Key data on higher education in Europe – European Commision, 2007[4]

[1] Annual expenditure on tertiary public and private educational institutions from public, international and private sources of funding includes direct expenditure and other payments. It covers expenditure on educational core services, ancillary services (e.g. meals, university halls of residence, sports activities, etc.) and research and development activities. It does not include indirect expenditure in the form of public transfers to the private sector (e.g. public scholarships, public or commercial loans, tax relief, etc.), or educational expenditure outside institutions

[2] Countries like Norway and Turkey are part of the analisys in order to have a broad image of european education

[3] For an in-depth analysys of key indicators regarding the financing of higher education see "Key data on higher education in Europe" – European Commision, 2007 available at http://www.eurydice.org/portal/page/portal/Eurydice/showPresentation?pubid=088EN and also see the data presented in the paper "Education at a glance 2007 – OECD indicators" - http://www.oecd.org/document/30/0,3343,en_2649_37455_39251550_1_1_1_37455,00.html

[4] Total public expenditure (or total general government expenditure) is expressed in national currency (in millions) and includes government expenditure – for example at local, regional and central levels of government, as well as social security funding – under different headings (for example, welfare, health, education, etc.)

The figure above shows that the public expenditure on tertiary education accounted for 2.58 % of total public expenditure in the EU-27.

Over half of all European countries earmark between 2 % and 3 % of their total public expenditure for tertiary education. In only four countries (the Czech Republic, Italy, Romania and Malta) the proportion is less than 2 %. Four of the Nordic countries (Denmark, Finland, Sweden and Norway) allocate over 3.5 % of total public expenditure to tertiary education. In Denmark and Norway, the share of total public expenditure allocated is 4.49 % and 4.78 % respectively.

Over half of all European countries earmark between 2 % and 3 % of their total public expenditure for tertiary education. In only four countries (the Czech Republic, Italy, Romania and Malta) the proportion is less than 2 %. Four of the Nordic countries (Denmark, Finland, Sweden and Norway) allocate over 3.5 % of total public expenditure to tertiary education. In Denmark and Norway, the share of total public expenditure allocated is 4.49 % and 4.78 % respectively.

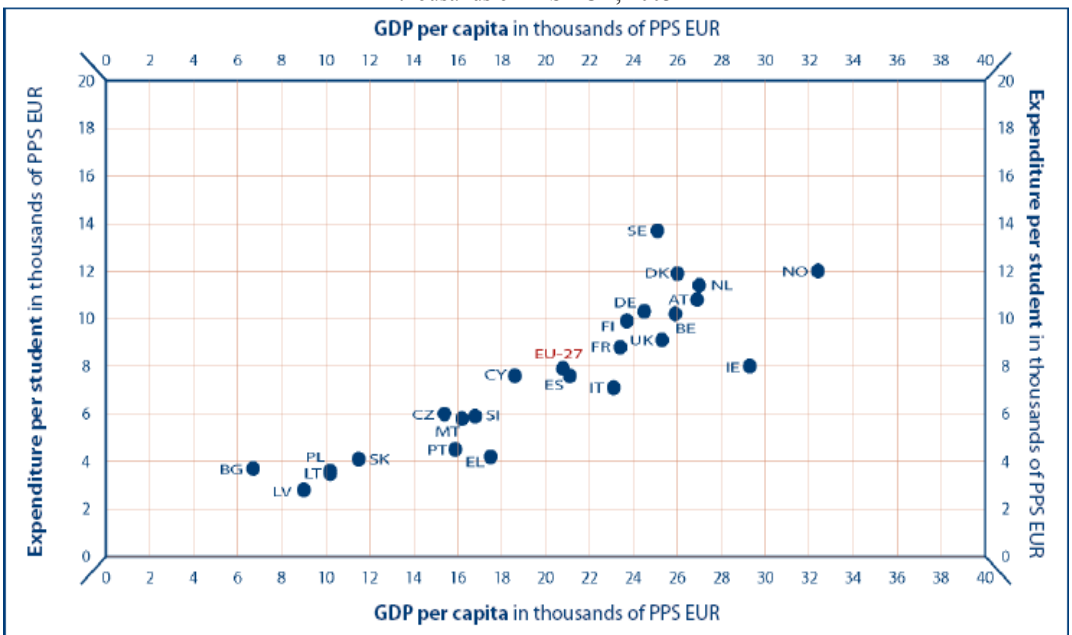
The share of total public expenditure on tertiary education is influenced by different factors such as demographic structure, the structure of tertiary level provision, participation rates and staff salary levels. Countries that spend similar proportions of their total public expenditure on tertiary education may however spend different proportions relative to their GDP, because of differences in both the size and sectorial coverage of their total public expenditure (on education, health, transport, etc.) compared to GDP.

Contribution per student

The resources countries invest in higher education may be highlited by looking at the expenditure per student in public and private institutions.

A better image of the investment in tertiary education can be obtained by comparing tvo variables: the amount spent to Gross Domestic Product (GDP) per capita. By this means, anyone can evaluate the resources available for tertiary education regarding to a country's wealth, size of its student population and demographic differences between countries.

Figure 13 Annual expenditure per student, on tertiary educational institutions, compared to GDP per capita, in thousands of PPS EUR, 2003



	EU-27	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	IT	CY	LV	LT	LU
Total expenditure per student	7 898	10 173	3 670	5 982	11 874	10 288	:	8 009	4 163	7 570	8 809	7 127	7 579	2 840	3 518	:
GDP per capita	20 800	25 900	6 700	15 400	26 000	24 500	11 100	29 300	17 500	21 100	23 400	23 100	18 600	9 000	10 200	51 500

	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK	IS	LI	NO	TR
Total expenditure per student	:	5 837	11 386	10 802	3 572	4 476	:	5 854	4 064	9 911	13 681	9 100	:	:	11 974	:
GDP per capita	13 200	16 200	27 000	26 900	10 200	15 900	6 500	16 800	11 500	23 700	25 100	25 300	26 000	:	32 400	5 700

Data source: Key data on higher education in Europe 2007[1]

[1] Explanatory note - Annual expenditure on tertiary public and private educational institutions per student covers all expenditure within a tertiary educational institution but does not cover indirect expenditure (i.e.public transfers to the private sector such as public scholarships, public or commercial loans, tax relief, etc.), or expenditure on education

The overall tendency is that the expenditure per student in public and private institutions rises with national wealth expressed in terms of GDP per capita (see Figure 13). Countries like Bulgaria, Latvia, Lithuania, Poland and Slovakia have the lowest GDP per capita and spend less per student than the other countries analised. In the case of Romania there is no data available concerning the expenditure per student. Norway has the highest GDP per capita, yet it is not the country whose expenditure per student is greatest.Sweden is the country wher the expenditure per student is the biggest – 13681 euro/student

Alternative funding sources

Most industrial countries have , in the past, subsidised the provision of higher education. Nowadays, a common feature of most European countries is the limited amount of private resources that is funding higher education. Most of the private financing comes from household expenditures (students and their families) while other private sources like alumni suport, enterprises, donations, charities play a much smaller role than in non UE countries like the US an Australia for example.

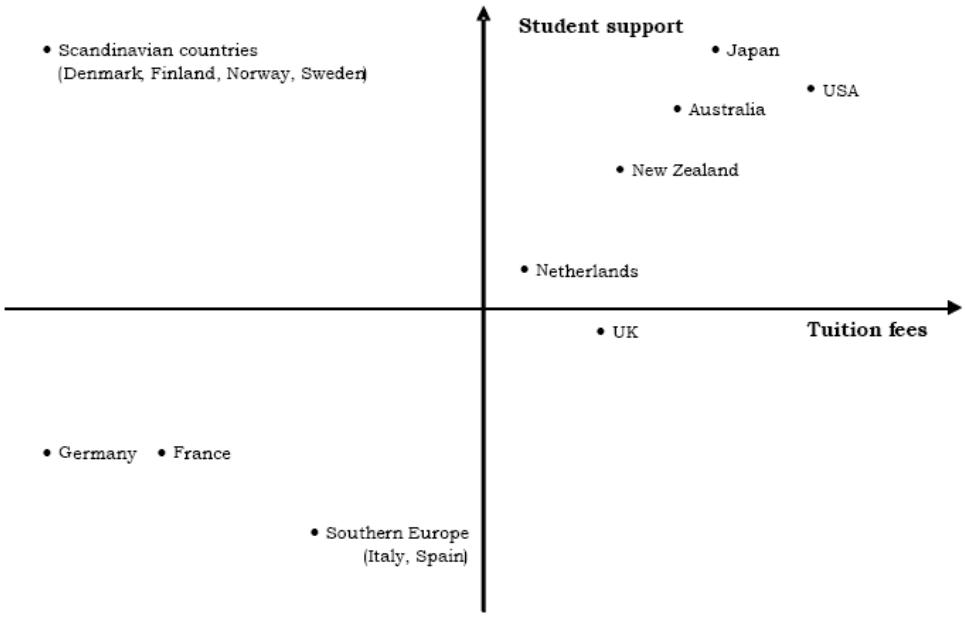
In recent years, several European countries - including here Romania, have tried to ease the financial burden of the state by introducing or raising the tuition fees charged to university students. In the UK for example the tuition fees are the highest in Europe.

These days alternative financing schemes, which rely on contributions from students, are being increasingly adopted. The problem is that some students may be unable to contribute and, taking this into consideration we can say that fair access to education is not granted(See Del Rey, 2006). The practice of latest years identified student loans as a means to overcome the problem of fair access to tertiary education. Even if loans are made available to overcome the financing constraints of students, education is often viewed as a risky investment, which can further hinder participation.

The US government approach is that while imposing tuition fees they manage to encourage students to pursue university studies through grants, scholarships and loans..

It is interesting to see that there is a strong correlation between tuition fees and student support. In the countries where tuition fee is the highest, the student support is likewise. Figure 4 provides a comparison of a selected number of European and non-European countries in two dimensions: the amount of tuition fees charged to the students as an indicator of the diversity of funding sources, and the extent of student support.

Figure 14



Source: Asplund (2007)

Conclusions

Since the 1990s, higher education systems in European countries have been characterised by intensified reforms and accelerated changes: What we know about change has changed already. The changes

outside educational institutions (household purchases of books or stationery). The indicator is based on full-time equivalent enrolment.

and new demands of society and industry have identified new challenges to the world of higher education and are directly and indirectly influencing higher education institutions (Strehl et. All 2007).

The main trend noticed in last years, is that the number of students is growing . On the other hand, spending per student at the tertiary level has in some cases fallen, as total expenditure remains the same, or it raises but does not keep up with the expansion of student numbers. The comparative review of how trends in educational expenditure per student have evolved shows that in many countries the expansion of enrolments, particularly in tertiary education, has not always been paralleled by changes in educational investment.(OECD 2007).

Acces to education is an important issue nowadays. Data analysis showed that public investment is the key in increasing levels of access to tertiary education. Thus, an increase in public expenditure on tertiary education equivalent to 1% of GDP is associated with a 21% increase in gross enrolment rates[1].

Politicians, managers and leaders continue to search for ways and methods to develop governance and management structures and cope with opportunities and threats brought by a permanently changing environment. What governments will have to continuea doing is to implement systems that follows the following objectives: raising the general level of financing, diversifying revenue sources of universities, increasing the degree of eficiency in money spending, ensure supplementary financing sources for the research activity in order to become internationally visible and ensuring financial suppor for students like allowances, grants and loans.

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Associate Professor Adrian Mihai Inceu
Associate Professor Dan Tudor Lazăr
Bogdan Andrei Moldovan
Alexandru Pavel
Paul Zai
"Babeş-Bolyai" University of Cluj Napoca, Romania

STUDY REGARDING THE MOST IMPORTANT PUBLIC EXPENDITURES IN EU27

Abstract: *This article is focused on the way how the most important public expenditures are decentralized in EU27 countries between 1999 and 2005.*

Key words: *financing systems, EU, decentralization, Central government budget, State budget, Local government budget, Social security funds*

JEL Classification: *H50, H72, O57*

Figure 1

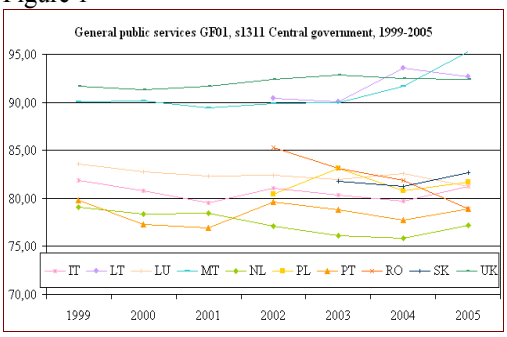


Figure 2

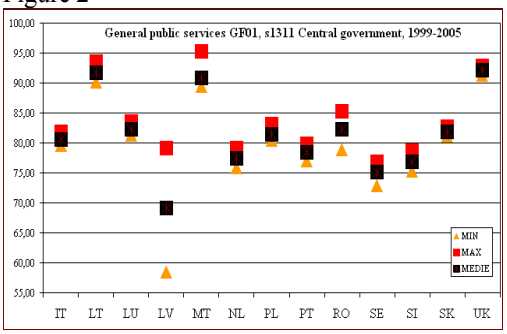
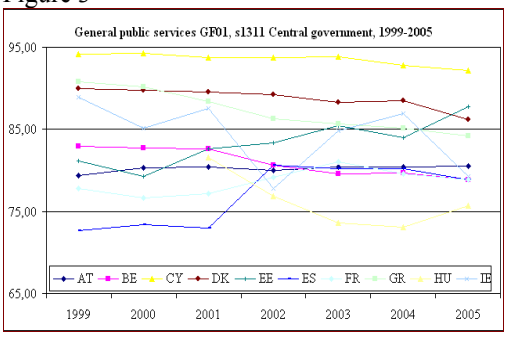


Figure 3



Decentralization means the transfer of administrative and financial competences related to public services from the central to local level. In our opinion a centralized system can not respond to the multiple needs of the local governments, because the local governments are the most responsible in front of the citizens when they are delivering different services. An exception for the aspects mentioned, are the sectors that have a strategic importance. This problem of decentralization is related to the political and technical factor from the central and local level.

The expenditures chapters that will be studied are the following: general public services (GF01), defense (GF02), public order and safety (GF03), economic affairs (GF04), environment protection (GF05), housing and community amenities (GF06), health (GF07), recreation, culture and religion (GF08), education (GF09), social protection (GF10).

All the data have been extracted from the European Union web site[1]. All the data have been processed in order to determine how much expenditures are located in the local budget.

The 26 countries that are studied are: Austria (AT), Belgium (BE), Cyprus (CY), Czech Republic (CZ), Germany (DE), Denmark (DK), Estonia (EE), Spain (ES), Finland (FI), France (FR), Greece (GR), Hungary (HU), Ireland (IE), Italy (IT), Lithuania (LT), Luxemburg (LU), Latvia (LV), Malta (MT), Holland (NL), Poland (PL), Portugal (AT), Romania (RO), Sweden (SE), Slovenia (SI), Slovakia (SK), United Kingdom (UK).

These expenditures correspond to general expenditures of the general government, calculated by taking in to account The European System of Accounts (ESA 95).[2] The methodological frame is

[1] http://epp.eurostat.cec.eu.int http://circa.europa.eu/irc/dsis/nfaccount/info/data/esa95/en/een00080.htm
[2] http://forum.europa.eu.int/irc/dsis/nfaccount/info/data/esa95/en/esa95en.htm

Figure 4

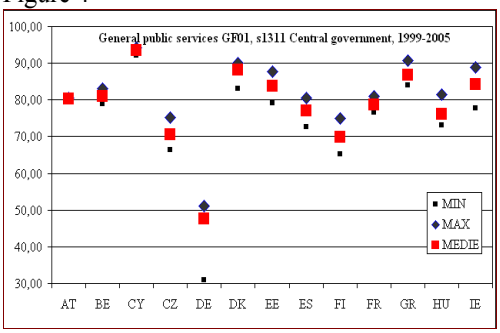
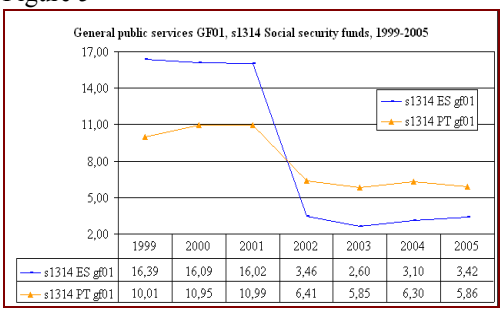
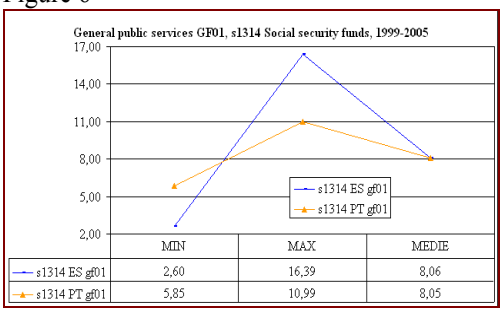


Figure 5



	1999	2000	2001	2002	2003	2004	2005
s1314 ES gf01	16,39	16,09	16,02	3,46	2,60	3,10	3,42
s1314 PT gf01	10,01	10,95	10,99	6,41	5,85	6,30	5,86

Figure 6



	MIN	MAX	MEDIE
s1314 ES gf01	2,60	16,39	8,06
s1314 PT gf01	5,85	10,99	8,05

Figure 7

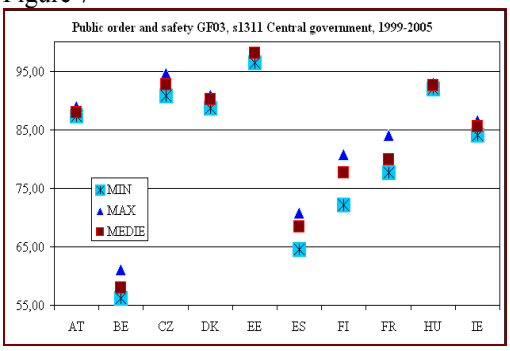
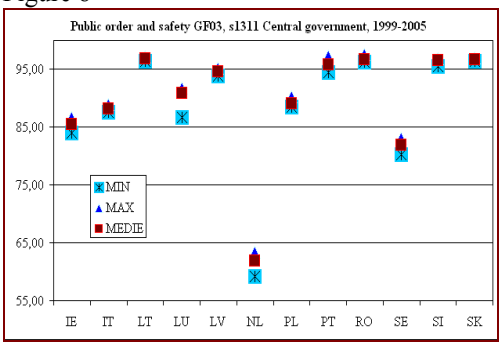


Figure 8



The European System of Accounts and the data are based on national accounts transmitted by the member states of EUROSTAT. We have to say also that the sector of general government includes four sectors (S13): Central government, State government, Local government and Social security funds.

Expenditures mentioned above are studied at different levels: central budget, federal (if is the case), local budget and social found in all countries. Our objective is to emphasize the way in which the expenditures are allocated to each budget. Our analysis is referring to the principal E.U. expenditures in accordance with the standard classification used.

We should mention that all the tables that are presenting the most important expenditures in absolute amounts, in Euro. Those data have been processed in order to calculate the percent of each type of expenditure from central budge (S1311), federal budget (S1312), local budget (S1313) and social security founds (S1314) in total expenditure for each country.

Additionally, for all expenditures we have calculated the minimum and maximum percent, the average on each year for all 26 countries. So, we can easily observe in which country the values are interesting, between 1999 and 2005. Follow-up we will try to present how are splinted the principal expenditures.

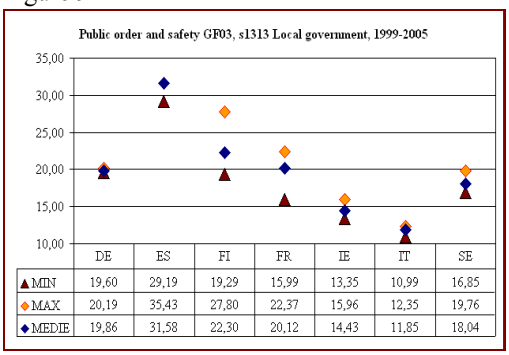
General public services (GF01). Referring to General public expenditure chapter from the state budget, we have to say that the highest percentages of the general public expenditures from the central budget in total general public expenditures in total general public expenditures are in Cyprus. In this country the maximum percent is 94,22% in 2000, and a minimum of 92,13% in 2005. The total expenditures regarding general public services from Cyprus have registered an increase in the analyzed period from 1026.2 millions euro in 1999 to 1696.7 millions euro in 2005. Denmark, Malta and Great Britain are in the same situation.

The countries in which are registered the most decentralized expenditure on general public services are Latvia (41,56%) and Finland (34,30%)[1]. We consider that we have to remind the fact that the levels of public services expenditures from Romania have an average of 16,78% in the analyzed period.

An interesting aspect that we have to underline is that this type of expenditures have important percentages in Social found, just in a few countries like: Estonia (where we have a maximum percent of 16,39% in 1999 and a minimum on of 2,60% in 2003), Portugal (the expenditures regarding General public services have an descendant tendency from 10,99% in 2001 to 5,86% in 2005), Luxemburg (with percents up to 1,82% in 1999), the rest of the 26 E.U. countries have percents

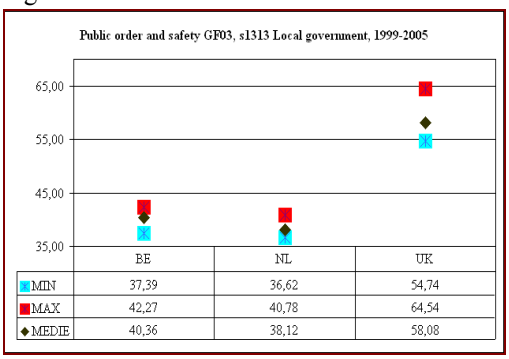
[1] the percents represents the level of local general public services expenditures from each country in total general public services expenditures from each country

Figure 9



	DE	ES	FI	FR	IE	IT	SE
MIN	19,60	29,19	19,29	15,99	13,35	10,99	16,85
MAX	20,19	35,43	27,80	22,37	15,96	12,35	19,76
MEDIE	19,86	31,58	22,30	20,12	14,43	11,85	18,04

Figure 10



	BE	NL	UK
MIN	37,39	36,62	54,74
MAX	42,27	40,78	64,54
MEDIE	40,36	38,12	58,08

Figure 11

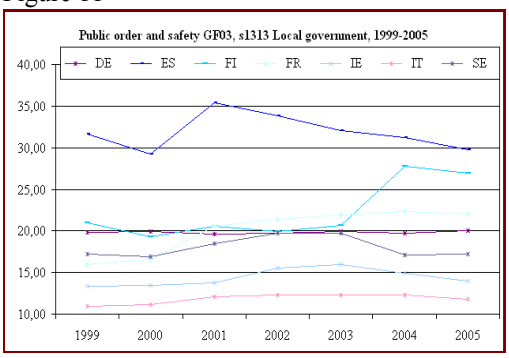
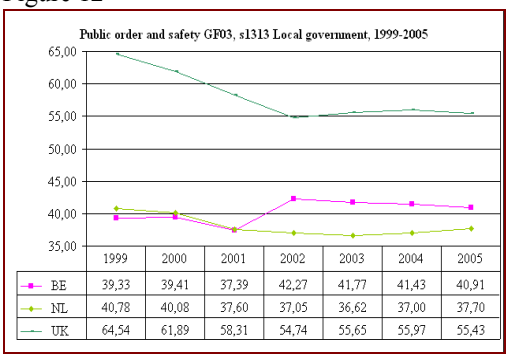


Figure 12



	1999	2000	2001	2002	2003	2004	2005
BE	39,33	39,41	37,39	42,27	41,77	41,43	40,91
NL	40,78	40,08	37,60	37,05	36,62	37,00	37,70
UK	64,54	61,89	58,31	54,74	55,65	55,97	55,43

close to 0. This fact shows that there are just three countries from those 26, in which the general public expenditures have percentages in Social found that have to be mentioned.

Defense (GF02). A particularity of this type of expenditures is the facts that in most of the countries there are centralized because these types of expenditures are strategic ones. So, there are 14 countries (Austria, Belgium, Cyprus, Germany, Spain, France, Greece, Ireland, Italy, Luxemburg, Malta, Holland, Portugal and Slovenia) from those 26 in which between 1999 and 2005 these expenditures are located totally in the central budget.

Czech Republic is the county that has the lowest percent of central defense expenditures in total defense expenditures in 2005(94,85%). In the rest of the countries that were not mentioned the percent of the defense expenditures in total defense expenditures is over 98%. The countries that have a percent of defense expenditures from the local budget in total defense expenditures above 1%, are only Czech Republic and Denmark. So, in Denmark the local budget defense expenditures were 27.2 millions euro in 1999. The highest defense expenditures from all 26 countries are in Czech Republic (in 2003 these expenditures were 80.6 millions euro.

In 2004 E.U. states have spent together approximately 210 billions USD. By the other hand U.S.A. spent in the same year 455 billions USD.[1] On international level we can observe that U.S.A. Russia and China tries to increase their military expenditures, and they are challenging each other. European Union is more concerned about the political and economical problems. European Union didn't increase so much military expenditures after 11 September 2001. One cause can be worldwide economic stagnation from the last years.

Public order and safety (GF03). First aspect that we consider that we have to underline is that only Czech Republic, Greece and Malta have public order and safety expenditures entirely located in the central budget. In Estonia this type of expenditures is very important taking in to account that in 2005 the maximum percent on central budget is 100,08%. This phenomenon is happening because public order and safety expenditures in local budget are -0.2 millions euro. The most decentralized public order and safety expenditures are in U.K., Belgium, Spain and Holland. In UK we have a maximum percent of local public order and safety expenditures in total public order and safety expenditures of 64,54%. In Spain local public order and safety expenditures decrease from 2853 millions euro in 1999 to 3814 millions euro in 2001. After that is decreasing to 3751 millions

[1] *SIPRI military expenditure database*

Figure 13

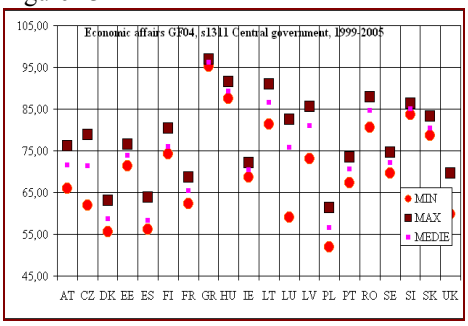


Figure 14

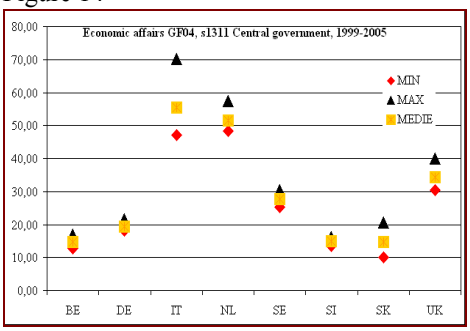
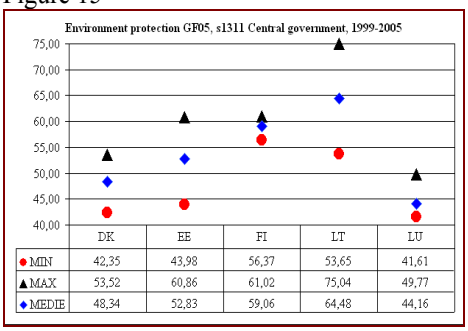


Figure 15



	DK	EE	FI	LT	LU
MIN	42,35	43,98	56,37	53,65	41,61
MAX	53,52	60,86	61,02	75,04	49,77
MEDIE	48,34	52,83	59,06	64,48	44,16

Figure 16

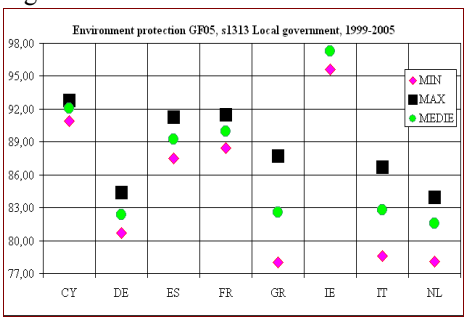
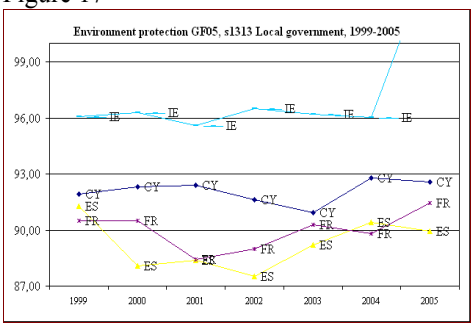


Figure 17



euro in 2003, and increasing at 3893 millions euro in 2005. The local public order and safety expenditures are just 46,2 millions euro in 2005.

In Romania we have some local public order and safety expenditures and we think that this expenditures are related to local police.

Economic affairs (GF04)

The level of economic affairs expenditure from the national budget in the total economic affairs expenditure is very high on the whole period: in Cyprus is 100% on the whole period, in Malta is 100% in the period 1999-2004 and 99,08 in 2005. In Greece the level of economic affairs expenditures from the central level reported to the total economic affairs expenditures is not changing very much, so on the whole period the percentage is changing from 95,2% and 96,91%. A high level of economic affairs expenditures from the central level in the total economic affairs expenditures is registered in Latvia. In this country in the analyzed period 1999-2005, the level of economic affairs expenditures from the central budget in the total economic affairs expenditures is increasing from 79,17% in the year 2000 to 85,51% in the year 2005.

In Romania in the period 1999-2005, the economic affairs expenditures form the central level as a percentage form the total economic affairs expenditures is decreasing from 85,08% in 2002 to 80,56% in 2005. Italy is the only country from those analyzed which registered the lowest degree of economic affairs expenditures from the central level in total economic affairs expenditures with a percentage under 30% in 2000 (29,92%).We can mention by analyzing the data form the local level, that the economic affairs expenditure from the local budget in total economic affairs expenditures in Italy is over 70% which compensate the low level of the economic affairs expenditures from the central level and moreover demonstrate the high degree of decentralization of these expenses in Italy.

The situation of economic affairs expenditures from the local level as a percentage in total economic affairs expenditures is: in Lithuania 41,05% in 2001 which represents an increase from the previous year (24,40% in 2000). Still 2001 is an unusual year for Lithuania because beginning with 2002 the percentage of economic affairs expenditures from local budget in the total economic expenditures is under 24%. The situation of Lithuania is very similar with that of Latvia where the percentage of economic affairs expenditures from the local budget in the total economic affairs expenditures in 2001 is 26,98% followed by a period in which the percentage has decreased (under 20%).

Figure 18

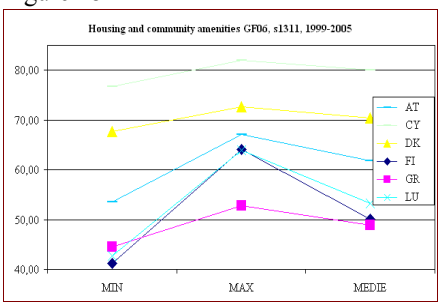


Figure 19

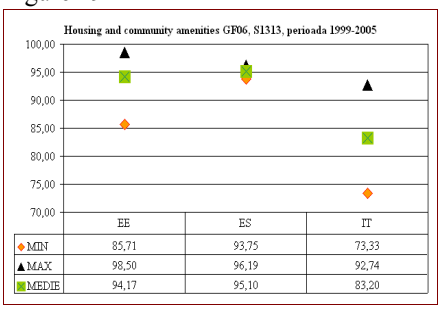


Figure 20

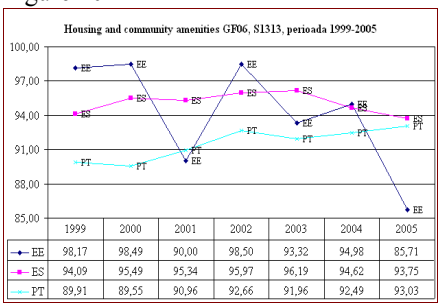


Figure 21

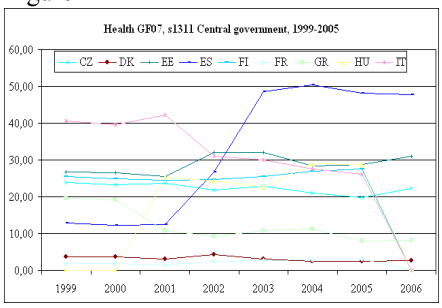
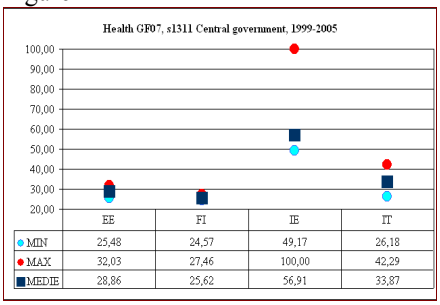


Figure 22



In Romania the percentage of economic affairs expenditures from the local budget in total economic affairs expenditures is low under 15% on the whole period, the exception year is 2005 when economic affairs expenditure from the local budget in the total economic affairs expenditure is 16,79%.

The analysis of the economic affairs expenditures from the Social Found in the total economic affair expenditures shows us that in the countries like: Austria, Cyprus, Check Republic, France and Malta there are no economic affairs expenditures in Social Found. Germany and Spain register a level of economic affairs expenditures from the Social Found in the total economic affairs expenditures over 10% on the whole period. In Romania the level of economic affairs expenditures from Social Found in total economic affairs expenditures is under 1% in the period 2002-2004 and 2,64% in 2005.

Education

We also can draw a conclusion regarding the degree of decentralization of educational system by analyzing the data we have in all of the countries studied.

We can observe a high degree of centralization of educational system in Cyprus and Malta, where the level of education expenditure from the central budget in the total education expenditure is 100% on the whole period. The lowest degree is registered in Germany where the level o education expenditure from the central budget in the total education expenditure is under 3% between 1999-2001 and under 3,5% in the period 2002-2005. Also Belgium has a percentage of the education expenditure from the central budget fewer than 15% on the whole period.

Regarding Romania, we can conclude that our country has a high degree of decentralization as it concern the education system considering the level of education expenditure from the local budget in the total education expenditure (over 50% on the whole period). Other countries which have such a high level of the percentage for education expenditure from the local budget in the total education expenditure are: Finland over 50% and Sweden over 60% on the whole period.

On the opposite side, as it obvious, the countries that have the lowest percentage of education expenditure from the local budget in total education expenditure are Cyprus and Malta (0%) followed by Greece under 3% and Portugal under 8%.

As regards the level of education expenditure from Social Found as a percentage of total expenditure, except for five states from the total of those analyzed, all the rest have no education expenditure in the Social Found. The exceptions are: Austria, Spain, Finland, Portugal and Romania. Finland and Portugal has the highest level of education expenditure form the Social Found as a percentage from the total education expenditure with average of 6,40% on the whole period in Finland and 3,74% in Portugal.

Mainly this decentralization process will transfer step by step (till 2010) all the duties of current education system from the central level to the local level. By increasing the decentralization process as regards the

Figure 23

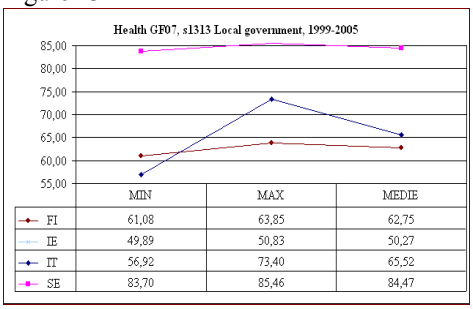


Figure 24

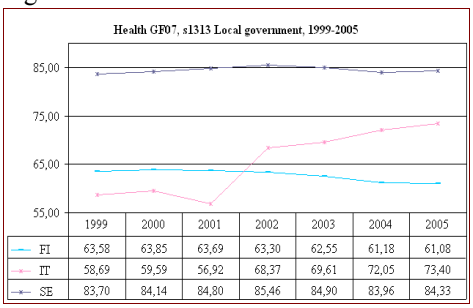


Figure 25

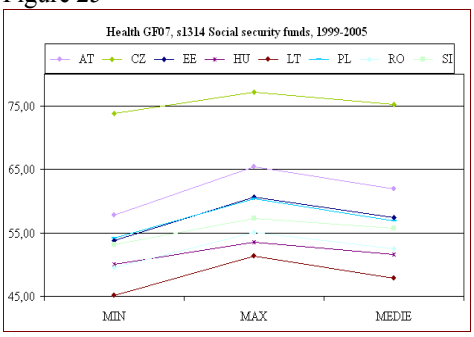


Figure 26

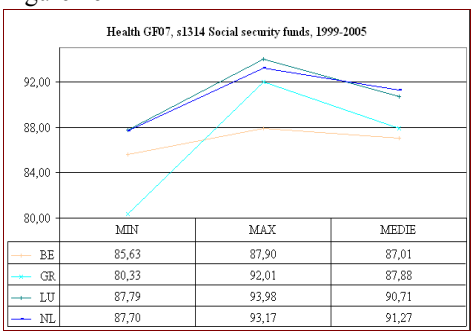
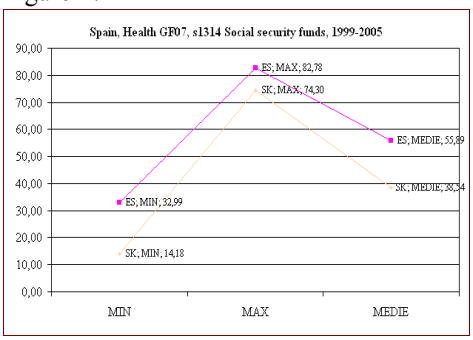


Figure 27



education, it should have as a result a better framework for cooperation between local administration and educational institutes. Another consequence should be: the settlement of the baseline for the stakeholder in order to may exercise these duties; increasing the central administration capacity to create better education public policy and a good coordination and monitoring system for these policies; increasing the capacity of local administration to manage the educational system form the local level.

The most important difficulties that can be marked regarding the decentralization process of educational system are mainly due to the resistance that the educational system is responding to these reforms. An important role has the implication of the politicians in the selection and promotion process in education system and more important in public founds allocation (distribution) process. We can also mention as a threat of decentralization process a bad managerial approach of the directorates from the educational institutes to put into practice all the new responsibilities that where given to them. As regards the public resources, in educational system the resources are inefficient used and due to this fact are not totally spent. In order to emphasis the quality of decentralization in educational area we can also mention the lack for cooperation structure between central and local institutes and at the local level between different educational organization (public or nonpublic).

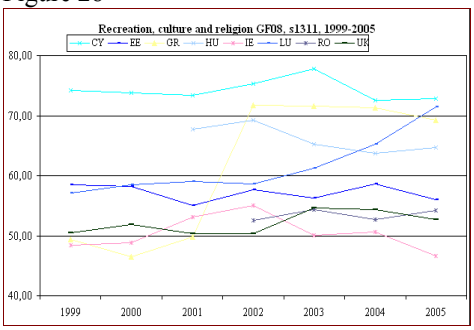
Environmental protection

In the last years the public expenditures regarding the environmental protection from the most civilized countries has known a significant increase, as a consequence of the increasing preoccupation of the governments and especially of the European Union to the problems of environmental protection. Romania is the only country from those analyzed in which the expenditures for environmental protection are mentioned only in the central budget. Other countries with similar situation but not totally, which has a high level of environmental protection expenditure in central budget are Slovenia over 95% on the whole period, Estonia over 50% and Denmark with a percentage over 40% on the whole period. The lowest percentage as of the environmental protection expenditure in the central budget is in Germany, Ireland and Spain.

Regarding the percentage of environmental protection expenditure from the local budget in the total environmental protection expenditure we can observe that this percentage is very high in: Ireland, Spain and Cyprus. In these countries the level of environmental protection expenditure from the local budget in the total environmental protection expenditure is over 90% in the whole period. Slovenia is one of the countries studied that has the lowest level of environmental protection expenditure from the local budget as a percentage from the total environmental protection expenditure, with an average on the whole period of 3,02%.

In the analyzed period 1999-2005 in whole of the countries the environmental protection expenditure form the Social Found in total environmental protection expenditure is 0%.

Figure 28



Health (GF07)

Health expenditure has known over the years a various number of reforms and it is a sensible subject as regards the decentralization process of this field.

Cyprus is a good example of centralization of this expenditure on the central level, as we can observe that on the whole period health expenditure from the central budget in Cyprus, as a percent of the total health expenditure, is 100%. The countries with the most centralized system as regards health expenditures are Cyprus, Malta and Great Britain.

Figure 29

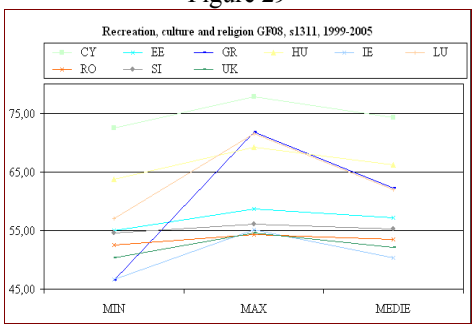


Figure 30

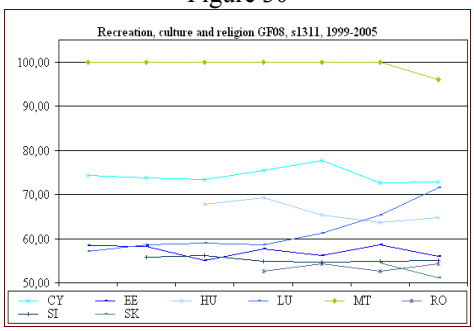


Figure 31

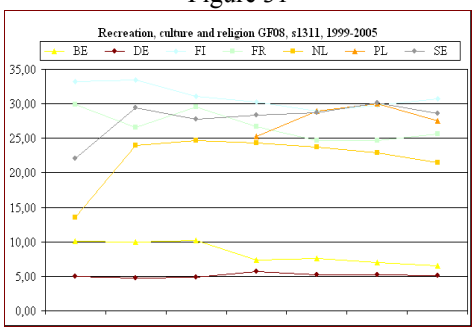


Figure 32

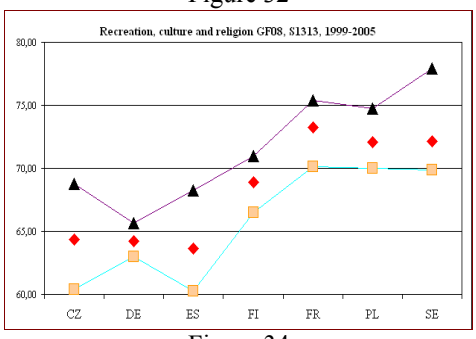
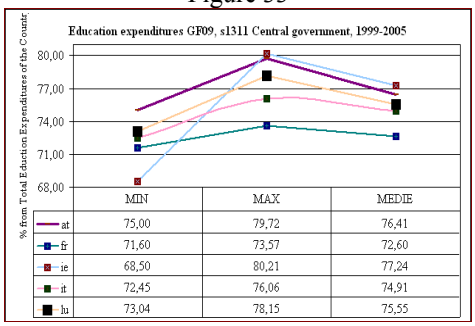
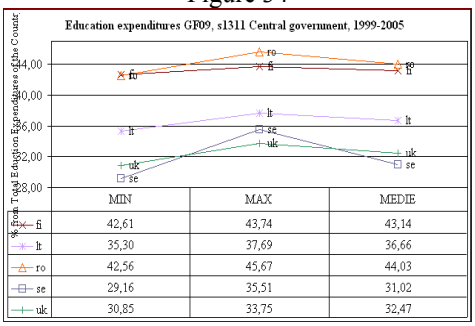


Figure 33



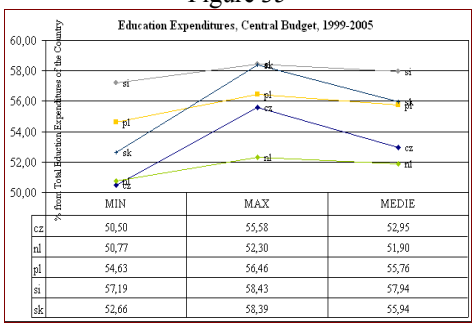
	MIN	MAX	MEDIE
at	75,00	79,72	76,41
fr	71,60	73,57	72,60
ie	68,50	80,21	77,24
it	72,45	76,06	74,91
lu	73,04	78,15	75,55

Figure 34



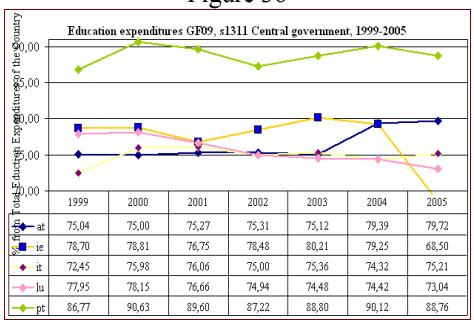
	MIN	MAX	MEDIE
fi	42,61	43,74	43,14
lt	35,30	37,69	36,66
ro	42,56	45,67	44,03
se	29,16	35,51	31,02
uk	30,85	33,75	32,47

Figure 35



	MIN	MAX	MEDIE
cz	50,50	55,58	52,95
nl	50,77	52,30	51,90
pl	54,63	56,46	55,76
si	57,19	58,43	57,94
sk	52,66	58,39	55,94

Figure 36



	1999	2000	2001	2002	2003	2004	2005
at	75,04	75,00	75,27	75,31	75,12	79,39	79,72
ie	78,70	78,81	76,75	78,48	80,21	79,25	68,50
it	72,45	75,98	76,06	75,00	75,36	74,32	75,21
lu	77,95	78,15	76,66	74,94	74,48	74,42	73,04
pt	86,77	90,63	89,60	87,22	88,80	90,12	88,76

Figure 37

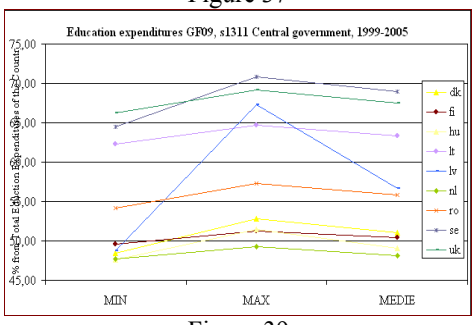


Figure 38

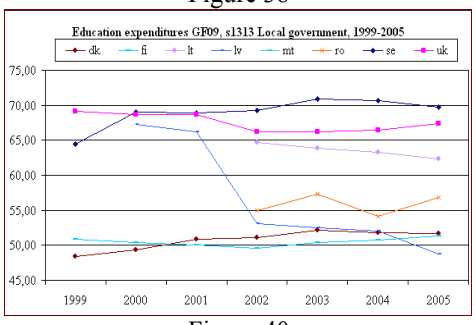


Figure 39

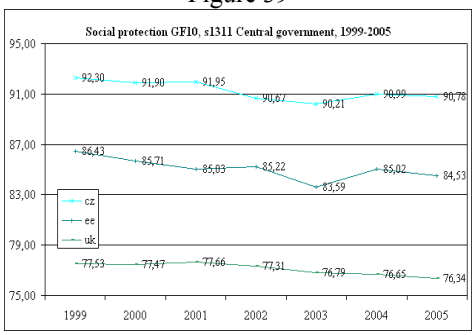
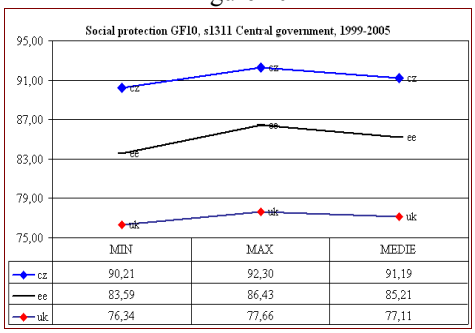


Figure 40



	MIN	MAX	MEDIE
cz	90,21	92,30	91,19
ee	83,59	86,43	85,21
uk	76,34	77,66	77,11

Figure 41

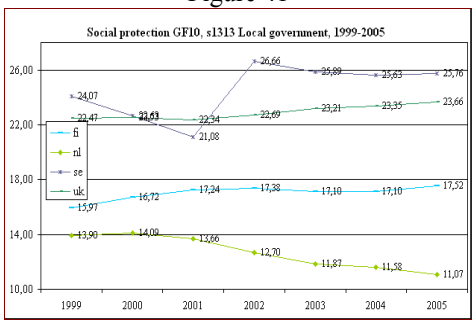


Figure 42

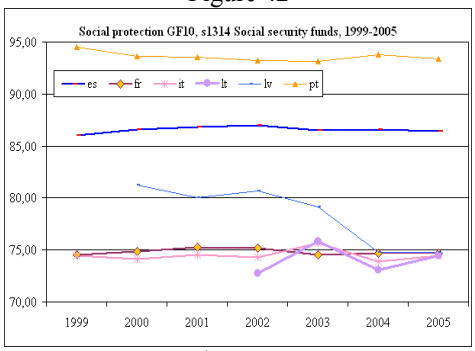
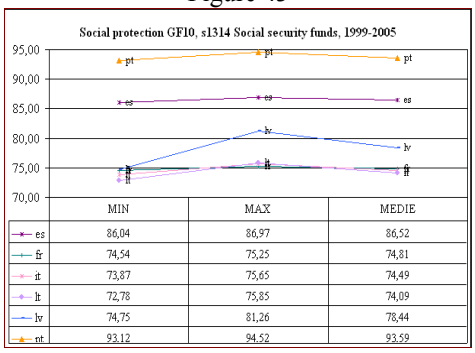
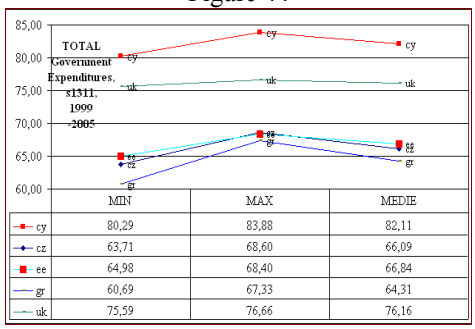


Figure 43



	MIN	MAX	MEDIE
es	86,04	86,97	86,52
fr	74,54	75,25	74,81
it	73,87	75,65	74,49
lt	72,78	75,85	74,09
lv	74,75	81,26	78,44
nt	93,12	94,52	93,59

Figure 44



	MIN	MAX	MEDIE
cy	80,29	83,88	82,11
cz	63,71	68,60	66,09
ee	64,98	68,40	66,84
gr	60,69	67,33	64,31
uk	75,59	76,66	76,16

Figure 45

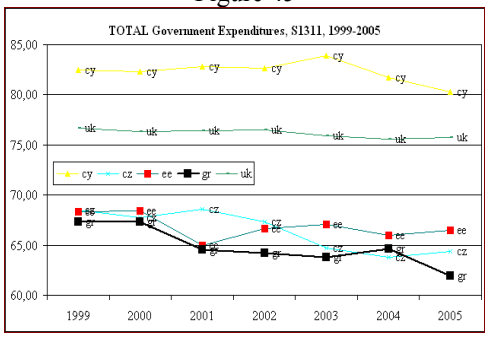


Figure 46

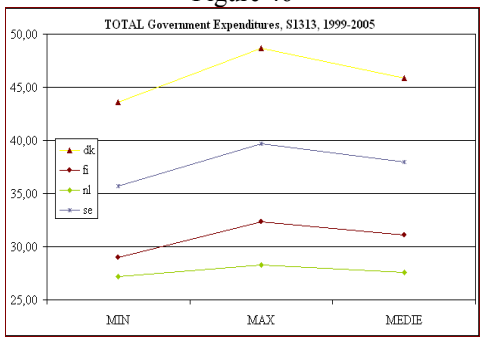


Figure 47

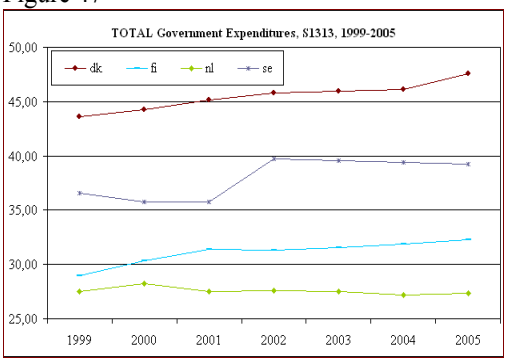


Figure 48

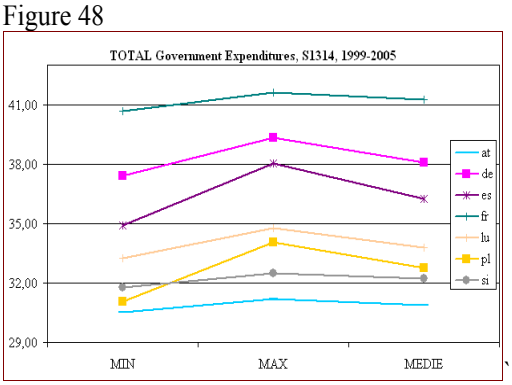
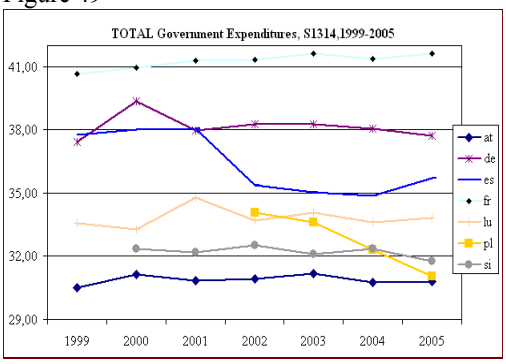


Figure 49



On the opposite side are Denmark, Finland, Italy and Sweden. A more interesting evolution of health expenditure can be observed in Spain where the percentage of health expenditure from the central budget in total health expenditure increases from 12,8% in 1999 to 48,2% in 2005. Also in Ireland the percentage of health expenditure from the central budget in total health expenditure increases form 49,17% in 1999 to 100% in 2005. An important remark is the fact that in Germany, France, Luxembourg, Holland.

The percentage of health expenditure from Social Found in the total health expenditure is over 90% in the whole-analyzed period.

Romania distributes 2-3% from GDP to health system. This represents one of the lowest distribution to health system in the past years that was ever been registered in central and eastern European countries- even that this indicator reflects according to World Bank the level of development of each country. Moreover the health degree of population is Romania is very low in comparison to neighbor countries. In this context, the stakeholders considered that the public expenditures in this sector are insufficient so that social security system was entitled.

Housing and community amenities (GF06)

Social protection represents a way by which social support is given to those in need with the main objective to give them the minimum resources. From the data analyzed in this sector we can say that in the countries where the Wealth State exists, social protection has a smaller role. In the northern countries and in the countries where the Wealth State is not so obvious, the social protection is more visible. As an effect, social protection is managed at the local level in Ireland an in Great Britain at the central level.

The countries with the most centralized system as regards the social protection expenditure are Malta with a percentage of the social protection expenditure from the central budget in the total social protection expenditure is 100% and Cyprus where this percentage is over 90% on the whole period. Other countries where the level of social protection expenditure form the central budget in the total of social protection expenditure is also high are Austria, Denmark, Finland and Greece with percentages over 50% on the whole period. Regarding the content of social protection expenditure the main percentage form this expenditure is given by the expenditure for family loans and allocation for old people. We can observe the increasing tendency of social protection expenditure in the last years considering the evolution of the demographic factors. As a consequence the taxes are increased in order to be able to support the increasing tendency of the expenditures. In the industrial states the income tax and social security contribution has increased in the last years to support the expenses for pension, health and other types of social security expenditures. Considering the current situation of free access to labor market in some country from European Union it could appear a problem as regards the continuous tendency for increase of social protection expenditures.

The most decentralized social protection expenditures are registered in Lithuania with a percentage for the social protection expenditure form the local level in the total Lithuanian social protection expenditure of 99,7% on the whole period. In Portugal the percent mentioned is over 89,5% for the whole period, in Estonia over 98,17% in 1999, in Spain 96,19% in 2003, in Italy 92,74% in 2001. In Check Republic is registered a significant increase of the expenditure for social protection form the local budget as a percentage in the total social protection expenditure from 49,8% in 2001 to 80,5% in 2003. In Holland the percentage of the expenses with social protection form the local level is 68,8% in 1999 and 81,31% in2004.

Social security (GF10) As we can observe from the data we analyzed, the level of expenses with social security from the central budget in the total of social security expenses from each country is very high. So, in Malta is 100% on the whole period, in Check Republic the highest level is 92,3%, in Estonia the maximum level is 86,43% and Great Britain the maximum level is 77,66% in the period 1999-2005. From what we have mentioned above we can conclude that these countries have the most centralized system as regards social security expenditures. From a short analysis on the situation of the whole 26 countries in 1999-2005 it can be observed a descendent tendency of the social security expenditure form the local level. Te most decentralized social security expenditures are registered in Denmark, Sweden and Great Britain. The percentage of social security expenditures from the local level in the total of social security expenditure decreasing in Ireland from 14,91% in 2004 to 3,8% in 2005.

Decentralization process from Romania is similar to that form the other new UE members but each country has its own particularities. The institutions, which must play the most important role, are the ministries and the local associative local collectivities. By decentralization process, government wants to increase the quality of public services by adapting these services to the local community needs. It is also very important to assure by decentralization the increase of satisfaction of the citizens regarding the public services, and also to increase more responsibility of local institution in front of the citizens. We can say that the implementation of cost and quality standards is a priority which has to be put into practice in order to can make correct forecasts regarding the public expenses and also to increase the responsibility of the government in revenue distribution. Decentralization is a continuous process.

Conclusions*:*

In conclusions we can say that there are four types of expenditures that are mostly located in the central budgets (S1311): general public services (GF01), defense (GF02), public order and safety (GF03), economic affairs (GF04). Defense (GF02), public order and safety (GF03) are more centralized because these sectors are strategic sectors.

Cyprus, Denmark, Malta and Great Britain are the countries where general public expenditures are mostly financed by the central budget. The same thing is happening about economic affairs in Czech Republic, Greece and Malta. There are 14 countries (Austria, Belgium, Cyprus, Germany, Spain, France, Greece, Ireland, Italy, Luxemburg, Malta, Holland, Portugal, and Slovenia) where defense expenditures are totally financed by the central budget.

On the other hand, environment protection (GF05), housing and community amenities (GF06), health (GF07), education (GF09) are the most decentralized expenditures. The countries with the most centralized system for health expenditures are Cyprus, Malta and Great Britain. On the opposite side are Denmark, Finland, Italy and Sweden. The most decentralized social security expenditures are registered in Denmark, Sweden and Great Britain. Education expenditures are more decentralized in United Kingdom, Sweden, Finland and Romania. The percentage of health expenditure from Social Found in the total health expenditure is over 90% in the analyzed period.

Public expenditures regarding the environmental protection from the most civilized countries has known a significant increase, as a consequence of the increasing preoccupation of the governments and especially of the European Union to the problems of environmental protection. Romania is the only country from those analyzed in which the expenditure for environmental protection is mentioned only in the central budget.

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- http://europa.eu/index_en.htm
- http://forum.europa.eu.int/irc/dsis/nfaccount/info/data/esa95/en/esa95en.htm

Associate Professor ***Ph.D.Mariana Mirea***
Assistant Ph.D. Student ***Anca Verona Serban Comanescu***
"Ovidius" University of Constanta, Romania

ALTERNATIVES FOR THE EVALUATION OF THE FINANCIAL STATEMENT STRUCTURES ACCORDING TO THE INTERNATIONAL ACCOUNTING STANDARDS

Abstract*: This paper starts from the idea that there is the need for some viable alternatives regarding the evaluation of the financial statement structures that will be recognised in the balance sheet and the profit and loss account. The general frame for the drawing up and submission of the financial statements detects four alternatives for the evaluation thereof. Many users rely on the financial statements as on their main information source and from this reason, such statements must be drawn up and submitted in accordance with their needs.*

Key words*: the historic cost, the current value, the structures of the financial statements, evaluation.*

JEL Classification*: M41*

Introduction

The cost of an asset purchased in the open market is an objective measure of its value at the point of time when it was acquired. What is meant by this is that there exists in properly kept records, quite easily verifiable evidence of the purchase value, from items such as invoices and cheques paid out. Objectivity is important because it means that there will be a high degree of uniformity in the way that different accountants in separate organisations will record similar transactions. Most users would prefer accounts to be based on objective evidence rather than on the subjective guesses of the managers.

However, the problem with historic costs is that if they are not adjusted they very quickly cease to reflect values that have much meaning. One of the most significant features of the twentieth century has been the ever increasing rate at which values have changed. This is due to a wide variety of causes including technological advances, population growth, energy and food shortages as well as the pervading influence of monetary inflation. Thus, whilst historic cost accounting has the considerable advantage of being based on objective evidence, it fails entirely to cope with the problem of reflecting current values of the assets, capital and liabilities or revenues and expenses in a business.

Once the historic cost basis is departed from, the problem of deciding on an alternative basis of valuation has to be tackled. It is important to remember that accounting is concerned to record economic values and not moral, social or other values. Economic values in our kind of society are based on market prices, that is the price at which goods are bought and sold by producers and consumers.

The basis of a market value depends on a complex array of factors. Fundamentally, value depends on the expectations the people in the market have about the future worth of something. If an asset promises to yield economic benefits in the future, it will have a current value. The current value, however, will take account of the inherent uncertainty of the future and also will charge interest for delay in obtaining a benefit. Cash in hand now is worth more than cash in the future because it can earn interest. In our economy markets for most goods are "efficient" in that they incorporate all the significant knowledge that is available to fix the current price. Thus, market prices incorporate the knowledge and experience of a wide range of expert dealers and form a reasonable basis of value for accounting purposes.

Market prices are readily available for a wide range of commodities and goods, but some things are unique so there is nothing exactly the same being bought or sold.

Starting from these considerations, the General Frame for the drawing up and submission of the financial statements issued by IASB (The International Accounting Standards Board) recommends the use of various evaluation bases for the structures that will be recognised in the balance sheet and the profit and loss account. According to the General Frame, evaluation is the process whereby value is determined through the following alternatives that include:

a) *the historic cost*. The assets are registered at the treasury or treasury equivalents amount paid at the moment of their purchase or at the actual value of the amount paid at the time of purchase. The debts are registered at the value of the equivalents obtained in exchange for a bond or, under

certain circumstances (for example, in the case of the tax on profit) at the value expected to be paid in cash or cash equivalent in order to pay off the debts during the normal course of business.

b) *the current cost*. The assets are registered at the cash or cash equivalents amount that should be paid if the same asset or a similar one were purchased at the present moment. The debts are registered at the cash or cash equivalents non- present value necessary to discount the bond at the present moment.

c) *the realisable (discounting value)* The assets are registered at the cash or cash equivalents amount that can be obtained for the time being by normal sale of assets. The debts are registered at their discounting value. This is the cash or cash equivalents non- present value that has to be paid in order to pay the debts during the normal course of business.

d) *the present value.* The assets are registered at the present value of the net future cash entries that are to be generated during the normal course of business. The debts are registered at the present value of the future cash exits expected to be necessary to discount the debts during the normal course of business.

Adjusting value by means of index numbers

Because a business may own thousands of different assets the process of revaluing every individual item each year could assume vast proportions. Thus it is often much more convenient to revalue groups of assets in line with the change in market value for the whole group. Index numbers are prepared by the Statistical Service which indicate the change in value in the market of particular asset groups. For example, if a firm equipped a new factory on 1 January N year with one hundred machine tools costing €5,000,000 what is their market value at the accounting date 31 December N year? Instead of trying to estimate for each individual machine the firm could obtain the market price index for machine tools as at 1 January and 31 December N year. Let us assume that at 1 January the index was 150 and at 31 December 180. To convert the value from the date of purchase to the accounting date we multiply the purchase price by:

$$\frac{\text{The Index at the accounting date}}{\text{The Index at the date of purchase}}$$

180 / 150 x 5,000,000 = €6,000,000

The value of €6,000,000 is the estimated present market price of similar new machinery. For accounting purposes depreciation to cover one year's usage would then have to be charged.

A firm which has assets that are different from most other firms may feel that it is worth preparing its own index numbers to convert the figures on the accounts, perhaps also because there are no suitable published index numbers available. In the case of specialised items like land and buildings normally a qualified valuer will be employed to estimate changes in the market price.

But a business cannot be evaluated in the same way: In a market there are two levels of value - the buying price and the selling price. For some things the difference may be small but often there is quite a significant gap. For many products there is a middleman or dealer who operates between the buyer and the seller and who takes some remuneration for his services. The more specialised and complex the product the larger the gap is likely to be between buying and selling prices.

The buying price on the market is generally called the replacement value of an asset. The price at which it can be sold in the market is its realisable value. For accounting purposes it has been proposed that the appropriate basis of value should be value to the business. In order to determine this you need to decide what a business would do if it were deprived of the asset. If the business owns a machine which cost €5,000, what is its value? If in the event of the machine being irreparably damaged, the firm would buy another machine then its value is its replacement cost. If, however, the machine would not be replaced, then its value would be based on realisable value, which is what it could be sold off for.

In a normal business where continuity of production and development exists you would expect most values to be based on Replacement Value. However, with technological product change being very rapid it is sometimes the case that replacement does not imply buying an identical item. When you replace something you buy the best thing available to satisfy your requirements. In other words you are concerned with the replacement of the services obtained from the asset, not the asset in its own right. The judgement about replacement or realisation can only be made by the management. However, it is a judgement and therefore basically subjective in nature.

Evaluation of the financial statements structures by means of the current cost

The second evaluation alternative provided by the ISAB General Frame refers to the current cost . In order to illustrate how adjustments to current value accounting take place a simple example will be worked through. The balance sheet for "X" Ltd which in abbreviated form and at historic cost is shown in Exhibit 1.

The Managers state that all the assets would be replaced if the business were deprived of them. A revaluation of the land and buildings by a qualified valuer has revealed that the replacement cost of the land and buildings in their current state would be €90,000. In terms of their condition when bought ten years ago this would be equivalent to €100,000 replacement cost and the depreciation on buildings therefore would be €10,000.

Exhibit 1.

Balance Sheet at 31 December N year			
	Cost	Aggregate Depreciation	€
Fixed assets			
Land and buildings	50,000	5,000	45,000
Equipment and machinery	100,000	20,000	80,000
Total of Fixed assets	150,000	25,000	125,000
Current assets			
Stock-in-trade		20,000	
Trade debtors		14,000	
Cash at bank		9,000	
Total of Current assets		43,000	
Current liabilities			
Trade creditors		13,000	30,000
			155,000
Less 10% loan stock			-65,000
Total			90,000
Share capital			50,000
Profit retained			40,000
Total own capital			90,000

The equipment and machinery was bought two years ago when the index for the relevant type of equipment was 160. The index at 31 December N year is 240. Converting the Balance Sheet figures to current value at 31 December N year gives:

$$\text{Equipment and machinery at cost} \times \frac{\text{Index at the accounting date}}{\text{Index when asset purchased}}$$

= 100,000 x 240/160 = €15 0,000

The aggregate depreciation will be converted at the same rate as the asset to which it relates. Thus the current value of depreciation is:

20,000 x 240/160 = €30,000

Stock-in-trade represents raw materials purchased evenly over the last two months of the year when the average price index for replacement was 250. At 31 December N year the index had risen to 255. The current value of stock-in-trade is therefore:

20,000 x 255 / 250 = €20,400

Exhibit 2.

Balance Sheet at 31 December N year					
Historic Cost		Current Value	Aggregate Depreciation		Change
	Fixed assets				
45,000	**Land and buildings**	100,000	10,000	90,000	+45,000
80,000	**Equipment and machinery**	150,000	30,000	120,000	+40,000
125,000	**Total of Fixed assets**	250,000	40,000	210,000	
	Current assets				
20,000	**Stock-in-trade**		20,400		+400
14,000	**Trade debtors**		14,000		-
9,000	**Cash at bank**		9,000	43,400	-
168,000	**Total**			253,400	85,400

The current value for trade debtors (after allowance has been made for bad debts) ought to take account of the fact that there is a time delay in obtaining payment. Normally, however, because the delay is not long the debtors are treated at their cash face value.

Thus debtors and cash are treated in the same way and for this purpose are different from the other assets we have been dealing with. Because money is the medium of exchange, its face value must be its

market value. Assets such as cash or debtors which have a fixed monetary value are called monetary assets. Monetary assets of course lose value in an inflationary period because you can buy less with each unit of money as time passes. All the assets in the balance sheet have now been reviewed in current terms. In summary the position is as shown in Exhibit 2.

The increase in the value of assets of 85,400 over historic costs represents a profit to the business. However, it is not a profit that has been realised through a sale, nor is it a profit that the business can afford to distribute as dividends if it wishes to retain the real value of resources in the business. Thus the increase on revaluation of assets should be credited to a capital maintenance reserve. The balance sheet after this adjustment will be as shown on Exhibit 3.

Exhibit 3.

Balance Sheet at 31 December N year			
	Current Value	***Aggregate Depreciation***	
Fixed assets			
Land and buildings	***100,000***	***10,000***	***90,000***
Equipment and machinery	***150,000***	***30,000***	***120,000***
Total of Fixed assets	***250,000***	***40,000***	***210,000***
Current assets			
Stock-in-trade		***20,400***	
Trade debtors		***14,000***	
Cash at bank		***9,000***	
Total of Current assets		***43,000***	
Current liabilities			
Trade creditors		***13,000***	***30,400***
			240,400
Less 10% loan stock			***-65,000***
Total			***175,400***
Share capital			***50,000***
Capital maintenance			***85,400***
Profit retained			***40,000***
Total own capital			***175,400***

So far attention has been directed only to the balance sheet. However, the impact of changing values is also important in calculating profit or loss. Adjustments in calculating the current cost of expenses will arise from items already mentioned.

Conclusion

As a conclusion, as regards the evaluation of the financial statements structures, various valuation bases can be used in various combinations and application degrees.

But the historic cost is the evaluation basis more often approached by entities when drawing up the financial statements. This is usually combined with other valuation bases. For example the stocks are usually registered at the minimum between the cost and the net realisable value, the securities – at the market price - and the debts related to pensions – at their present value. Moreover, some entities use the current cost as a response to the incapacity of the accounting model based on the historic cost to settle matters related to the effect of non-monetary assets price changes.

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Associate Professor Ph.D. Mariana Mirea
Assistant Ph.D. Student Anca Verona Serban Comanescu
"Ovidius" University of Constanta, Romania

FINANCING DECISION BASED ON THE WEIGHTED AVERAGE COST OF CAPITAL

Abstract: *The paper refers to theoretical and practical aspects of the weighted average cost of capital, as an investment remuneration essential indicator, peculiar for each and every country, including beyond the country risk, additional risk factors specific to the relevant filed and related to the implementation and establishment of standard regulations. In order to have a general view over the total cost at which financial resources can be attracted from the market, this synthetic indicator is used to calculate an average weighted cost with the structure of the capital (practically the weight of credits, bonds or shares in the total capital necessary for the development of the business) and allows the decision maker to chose the lowest average cost plan among several financing plans.*

Key words: *the cost of capital, financial resources, updating rate*

JEL Classification*: M41*

Introduction

The financial strategy aims at achieving the three main actions of the entity under equilibrium conditions: *the investments, their financing and distribution of profit.*

The financial strategy outlines the possible directions of the three correlated actions in order to increase the value of the entity, the owners' equity, and finally, the market value of the entity own capital.

The *cost of capital* notion appears in the context of the financial strategy of an entity; this cost allows one to establish whether a financial project ensures the welfare of its owners and represents an essential criteria for application of the welfare maximisation principle in the financial theory. The cost of capital represents the earnings the investors expect to obtain by applying the available cash flows in investment alternatives with a certain risk degree.

The weighted average cost of capital

The weighted average cost of capital represents the cost of various financing sources that are at the disposal of the entity, which is the cost of the entire capital invested in a business, irrespective of its source (owners, banks etc)

The cost of capital has two components: the leverage cost and the own capital costs. The two components are the basis for the calculation of *the weighted average cost of capital (W_{acc})*. The computation formula is as follows:

$$W_{acc} = \frac{\sum_{s=1}^{n} W_s * C_s}{100}$$

where: W_S = the weight of every capital source in the total capital
C_S = every capital source cost, in percentages

The weighted average cost of capital can be established either by the *accounting weighting method* using the accounting records data (reassessed up-to date) or *the stock exchange weighting method* based on the share capital assessed at the stock exchange (the stock exchange capitalisation) a new cost thereof being calculated based on the following formula :

$$K\% = \frac{D_0}{P_0} + g$$

Where: K% = the stock exchange assessed capital new cost in percentage;
D_0 = last dividend;
P_0 = the market price of a share;
g = the dividend annual increase constant rate.

How to determine the weighted average cost of capital

Due to the fact that the computation of every financial indicator is not itself a purpose the usefulness of the *weighted average cost of capital indicator* can be found in various fields of interest at the microeconomic level. Thus:

1. both the creditors and shareholders expect to be remunerated starting from the opportunity cost value determined by the investment of their funds in a certain entity in lieu of another investment with a similar risk. From this point of view the weighted average cost of capital (WACC) can be used as an updating rate for the evaluation of the cash flows of an entity. The evaluation methods that can be used are various as well as the updating rate construction methods that have to be in accordance with the chosen evaluation method. As regards the evaluation methods based on updating future cash flows, WACC can be used, the value of the entity being given by:

$$V_0 = \sum_{t=1}^{n} \frac{CF(A)_t}{(1+WACC)^t} + \frac{VR_n}{(1+WACC)^n} + R_{av} - thedebts\ value$$

where:

CF(A) = available cash flow

CF(A) = [Net Profit + Depreciation + Interests (1-τ)] – (ΔIMO + ΔACR net);

τ = tax on profit share.

R_{av} = redundant assets value (assets owned by the entity but that are not taken into account for the future cash flows).

2. as per the investors point of view (shareholders or creditors), WACC represents the minimum level of the total profitability that an entity must achieve from the use of its assets in order to maintain the value of the capital invested in its assets.

3. thirdly, the WACC calculation proves to be useful when selecting the investment projects, this being considered as the minimum level (below which the investors would not accept to be positioned) for the profitability required for each investment of the entity that has a risk identical to the one of the entity as a whole.

$$NPV = \sum_{t=1}^{n} \frac{CF(D)_t}{(1+CMPC)^t} - I_0$$

Where: NPV = the net present value

I_0 = the value of the initial investment;

CF(D)t = the expected after- tax cash annual flows.

If the investment project has a risk that is different from the risk of the entity as a whole, then the investment cash flow updating rate can be higher, lower or equal to the entity WACC value. A solution in this respect is the use of the CAPM pattern for the calculation of the updating rate. The SML straight line will be the geometrical place of all the investments updating rates that are directly proportional to the systematic risk (measured through the project) of the analysed investments.

As a synthesis, WACC can be expressed based on the following formula:

$$WACC = \sum_{i=1}^{m} Wi * Ki$$

where: Wi = the weight of the invested capital based on sources of origin;

Ki = profitability required by every financing source;

m = the number of used financing sources.

The computation of WACC can be difficult in practice, being necessary both every financing source cost estimation and the choice of the capital sources weights system: market values or accounting values.

Both solutions have a *historic character*, being calculated on the basis of the previous evolution or the measure observed at one moment of the value (market or accounting value) of the capitals. We must admit the hypothesis that the so determined financial structure is optimal and remains constant in time. In other words, adopting and financing new investment projects do not significantly modify the historic structure of the capitals. This difficulty of the historic character can be avoided by *fixing a "target" financial structure* that would maximise the value of the entity.

If we interpret the capital cost as an opportunity cost, one recommend the use of the market value whenever possible**,** even for the securities that are not quoted at the stock exchange or are hardly transactional. For all these, one proceeds to a comparative or deductive estimation in relation to other more liquid securities and to representative market values.

In the presence of the tax on profit and under leverage conditions, the own capitals market value increases with the value of the fiscal savings resulting from the interest deductibility from the taxable matter. Under these conditions of leverage and constancy of costs of credit, a reduction of the weighted average cost of capital takes place.

The updating rate of an investment project (kinv.) with a risk equal to that of the entity and financed in the capital structure of the entity (with the same leverage rate) is equal to the weighted average cost of the capital of the financing entity (k). The opportunity cost of the capital allotted in an entity is established differently on every type of entity as follows:

a) without new investments but with investments for the rehabilitation of the production capacity;

b) with new investments totally financed form the own capitals;

c) with new investments financed from own capitals and loans.

For the beginning the own capitals costs of the entity will be estimated (ke) in order to be able to determine the updating rate of the analysed investment (kinv.).

• for the un-leveraged entities without new investments, but with investments for the maintenance of the productivity capacity (g = 0), the cost of the own capitals (ke), as per the *Gordon and Shapiro pattern(1956)*, is estimated as follows:

$Ke = \text{Net profit}_1 / V_0$

• for the entities totally financed from own capitals but with self financed new investments (g=ROE .b), this will achieve an increase self financed rate (g) and will offer the shareholders both earnings from dividends as well as from growth-stocks.

• for the leveraged entities, without new investments (g = 0) and debts without risk (βd = 0), the entire net profit is distributed as dividends, and the depreciation finances the investments for the maintenance of the production capacity. In their turn, the investments for rehabilitation of the production capacity have the same risk with the operational economic asset and, therefore, they will have an updating rate (kinv.) equal to the weighted average cost of the entity capital: kinv. = WACC, to be determined based on the above formula.

In an entity where the growth is zero, the maintenance investments will have NPV equal to zero and implicitly, RIR = kinv. Under these circumstances the value of the entity is not changed, the own and borrowed capitals are remunerated at their costs level and the value also remains unchanged.

• for the leveraged entities with new investments and debts without risk (βd = 0), the growth rate g= ROE.b, is a sustainable rate. At this level of growth, the net profit annually reinvested can sustain the development thereof without changing the leverage rate level. Under these circumstances the weighted average cost of capital is not changed.

Case studies regarding the computation of the weighted average cost of capital

I. Find the weighted average cost of capital using the above two mentioned methods, considering the following information:

- Share capital (1,000 shares with a nominal value of 0.20 lei) = 200 lei, the cost of the own capitals 15% ;
- Long term debts = 80 lei, the cost of long term debts 9% ;
- Average term debts = 60 lei, the cost of the average term debts = 10% ;
- Short term debts = 40 lei, the cost of the short-term debts = 12%.

The entity shares are quoted at the stock exchange at a rate of 0.30 lei, the last dividend being 0.03 lei, and its estimated growth is 5% (0.05).

Solution :

a) W_{acc} by the accounting weighting method (table 1) :

Table 1

Type of capital	*Amount (in lei)*	*Weight (%)*	*Cost (%)*	Weighted cost (W_{acc} in %)
0	1	2	3	4
Share capital	200	52.63	15	7.8947
Long term debts	80	21.05	9	1.8947
Average term debts	60	15.79	10	1.5789
Short term debts	40	10.53	12	1.2632
TOTAL	*380*	*100*	-	*12.6315*

$$W_{acc} = \frac{\sum_{i=1}^{n} the\ capital\ value_i * \cos t_i}{\sum_{i=1}^{n} capitals}$$

$$W_{acc} = \frac{200*15+80*9+60*10+40*12}{380} = \frac{4,800}{380} = 12.6315\%$$

b) W_{acc} by the stock exchange weighting method (table 2) :

Table 2

Type of capital	*Amount (in lei)*	*Weight (%)*	*Cost (%)*	*Weighted cost (W_{acc} in %)*
0	1	2	3	4
Stock exchange capitalisation	300	62.50	15	9.375
Long term debts	80	16.67	9	1.50
Average term debts	60	12.50	10	1.25
Short term debts	40	8.33	12	1,00
TOTAL	*480*	*100*	-	*13.125*

$$K = \frac{D_1}{P_0} + g \ ; \quad K = \frac{0.03}{0.30} + 0.05 = 0.15*100 = 15\%$$

$$W_{acc} = \frac{300*15+80*9+60*10+40*12}{480} = \frac{6,300}{480} = 13.125\%$$

II. Please find the optimal sources for the financing of the extension investment in the financial year 20(N+1), in the amount of 2000 lei. The following information is available:

- Self financing at the end of the financial year 20(N) = 975 lei, and the net profit 875 lei ;
- Own capitals 4.375 lei, and the long-term debts in the balance are 375 lei, remunerated at an average annual interest rate of 12%. The new loans shall be given at an annual interest rate of 15% (in real terms).

The sources for the financing of the investment will be chosen between:

a) Total own internal sources and external own sources in addition ;
b) Total internal own sources and borrowed sources for the difference.

Solution:

a) Internal own sources (self financing) = 975 lei
External own sources (capital growth) = 2000 – 975 = 1.075 lei (↑K)
R_f = Net profit / Own capitals = (875 / 4.375) x 100 = 20 %

$$W_{acc} = \frac{(\uparrow K + OWN\ CAP._N) \times R_f + DEBTS_N \times Rd_N}{(\uparrow K + OWN\ CAP._N) + DEBTS._N}$$

$$W_{acc} = \frac{(1,025 + 4,375) \times 20\% + 375 \times 12\%}{5,400 + 375} = \frac{112.500}{5.775} = 19,48\ \%$$

b) Internal own sources (self financing) = 975 lei
Long term bank loan = 1,025 lei

$$W_{acc} = \frac{OWN\ CAP._N \times R_f + DEBTS_N \times Rd_N + \uparrow DEBTS \times Rd_{(N+1)}}{OWN\ CAP._N + (DEBTS_N + \uparrow DEBTS)}$$

R_f = Net profit / Own capitals = (875 / 4.375) x 100 = 20 %

$$W_{acc} = \frac{4,375*20\% + 375*12\% + 1,025*15\%}{4,375 + (375 + 1,025)} = \frac{1,073.75}{5,775}*100 = 18.59\%$$

The criterion for the selection of the optimal financing sources is the minimum $W_{acc.}$ In the above case the financing of the investment through internal own sources and borrowed sources offer the minimum cost (b).

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Conf. univ. dr. Iosif Moldovan
"Lucian Blaga" University of Sibiu, Romania

THE MECHANISM OF PUBLIC PROCUREMENT PROCESS AND MONITORING

Abstract: *The evolution of the Romanian society after the 1st of January 2007 needed a content readjustment of the majority of the economical domains. The need for the reform of the public procurement procedures became obvious due to several reasons that will be presented in the work.*
The notion of public procurement can be defined as the result of a process which takes place in order to obtain: products, services or works which are in accordance with the Public procurement law.

Key words*: public funds, Romania*

The entities which are able to carry on public procurement activities are called **contracting authorities**. Based on G.O. no. 34/2006 this category includes the following authorities:

- public authorities or institutions at local, regional or national level;
- public law organizations, other than the ones mentioned above, with juridical personality (based on juridical status) established in order to respond to general interest needs and financed from the public budget. These organizations are under the authority of a public institution or an institution which has more than half of the members within the administration council (steering committee) appointed by a public institution.

The logical framework of the public procurement issues from the fact that the contracting authorities mentioned above develop activities which have as main and final goal: the accomplishment of a public interest. Within these activities, as well as the private companies, the contracting authorities „consume" products, services and works which they have to procure from the market by respecting the legal provisions concerning public procurements in accordance with the principals regarding the expenditure of the public financial resources.

A different public procurement mechanism regulated by GO 60/2000 functioned within the Romanian economy during the pre-adhesion period. Due to the new economical approach this mechanism had to be changed.

The issues taken into consideration when the public procurement reform was put into practice, were the following:

a) the need of realizing an efficient, reliable and competitive system in accordance with the EU regulations
b) the elimination of the weak points from the old system that were pointed out during 2001 – 2004 period, referring to: (1) legislative crossing and uncertain competence distribution of the involved public institutions; (2) legislative provisions derogation concerning the assignment of some important contracts; (3) inadequate ex-ante intern control system; (4) insufficient monitoring and regulation personnel; (5) inefficient system concerning the gathering of public procurement information; (6) slow and not competitive system in the field of solving the reclamations.

The importance of the public procurement mechanism reform was materialized through establishing a double branched action plan within the reform strategy (H.G. nr. 901/2005):

I. the improvement of the legislative framework
II. the enforcement of the legislation implementation capacity

The improvement of the legislative framework was needed as an out put (follow up) of the European legislation transposition into the Romanian one.

The 18/2004/CE decision concerning the coordination of the assignment of the works, supply and services contracts and the Decision 17/2004/CE referring to the coordination of the allotment procedures applied by the entities that operate in the water, energy, transportation and postal services sector.

The new legislation integrates the traditional system of the public procurements as well as the electronic procurement system, avoiding legislative crossing. The new legislation includes as well regulations that refer to the assignment of the works or services concession contracts or to other forms of public-private partnerships.

The application standards of the framework legislation are similar to the application guides used in the process of the public procurement assignment contracts within Phare, ISPA and SAPARD financial instruments.

The improvement process of the legislative framework had to be accomplished at least 6 months earlier than the adhesion date, in order to assure a long enough adaptation period of the final beneficiaries to the new legislative provisions. It was well acknowledged the fact that the transposition of the community aquis represents a „must" for Romania in the process of accessing European funds, that will be available through Structural Funds beginning with 2007.

The strengthening of the legislation implementation capacity, will act at the level of all contracting authorities (central and local) as well as at the level of the institutional structures which have a regulation and a monitoring role.

At the level of the contracting authorities the strengthening of the implementation capacity is realized through:

- the allotment of the appropriate material and human resources at the level of the public procurement departments;
- the access to methodological consultancy
- the training of the involved personnel

The institutions that have authority in the field of public procurement were created at central level and were given the necessary independence.

The institutions involved in the process of public procurement are the following:

1. **The National Authority in the Field of Public Procurement Regulation and Monitoring** established through G.O. no. 74/2005 as a juridical personality independent public institution, subordinated to the prime minister and having the following tasks:

- ensuring a coherent legislative framework in accordance with the community aquis; the accomplishment of the obligations resulted from the application of the EU
- the realization of a communication network with the structures within the European Commission, with the correspondent institutions of the Member States and with the national public interest units;
- providing an appropriate legislation framework in the field of public procurement;
- the monitoring of the public procurement system
- Consultancy for the contracting authorities

2. **The National Council for Reclamations Solutioning,** as an administrative organism, which has a jurisdictional role and functiones under:
3. **The Ministry of Public Finances** (M.F.P.=, through G.U.O. no. 30/2006, the MPF was designated as the special unit for the checkout of the procedural aspects of the assignment process of the following contracts:

a) works and concession of works contracts with a total value (without VAT) higher or equal to 250.000 euros;
b) services or concession of services contracts with an estimated value (without VAT) exceeding or equal to 40.000 euros;
c) supply contracts with an estimated value (without VAT) exceeding or equal to 40.000 euros;
d) Framework – agreements concluded in view of allotment of the contracts mentioned at points a-c

The checkout process refers to the public procurement stages which take place beginning with the publication of the participation call and ending with the assignment and subscription of the contract.

4. **The Electronic Public Procurement System** with a well defined role in the process of public procurement publicity.
5. **The Court of Accounts** checks the efficacity and the efficiency of the public procurements

Concerning the process of public procurement, the enforced legislation stipulates the compliance with the following assignment principals:

a. **nondiscrimination –** assuring of a real competition for any economical independent of the nationality
b. **equal opportunity** – rules, requirements and equal criteria for all potential contractors from the economical field
c. **mutual acknowledgement** – the acknowledgement of the products, services, works offered on the EU market; the acknowledgement of the diplomas, certifications, documents emitted by abroad authorities as well al technical specifications
d. **transparency** – the public information of all stages of the public procurement

e. **Adequacy** – through the correlation of the contracting authority needs with the object of the public procurement contract and with the accomplishment requirements
f. **efficiency concerning the use of funds** – the acknowledgement of the economical as well as of the social advantages, of the environment protection and the promotion of the sustainable development
g. **the responsibility assumption –** through assuring professionalism, equity and a fair decision making process concerning public procurement

Generally speaking, the process of public procurement has to follow the next stages:

1. the public procurement planning
2. the application of the public procurement procedures
3. the contract assignation
4. the contract management

1. The planning of the public procurements

In order to accomplish this stage, the following steps have to be followed:

1. the identification of the right objectives at the level of the contracting authority
2. the analyze of the opportunity concerning the accomplishment of each need and their prioritization
3. the identification of the procurement procedure that is going to be applied;
4. the elaboration of the Public procurement annual program
5. getting the necessary approvals
6. Establishing the activity schedule for the application of each procedure

It is mainly about the fundamentation of the public procurements based on needs identification, opportunity analyze and prioritization, followed by the identification of the necessary financial resources.

Within this context, the Public procurement annual program is a compulsory document that is elaborated by every contracting authority. The program contains all the contracts that the authority intends to conclude during the next year.

2. The application of public procurement procedures

The public procurement contracts can be:

- works contract which contains the design and the execution of the construction (sets of civil constructions or works designed to fulfill a technical or economical function)
- purchase product supply contracts, leasing or renting
- services contracts concerning the execution of one or several services
- mixed contracts (services supply)

Within the process of public procurement procedures, the contracting authority has to respect certain publicity or participation rules, has to estimate the value of the public procurement contract, to establish the assignment documentation and to monitor the accuracy of the attribution procedure.

Publicity rules

Within the process of public procurement, the contracting authority must assure the transparency of the public procurement contracts and the conclusion of the framework agreement through publishing the intention, participation and assignment adds.

Intention add

- it is required in the following situations:

1. the total value of the goods that follow to be purchased within a year exceeds 750.000 euros;
2. the value of services during one year exceeds 750.000 euros;
3. the value of the work exceeds 5.000.000 euro

The publication of the intention add does not oblige the contracting authority to organize the public procurement.

The intentions add has to be published:

a) in the EU Official Journal, in the Public Procurement Electronic System and in the Romanian Official Journal, Section IV, Public procurement; or

b) just in PPES, provided that a short information notice was sent to the European Commission before the publication

Participation add

The participation add has to be published in PPES and in the Romanian Official Journal, Section IV, Public procurement and according to the situation, in the official journal of the EU

The publishing in the PPES and in the Romanian Official Journal is needed in the following cases:

- supply > 40.000 euros
- services > 40.000 euros;

- Works > 250.000 euros.

The publishing in the EU Official journal is compulsory for the following situations:

- supply > 125.000 euro;
- services > 125.000 euro;
- utility sector > 420.000 euro;
- Works > 5.000.000 euro.

Assignation add

The contracting authority must transmit for publishing an assignation add no longer than 48 days, after accomplishing the following:

a) concluded the assigning procedure – open tender, restricted tender, competitive dialog or negotiation – through the assignation of the public procurement contract or through the conclusion of the framework contract;

b) finalized a solution contest through awarding the winning contestant;

c) attributed a public procurement contract through a dynamic procurement system;

The assignation add has to be published in the Public Procurement Electronic System, in the Romanian Official journal, Section IV, Public procurement and according to the situation in the official journal of the EU

(1) the publishing in the EU Official Journal is compulsory in the following situations:

- supply > 125.000 euro;
- services > 125.000 euro;
- utility sector > 420.000 euro;
- Works > 5.000.000 euro.

The adds have to be transmitted for publishing towards PPES, in an electronic version. The PPES will transmit the documents for publishing to the EU Official Journal and to the Romanian Official Journal.

The intention add – is published when the deadlines for the offer application are shortened and when: the total value of the public procurement over a 12 months period is equal or exceeds 750.000 Euros (in the case of services procurement) and 5.000.000 euros (in the case of works procurement).

The participation add has to be published in the following situations:

a. Organizes an open tender, restricted tender, competitive dialog or negotiation – through the assignation of the public procurement contract or through the conclusion of the framework contract;
b. A dynamic procurement system is launched
c. A solution contest s organized

The participation add is published in the EU Official Journal provided that the estimated value of the supply of services contract exceeds the RON equivalent of 125.000 Euros for the classical system, 420.000 Euros for the rest of the utilities and 5.000.000 euros for works.

The assignment add must be transmitted by the contracting authority in a period of no longer than 48 days after the procurement procedure has been concluded.

The add will be posted on the PPES and in the Romanian Official Journal, section IV.

The publishing of the add in the EU Official journal is compulsory, provided that the estimated value exceeds the equivalent in RON of 125.000 euros for the classical procurement system, 420.000 euros for utility system and 5.000.000 for works.

General participation rules

Any economical bidder can participate in the assignment procedure:

- individually
- association (partnership) – several economical bidders
- Subcontracting – of a part of the work, but nevertheless the leader of the association or the bidders is responsible for the accomplishment of the contract

Within a public procurement procedure the economical bidder is not allowed to associate twice or more than twice or to apply individual offers.

The estimation of the public procurement contract

Is done according to:

- information collected from the market
- the estimated duration of the contract
- costs issued from the accomplishment of the contract

- The ROL - euro exchange rate published by the Romanian National Bank in the previous day

Ex. Product procurement:

- by leasing purchase

$V_e = V_{produs} + V_{instalare\ şi\ punere\ în\ funcţiune\ prin\ leasing}$

$V_e = \Sigma_{ratelor\ plătibile} + V_{reziduală\ contract\ servicii}$

Ve = (tarif lunar /prestatie serviciu similar) x nr. luni

The assignment documentation

The assignment documentation are those documents which contain formal, technical and financial requirements which describe the object of the public procurement contract which represent the base on which the economical bidder will elaborate the offer.

The assignment documentation has to be finalized before the publication of the add or of the tender participation call, and will include:

1. the procurement data chart
2. the task book or the description documentation
3. the compulsory contractual clauses
4. forms and samples

The procurement data chart includes information concerning the contracting authority, such as: address, legal activity, contact person, the object of the procurement contract, the procurement procedure, approval or disapproval of the alternative offers, the deadline of the offer application, minimum qualification requirements concerning the manner of the technical and economical elaboration proposal and detailed information in terms of the attribution criteria.

The assignation criteria can be:

- The most advantageous offer from the economical point of view, or the lowest price, which can not be modified during the process of the public procurement.

Concerning the competitive dialog public procurement procedure, the criteria which is used, has to be the most advantageous offer from the economical point of view.

The task book (the descriptive documentation) is the document where are included the products, services or the necessary works of the contracting authority. It is compulsory for the book to contain the technical specifications: requirements, technical recommendations and characteristics, environment impact assessment requirements, exploitation reliability, production technologies.

The works contracts can include design and calculation recommendations of the costs, reception conditions, etc.

The descriptive documentation – can replace the task book when the public procurement is held through competitive dialog. This documentation contains:

- the needs, objectives, constraints description of the contracting authority.
- information concerning the dialog process in order to identify reliable offers and solutions.
- the possibility of realizing the dialog in alternative rounds aiming to reduce the number of doubtable offers and solutions

The contractual clauses can be compulsory or specific

The compulsory contractual clauses are the ones referring to the legal base of each public procurement contract, parties, terms, object, price, sections.

The specific contractual clauses are added to the compulsory ones, over which they have no effect.

These refer to:

- Subcontractors, good execution guarantee, price adjustment ways, contract execution special conditions.

Assignment procedures

The public procurement assignment contract procedures are:

a) open tender - the procedure that every interested economical operator is entitled to

b) restricted tender - the procedure that every interested economical operator is entitled to apply for, but only the selected applicants have the right to deposit the offer;

c) the competitive dialog - the procedure that every interested economical operator is entitled to apply for and through which the contracting authority leads a permanent dialog with the admitted applicants, aiming to identify one or more reliable solutions to their needs. Based on these solutions, the selected candidates will elaborate the final offer.

d) negotiation - the procedure through which the contracting authority lead consultations with the selected candidates and also negotiates the contractual clauses, including the price, with one or more of the candidates. The negotiations can be:
- negotiation together with a prior publication of a participation add;
- negotiation without the prior publication of a participation add;
e) offer call - the simplified procedure through which the contracting authority calls for offers from several economical operators;
f) special attribution ways
a. **The opened tender** – offers the possibility to apply to every interested economical agent. Usually it has only one stage.

- one stage process
- publicity rules

The offer can be applied during a period of at least 52 days from the date of the participation add transmission.

Terms reduction:

The period of time between the data when the participation add was transmitted towards publication and the deadline of the offer application can be reduced as follows:

1. If:
   - the estimated contract value exceeds the limits for its publication in the EU Official Journal
   - An intention add was not published

Than:
- the minimum deadline for the application will be of 52 days;
- if it is electronically transmitted to JOUE in 45 days;
- if the documentation s available on PPED in 47 days;
- if it is transmitted on-line to JOUE, and the documentation is available on PPES in 40 days

2. If:
   - the estimated contract value excedes the limits for its publication in the EU Official Journal
   - An intention add was not published

Than:
- - the minimum deadline for the application will be of 36 days
- - if it is electronically transmitted to JOUE in 29 days;
- - if the documentation s available on PPED in 31 days;
- - if it is transmitted on-line to JOUE, and the documentation is available on PPES in 24 days

3. If:
   - the estimated contract value exceeds the limits for its publication in the EU Official Journal
   - the participation add has to be published in PPES;

Than:
- the deadline for the offer application in case it is transmitted to PPES is of 28 days;
- the documentation can be accessed on PPES in 23 days

The amount limits for the publication in the EUOJ are:
Services > 125.000 euro
Goods> 125.000 euro
Utilities > 425.000 euro
Works > 5.000.000 euro
The tender documentation for an economical operator has to be available in maximum 4 days.
The contracting authority is obliged to respond to the clarification requirements of the economical operators no later than 3 days. The response will be equally given to all economical operators registered at the tender without indicating the economical operator which asked for the clarifications.
The contracting authority has to transmit the clarification response at least 6 days before the offer application (provided that this issue is possible).
b. Restricted tender – in this case, every bidder can apply, but only the selected ones are able to deposit the offer. The tender has two stages:

- Candidates selection stage, and the evaluation stage of the deposited offers

The selection criteria is done according to the technical and economical – financial capacity. The selection criteria will be transmitted to the candidates, together with the appropriate rules and the minimum number of selected candidates.

Stage I
The applications can be deposited during a period of at least 37 days from the publication of the participation add.
In the case of the restricted tender, the period of time between the date of the participation add publication(at the candidates selection stage) and the deadline of the candidature application, can be reduced as follows:
1. If:

- the estimated contract value exceeds the limits for its publication in the EU Official Journal

Than:
- - the minimum deadline for the application will be of 37 days
- the deadline can not be respected due to emergency reasons – 15 days
- - if it is electronically transmitted to JOUE in 30 days;
- if the documentation will be transmitted on electronic support to the EUOJ, and the deadline can not be respected due to emergency reasons – 10 days
2. If:

- the estimated contract value is equal or less than the limits for its publication in the EU Official Journal

Than:
- The minimum term that can be given for the candidature application, in case they are transmitted to PPES is of 16 days;

Stage II
Concerning the restricted tender, the offers will be applied during the second stage of this procedure, after the selection of the candidates has been done.

The offer evaluation stage is initiated through a call for participation of the economical operators selected in the first stage, together with the assignment documentation.
The call for participation has to be transmitted at least 40 days earlier than the deadline for the offer application.
The reduction of terms:

The period of time between the transmission of the participation call for the second stage of the procedure and the deadline for the application of the offers, can be reduced as follows:

1. If:
   - the estimated contract value exceeds the limits for its publication in the EU Official Journal
   - an intention add has not been published

Than:
- the minimum term for the offer deposition is of 40 days
- if the minimum period can not be respected due to emergency reasons – 12 days
- if the documentation is available on PPES – 35 days
- if the documentation will be transmitted on electronic support to the EUOJ, and the deadline can not be respected due to emergency reasons – 12 days

2. If:
   - the estimated contract value exceeds the limits for its publication in the EU Official Journal
   - An intention add has been published

Than:
- the minimum term for the offer deposition – 22 days
- if the minimum period can not be respected due to emergency reasons – 12 days

3. if:
   - the estimated contract value is equal or less than the limits for its publication in the EU Official Journal

Than:
- the minimum term for the offer deposition – 22 days
- if the documentation is available on PPES – 17 days
- if the minimum period can not be respected duet o emergency reasons – 12 days

c. The competitive dialog is applied when all the following conditions are accomplished:
1. the contract has a special complexity (the contracting authority can not define the technical specifications that have to satisfy the needs and the requirements and can not establish the juridical and financial framework of the project)

2. the application of the opened or restricted tender procedure makes impossible the assignment of the public procurement contract

It follows 3 stages:

- pre-selection
- dialog with the admitted candidates
- Evaluation of the final deposited offers

During the first stage the candidates are selected, based on the pre-selection criteria and on the rules specified in the participation add.

During the second stage, the dialog process follows, until the right solutions are identified. Within this stages, there are discussed the following issues: technical aspects, financial aspects, contractual elements after - the public procurement objective description, the authority constraints and in some cases the bonuses that will be awarded to the dialog participants have been communicated.

During the third stage, the selected participants will be invited to deposit the final offer, after the contracting authority, together with the participants have commonly established the deposit deadline. During this stage, clarifications or details of the offer can be asked.

The period of time between the transmission of the participation call for the first stage of the process and the deadline for the application of the candidature can be reduced as follows:

1. If:
   - the estimated contract value exceeds the limits for its publication in the EU Official Journal

Than:

- the minimum term that can be offered for the candidature application – 37 days
- - if the documentation will be transmitted on electronic support to the EUOJ - 30 days

2. If:
   - the estimated contract value is equal or less than the limits for its publication in the EU Official Journal

Than:

- the minimum term that can be offered for the candidature application if the documentation is electronically transmitted to the EUOF – 30 days

d. <u>The negotiation</u> – the procedure in which the contracting authority offers consultancy to the selected candidates and negotiates the clauses of the contract, including the price, with one or more of the candidates.

The negotiation can be:

I Negotiation with a prior participation call, which can be realized as follows:

- publication of a participation call
- making available the descriptive documentation for the economical operators
- pre-selection of the candidatures (not less than 3 bidders)
- transmission of the participation invitation to the pre-selected candidates
- negotiations with every candidate until he declares, or the contracting authority notices that the offer can no longer be improved
- establishment of the final meeting and the application of the final offers
- offer assessment and the transmission of the report concerning the result of the assignment procedure
- transmission of the assignment add for its publication

The period of time between the transmission of the participation call for the first stage of the process and the deadline for the application of the candidature can be reduced as follows:

1. If:
   - the estimated contract value exceeds the limits for its publication in the EU Official Journal

Than:

- the minimum term that can be offered for the candidature application – 37 days
- the period can not be respected duet o emergency reasons – 15 days
- if the documentation is electronically transmitted to the EUOF – 30 days
- if the documentation is electronically transmitted to the EUOF, the period can not be respected duet o emergency reasons – 10 days

2. If:
   - the estimated contract value is equal or less than the limits for its publication in the EU Official Journal

Than:

- the minimum term that can be offered for the candidature application if the documentation is electronically transmitted to the EUOF – 12 days

II The negotiation without a prior participation call publication is realized as follows:

- Transmission of the participation invitation to one or several economical operators, as well as of the descriptive documentation
- deposit of the preliminary offers and their assessment

- negotiations with every candidate until he declares, or the contracting authority notices that the offer can no longer be improved

- Establishment of final meetings and the final offer application

- the assessment of the offers and the transmission of the report concerning the result of the assignment procedure
- transmission of the assignment add for its publication

e. <u>The call for offers</u> – the simplified procedure through which, the contracting authority, calls for offers, from several economical operators.

The contracting authority has the right to apply the "call for offers" procedure, only when the estimated value (without VAT) of the public procurement contract is less than the RON equivalent of the following limits:

a) for delivery contract - 40.000 euro
b) for services contract - 40.000 euro
c) for building contract - 250.000 euro

The period of time between the transmission of participation invitation and the dead line of depositing the offers may be modified in this manner:

- The participation invitation is published in PPES in 10 days
- The documentation is accessible in PPES in 6 days

The contracting authority has the right to organize <u>solutions contests</u>. This is a procedure through which the authority purchase especially in the field of territory arranging, of environmental and urban planning, of architecture or date processing, plans or projects, through selecting the best offer, based on competitiveness issues by the joury, with or without awarding prices.

The solution contest is initiated by publishing a participation add through which invites the economical operators to deposit their projects. The projects must be anonimus, and the name will only be reavealed at the moment when the joury has reached a decision.

The jury is independent concerning the decisions process.

A period of at least 52 days is given for the depositation of the offers, from the date of participation add publication.

f. The special assignment modalities are the following :

- the framework agreement
- the dynamic procurement system
- electronic tender

<u>The framework agreement,</u> represents a written agreement between one or more contracting authorities and one or more economical operators (not fewer than three) for establishing the essential conditions that will regulate the public procurement contracts that will be assigned in a given period (max 4 years) especially for the **price a**nd according to the **amount** .

This modality can't be used in an abusive way, in order not to obstruct the competitition. Usually, this process ends by applying the opened or restricted tender.

The system of dynamic procurement, is an entirely electronic process, time limitted and opened for any economic operator who accomplishes the qualification criteria and who presented an initial offer according to the task book requirements.

This modality is used only for the procurement of some current use products whose characteristics satisfy the needs of contracting authorities.

In this case the solicitation of taxes for interested economic operators or participants is prohibited, the duration mustn' t get beyond four years and the contracting authority must respect the rules of open tender procedure in all its phases.

Characteristic for this modality is the fact that only electronic manners are used respecting the provisions for communication and transmission of the offers.

The electronic tender is a repeting process of offers, realized through electronic means where, after a first evaluation of offers, the bidders have the possibility of reducing the presented prices or of improving the other elements of the offer.

The final evaluation is automatically realized by the electronic system used.

Consultancy, projection or other such issues can't be performed through this means.

The electronic tender is used in the following cases:

- opened tender
- restricted tender
- negotiation with preliminary publishment of the participation add
- call for offers
- at the competition renewal between economic operators which signed framework agreement
- at the deposing of the firm offerts within the system of the dynamic procurement

3. Contract assignment

The assignment of the public procurement contract takes place after the evaluation commission has analyzed the received offerts and the commission assigns the contract to the bidder that was declared the winner of the tender according to the established criterias – the most advantageous offer in terms of economic criteria or based the lowest price

The contract is signed after at least 7 or 15 days from the announcement of the application procedure result.

The contract assignment is formalized by the elaboration and publishing of the assignment announce.

Any person who considers that his rights have not been respected, during the public procurement process, has the right to use one of the legal procedure, reclamation or action in the court of law.

The litigation is sent at the National Council of Reclamation Solutioning

Based on the documents from the procurement file, the contracting authority will elaborate an annual report of the assignment contracts in the preceding year that will be hand in to The National Authority for the Public Procurement Regulation and Monitoring, in electronic format until 31 march of every year.

4. The contract management

The legislation for public procurement refers less at this last stage. At thi8s moment are set into place some accounting, financial, construction equity regulations, the environmental protection or the commune civil and commercial legislation.

During this stage, an important role is played by the project management, more exactly the design of each contract like a project and its administration in a manner that must accomplishment the public interest in accordance with the procurement in terms of quality, cost and established terms.

The reform of the public procurement system could be realized through the establishment of some institutions with clear defined tasks and through the implementation of an adequate legislation. The systematized step by step elaboration of the legislation which has to be thoroughly respected throughout the public procurement process, represents a real need for the applicants, taking into consideration the impact of the national public financial resources and of the EU funds, which will strongly influence the economical development of Romania for the programming period 2007 – 2013.

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Vasile Moțoc
Administrative Manager , "Lucian Blaga" University of Sibiu, Romania
Ioana Moțoc (Leca)
Head of the PIU department – Municipality of Sibiu, Romania

PERFECTIONING THE ACTIVITY OF PREVENTING, SUPERVISING AND RECOLLECTING OF THE BUDGETARY DEBTS– PREMISES FOR INCREASING THE PROCEEDS OF THE PUBLIC BUDGETS

Abstract: The Thesis/Paper deals with some of the priorities in the activity of preventing, controlling and recuperating the budgetary debts in order to improve the performances of the financial administration materialized through the growing of the degree in which the taxpayers voluntary declare and pay their budgetary obligations and the speeding of this process in front of the phenomenon of not-paying or payment delays or for preventing the formation of budgetary arrears and for efficiently deal with those already registered that could not be prevented and thus to achieve/register a growth in the budgetary influx.

JEL Classifications: G38

In the activity of recollecting the budgetary debts, the fiscal administration deals with two categories of contributors both legal persons:

- viable legal persons which are not in the situation of payment ceasing or bankruptcy procedure;
- legal persons which are in difficulty, meaning those who are in the situation of payment ceasing or bankruptcy procedure;

A different procedure is recommended for these two categories of contributors.

In the first case, if a dynamic action of tax collecting is wanted, the problem of selecting the measurs of tax collecting and suitable strategy for the constraint payment must be put so that not to force the entrance of the contributors into bankruptcy.

Of course, this won't be the case for collecting a budgetary debt from a society in difficulty where a procedure in accordance to its plan of reorganisation needs to be applied.

Another important aspect is represented by the means of tax collecting, in accordance to the acknowledging the motifs for which the tax was not payed on the date of payment.

As we have already mentioned, regarding the administration of contributors, the fiscal administration must actively intervene. For a good administration it is a must to permanently maintain a contact with the contributors before the fiscal date of payment, fact that allows detecting the risks on time, when not respecting the payments of the budgetary debts and distinguishing between the phenomenon of temporarily difficulty and that of lasting difficulty.

The speed of reaction of the fiscal administration in front of the phenomenon of not paying, even anticipating it, allows the exact knowing of the causes and delimitating them in:

- temporarily financial difficulties of the debitor (for example – the society can not pay the decalred fees and taxes at the moment, because of one or more of its important clients delayed the paying of the invoices for a few days);
- permanent financial difficulties, caused by the bankruptcy of one of its main clients;
- A possible measure that has to be taken (especially in the case of contributors with a turnover that exceeds a certain significant value), would be the establishing of a meeting with the contributor, by delegating an inspector to the registered office of the company and making, together with the debtor, the exact analysis of the motifs for which the budgetary debts was not payed, in order to take the appropriate measures.

The administration must never remain without reaction in front of a payment incident.

Another problem that must be taken into account is represented by comunicating the documents of constraint payment, no matter the reasons for which the debts was not payed. The debtor must be acknowledged that the fiscal adminsitration intends to collect the debts even by constraint.

This communication to the debtor contributor, followed by initiating the procedure of constraint payment, must not limitate the measures taken by the fiscal administration for renouncing to amiable measures of tax collecting, such as: calls, meetings and even delegations to the registered office of the company.

In case the amiable procedures had no effect and the court is required to apply the ensuring measures, this notice has to be sistematic for the important debts (that exceed a well established level of significance) that are hard to collect.

The difficulty when collecting the taxes can occur in the following situations:

- when there is a visible disproportion between the cuantum of budgetary debts and the guarantees of tax collecting that the contributors might own, after a carefull studying of the fiscal file;
- at the beginning of the debtor's action to avoid the payment of its debt (changing the registered office, saling or transferring the goods of the society).

Difficulties that occur when collecting budgetary debts must be objectively appreciated, no matter if this contributor is or is not of bad will.

There are, indeed, situations in which the contributor is not of bad will (for example, financial difficulties caused by the bankruptcy of an important client and that places the society in a position of cvasi ceasing the payments), but in which the neccessity of defending the state's rights imposes / requires to apply ensuring measures.

When applying the measures of constraint payment it is required that, the ways of law enforcement upon the incomes, real estates and movables must always be simultaneously activated.

It is about pressing the debtor contributor harder than he can resist, in order to determine him to pay his debt.

Only a well/knowing of the contributor's real situation, of his goods, banking accounts and fiscal file can allow the using of the most efficient measures.

No hesitation is allowed when warning the contributor about the possibility of starting the procedure of judicial adminsitration and bankruptcy based on the reason of not paying the budgetary debts, in other words, to wind up and solve out a society, even if the procedure is very delicate in reality.

When amiable measures of tax collecting are applied, and then constrained ones, the fiscal administration faces some difficulties regarding the collecting of budgetary debts. Still, it is responsible for accomplishing the collecting of the budgetary debts, being forced to prove that all the means of tax collecting have been legally and effectively used even if the results were not postivie ones.

The purpose of judicial procedures for administration and bankruptcy is, as possible as it can be, the saving of working places and the maintaining of the activity of the society. In the context, the recollecting of the debts of a society in difficulty doesn't represent a priority.

According to the laws of bankruptcy, the chances of retrieving the budgetary debt depends on the degree of debts and the judges decision regarding the maintaining the activity of the society placed in difficulty, by aproving the plan of reorganising the society.

The speeding of reaction of the financial administration in front of the phenomenon of not paying the fiscal obligations by the debtor conntributor must be accomplished.

All the planned measures must lead to the improvement of the performances of the fiscal administration in order to prevent arrears and to efficiently deal with those already registered but that couldn't be prevented, so that to achieve a growth in budgetary tax collecting.

The European administration standards of a fiscal administration uses fundamentatl indicator to collect taxes and to efficiently measure the actions, indicators tht are established on the basis of monitoring and rigurously analysing the obtained statistic data.

An efficient analysis upon the rules of tax collecting in other European fiscal administration shows that the Romanian fiscal adminsitration must take into account the same type of fundamental indicators of tax collecting in order to comparatively evaluate it activity and to facilitate the exchange of information in this domain.

To achieve this purpose it is necessary to make a classification and a statistic presentation of the Romanian budgetary arrears in order to establish the degree in which this set of tax collecting indicators applied in the U.E. states can be succesfully adopted and applied in our country.

Taking into account the fact that most fiscal files reffer to small amounts of money, it is necessary to use a method according to which a differential approach is preferred depending on the value of the debt instead of adopting the same approach taking into account only the chronological occurence of the debt.

Using the advantage of the Informatical techniques a lsit containing the tax amounts in a decresing order can be edited and, it can be easy that from the total amount of debts a percentage from 50 % - 60% is being owed by a relatively small number of contributors or less than a third from the total amount of the budgetary debts is being owed by a greater number of debtors.

After analysing the structure of the registered arrears, we can group them as follows:

- arrears upon which the fiscal administration can intervene;

- arrears upon which the fiscal administration can't intervene;
- arrears upon which the fiscal administration is legally forbidden to intervene, for example: the debts of companies that are in a bankruptcy procedure or juridical dissolvation, debts of societies that are in a process of privatization, debts that are not final because they were cotested in court;
- arrears against which an action is impossible being debts owed by unsolvable contributors.

Applying the principle of a good controll assumes an immediate and continuous action of supervising of the daily correspondence between the handed in declarations and the payed taxes needs to be done in order to establish the contributors that are about to be notified as a first operation of the constraint payment.

The notifications have the purpose of reminding the debtor the amount of money, the nature of the debt, the penalties for delaying and give a 15 days term for paying.

In order to end this action a supervising of the payments is needed as a result of this notifications sent to the contributors.

If, even this term is ignored, after those 15 days given by law, the legal fiscal service must immediately announce the office of law enforcement.

The reaction of the office of law enforcement must be rapid and consists in taking the first measures of contraint payment – sending a written notification towards the debtor together with an executory order.

For reaching a real goal, a strong pressure needs to be applied by the fiscal adminsitration upon the debtor contributor, that must multiply the number of measures for each fiscal file.

The constant supervising of the terms for each of the applied measures is an important condition for ensuring the efficiency of every recollecting action and for ending of a debt, meaning paying, constraint paying or acknowledging the insolvability.

Dealing with the fiscal files, unrecoverable ones too, must be done till the end, meaning the moment in which they can be registered as complete loses.

Some observations regarding the process of tax collecting and arrears dealing can be done:

- for the contributors that are public institutions, the fiscal units do not really have a total freedom of action while collecting the debts, even if the law doesn't forbid them to intervene;
- a preference for not paying, depending on the type of tax can be found, the phenomenon being predominant in the case of value added tax (VAT) rather than in the case of the income from wages;
- a growth of handed in declarations not covered by payment cand be observed, a phenomenon that is constantly growing;
- the declarations handed in but partially covered by payments are numerous at small values;
- partial payments are predominant in number in front of entire payments of the owed amounts;
- the level of partial payments represented by the ratio between the partial payments done by the contributor and the declared amount of the same contributor represents 20 – 50% of the declared amount;
- the delayed acknowledging of the not paying as a result of not sistematically apply the comparison between the handed – in declarations and the effective payments simulates the delaying by the contributor of the moment of payment;
- the neccessity of using space out payments as an exceptional means for the contributors who have real difficulties of circumstantial payments;
- in the process of editing and sending payments notifications we can observe a delay that exceeds the acceptable number of days for the notification to be received by the contributors.

The speed of reaction of the offices for constraint payment can be appreciated and measured in such terms as follows:

- the period of time that passed from the moment the office for law enforcement was anounced till the moment of sending the written notification and the executory order;
- the period of time that passed from the moment the notification was sent as a first measure of constraint payment and initiating other constraint measures;
- the period of time between measures;
- the period of time between announcing the office for law enforcement and ending the debt.

The practice proved that an action of constraint payment must not take longer than 3 years because in most cases the administrative expenses are not justified by the value that has to be recollected / recovered.

Respecting some strict terms of action proves the debtors that the fiscal adminsitration rules both the contributors' administration and the taxes they owe and it is interested in preventing the budgetary arrears by establishing priorities for recovering the current obligations and debts.

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Lecturer PhD. Irena Munteanu
"Ovidius" University of Constanta, Romania
Senior Lecturer PhD. Elena Druică
University of Bucharest, Romania
Lecturer PhD. Norina Popovici
"Ovidius" University of Constanta, Romania

WILL THE UK ADOPT EURO?

Abstract:*Weak or strong, the national currency symbolically represented a country and even a national identity. Although the idea of a single currency took shape in time, some states accepted reluctantly the adoption of the euro as national currency, while others never accepted it. The Great Britain is part of the latter category, but it represents a special case. On the one hand, the pound sterling is the oldest national currency in Europe; on the other hand, UK played and still plays an important international role. Therefore, we have developed an interest in researching the context in which the UK decided not to adopt the euro and the possibility of doing so in the future.*
Many analysts, researchers or simple citizen asked themselves the same question that begins our study: Will the UK adopt the euro? Without pretending to find the perfect answer, we shall try to draw some conclusions based on scientific arguments, conclusions that can lead to finding the answer to the question.

Key words*: Euro, Euroscepticism, convergence, flexibility, financial services*

JEL Classification*: E42*

A SHORT HISTORY OF THE POUND STERLING

The problems related to the adoption of the single currency are complex. We cannot avoid the question why some countries adopted the single currency so enthusiastically, while others had their reserves. When we talk about the United Kingdom, the contradictions are all greater. A good starting point for our research would be the history of the pound as past experiences influence present attitude and future decisions.

The UK enjoyed the existence of a currency with over a thousand years' history. Starting with the years 900, the Viking invasions and the increasing need of resources lead to the development of the coinage process in England. In order to control the thirty coinage centres, the introduction of a national single currency to be introduced. This was happening in 928, many centuries before the history of other national currencies even begun. Thus, England was the first country in Europe to initiate the use of a single currency in the post-Roman era, preceding France by more than 600 years and Germany and Italy by almost 900 years.

The advance the British Empire had in the Industrial Revolution, the development of the banking sector and the territorial expansion in the 19th century all contributed to the transformation of the pound into an internationally important currency. Following the example of the UK, many countries adopted a single standard (gold) system, giving up the single standard (silver) or the bimetallist ones, making the gold standard into an international standard. Nevertheless, the situation changed with the beginning of the First World War, when the UK gave up the gold standard. The attempt to return to the gold standard in 1925 was an unfortunate one. Towards the end of the Second World War, the Bretton Woods accords confirmed the American politic and economic supremacy and the special place the dollar had against the pound.

Afterwards, the national currencies status modified through the post-war monetary reforms in each country. Germany had such a reform in 1948, after suffering from several hyperinflations. The formerly German occupied countries, from France to Norway, relatively mastered the war induced inflation through short notice drastic reforms, by which the value of national currencies was repeatedly adjusted. The efficacy of these reforms was based on a correct and organised management of the monetary mass in circulation and through price controlled reduction. Unlike UK, the other European countries experienced invasive monetary reforms followed by unprecedented living standard growth. From this perspective, the establishment of the Economic and Monetary Union (EMU) was a step forward for these states, and not a leap into the unknown as some of the British considered it.

As a conclusion, most of the European states, be there greater or smaller, changed the status of their national currencies on a more or less frequent basis. Unlike the, the pound sterling was never replaced by a

"new pound" over 1300 years. (In Germany, the national currency underwent repeated transformations: Reichsmark, Rentenmark, Ostmark, Deutschemark). In this context we can understand the refractory attitude of the UK towards the adoption of the single European currency nowadays.

EUROSCEPTICISM

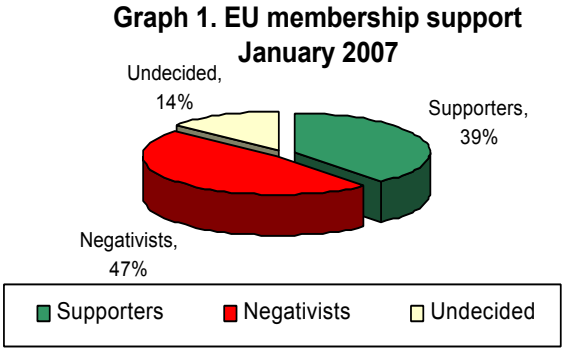
Euroscepticism is a term coined for the opposing movement within the European integration movement. The term originates in UK and referred to those members of the Labour and Conservative Parties that showed scepticism regarding the official support of the UK membership in the European Economic Community. Since then, the term expanded and nowadays comprising everything to do with the opposition to the European Union, its policies, the adoption of the single euro currency and the formation of any pan-European entity under the form of a European centralised super-state, federation or confederation. The term entered other European languages as a borrowed word, for instance Europaskepsis in German. Euroscepticism is often associated with supporting national sovereignty, since the EU is eroding this sovereignty.

In the case of the Great Britain, the debates regarding Euroscepticism were a major importance political issue ever since the beginnings of the EU and never ceased to the present day, when the UK is a member of it. In 2004, 37 members of the British, Polish, Danish and Swedish Parliaments formed a new European Parliamentary group called "Independence and Democracy" whose goal was the rejection of the single Constitution in Europe and of all other European integration processes. Some delegations of this group, including the Great Britain Independent Party, opted for the complete withdrawal from the European Union.

In order to make clear the degree to which Euroscepticism is present in UK and to complete the EU membership framework, there was conceived an opinion poll – called Eurobarometer 67 – which would touch the main problems related to the UK citizens and their relation with the European Union and the single euro currency. The main aspects and the results that are relevant for our research are presented as follows.

EUROBAROMETER 67

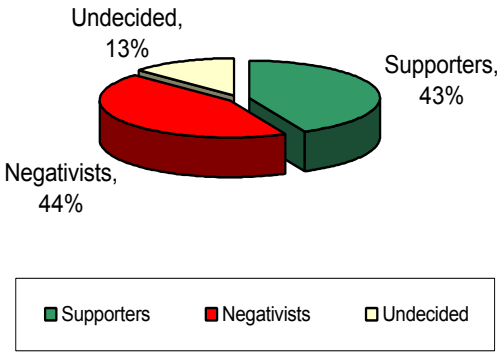
The research regarding the Great Britain's attitude towards the European Union, the euro zone or the replacement of the pound with the single European currency were resumed and published during the past years in rapports named Eurobarometers. The documents are made for the European Commission as they are requested and coordinated by the Directorate-General for Communication. The reference period of the analysis for Eurobarometer 67 was 10th April – 7th May and the publication date, June 2007. The survey was made by TNS Opinion & Social on a 1319 persons sample. The published rapport approached several key aspects such as: the benefits of European Union membership, the positive results of accession, the European Constitution, the EU awareness level, the trust in national and EU institutions, education.



Regarding the *benefits of EU membership*, the poll showed that at the beginning of 2007, 47% of the interviewed considered that the Great Britain did not benefited from EU accession, while a 39% considered accession as positive from all points of view (Graph 1)

After only six months, the scales tipped more in favour of the accession supporters, so 43% considered accession as beneficial, while 44%, only a percent more, sow things in a negative way (Graph 2).

Graph 2. EU membership support
June 2007

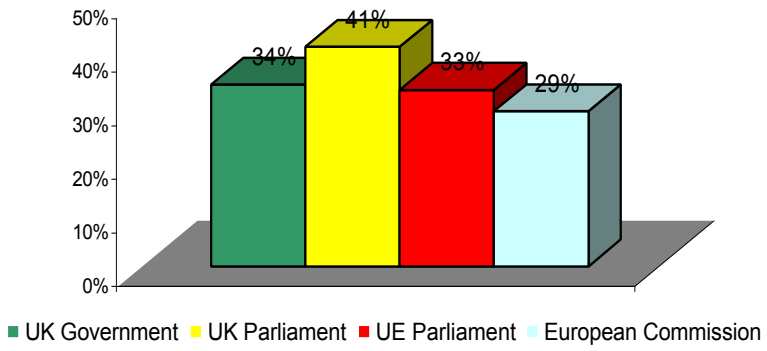


The age groups analysis revealed that 55% of the youth (15-24 years old) supported EU membership, while 30% of the elderly (over 55 years old) gave a negative vote. Concerning the positive results of the accession, the most popular benefits were: peace amongst the Member States of the EU (34%) and the free movement of people, goods and services (33%).

Another aspect touched by Eurobarometer 67 was the *European Constitution*. Although this concept is quite unknown to the British, 43% of the citizens favoured it, while 36% were against and 21% were undecided yet. It seems like the young population showed again a pro-change attitude and the elderly remained conservative. Thus, 485 of the persons between 15 and 24 were in favour of the European Constitution, while 36% of those over 55 were against.

It is interesting to see the results of the survey concerning the *EU awareness level*. Regarding EU composition, only 40% of the British poll knew that it is formed of 27 Member States; the rest of 60% gave wrong answers. Of the latter, 30% thought it is formed by 15 Member States; the rest did not know the answer. Compared with September when the question concerning trust in national and EU institutions, the percentage of those trusting UK Government grew by 10% from 24% to 34%. A similar growth was registered regarding UK Parliament, from 29% to 41%.

Graph 3. The British trust in institutions



As to EU institutions, the analysis concerned the European Parliament, the European Commission and the EU Council. 33% of the poll trusted the European Parliament, 46% were sceptical (did not give any confidence vote), while the rest of 21% considered they were not well enough informed and could not have any opinion about this subject. Concerning the European Commission, 29% of the poll considered it a trustworthy EU institution, 42 % rejected this idea, and 29% were not able to offer an answer from lack of knowledge in the field.

Another important aspect of the Eurobarometer 67 was decision-making. One of the major obstacles to European integration was the British aversion to accepting Brussels legislation, motivating that it diminishes UK Government control. Within Eurobarometer 67, the poll were asked if decisions should be made only by the UK Government, or jointly at EU level, the fields envisaged being: technological and

scientific development, environment protection, fighting terrorism, taxation, fighting unemployment, defence and foreign affairs, immigration, education, health and social welfare, consumer protection, support for regions facing economic difficulties, competition, national economy. 78% of the British poll considered that taxation should remain a national objective. Although high, this percentage remains below that of Denmark (90%), Sweden (89%) and Finland (86%).

695 of the British poll considered that fighting unemployment must be taken at national level, without interference from the EU. At the same time, 28% were for joint EU decisions and 3% abstained.

Also for the others analyzed fields, the British expressed in favour of national decision-making: foreign affaires (56%), immigration (59%), education (77%), health and social welfare (75%), consumer protection (56%), national economy (72%).

Eurobarometer 67 reveals for our research the following partial conclusion: although trust in EU institutions grew recently, the British prefer national decision-making in all fields, especially the economic one.

THE "5 ECONOMIC TESTS" - BAROMETER FOR THE SINGLE CURRENCY ADOPTION PROCESS

The "5 economic tests" represent a model elaborated by the Great Britain Government used in order to evaluate the level of preparation to accessing the Euro Zone and , implicitly, to adopting the single euro currency. A basic principle of these tests is their independence to any political decision regarding accession. The tests were elaborated in 1997 by the former Labour Party member, Gordon Brown and by his assistant Ed Balls, the International Monetary Fund considered them as "corresponding to the most relevant economic considerations in the euro accession evaluation process".

The tests were issued under the form of five questions:

1. Are the economies of UK and the other Economic and Monetary Union (EMU) Member States convergent? (Convergence)
2. Is the UK economy flexible enough to cope with unpredicted and undesired events? (Flexibility)
3. Will the euro adoption encourage investments in the Great Britain? (Investment)
4. Will the euro adoption be beneficial for the financial services sector? (Financial services)
5. Will euro accession bring advantages for the labour market? (Employment and economic growth)

The responsibility for the final evaluation falls with the Treasury of the UK which started its activity on this objective in 1997. Then it was decided that the UK economy was not convergent enough with the economies of the other Euro zone members and that it had a flexibility deficit. The Government pleaded for a revaluation of the UK in view of these facts, a revaluation that started in June 2001 and was published in June 2003.this new revaluation was larger than its predecessor, having 250 pages and 18 practical studies elaborated for the real estate market, labour market flexibility, Euro zone monetary and fiscal framework. Only one of the "five economic tests" was passed, the fourth, regarding financial services, and the conclusions were largely the same as in 1997. Although there was a great progress on convergence, there are still great structural differences, for instance on the real estate market, that cannot be overlooked. Even if UK flexibility improved, it did not reach the level necessary for the accession. Among the conclusions of the study was also that The City, the financial centre of the Great Britain will benefit the most on a long term from euro adoption.

Gordon Brown advocated the necessity for a new revaluation by the five tests taking into consideration the 2004-2007 period, but such an activity was not begun to the present. The subject is still a heated one in the mass media and in politicians' debates.

FUNDAMENTS FOR THE ACCESSION DECISION. PROS AND CONS

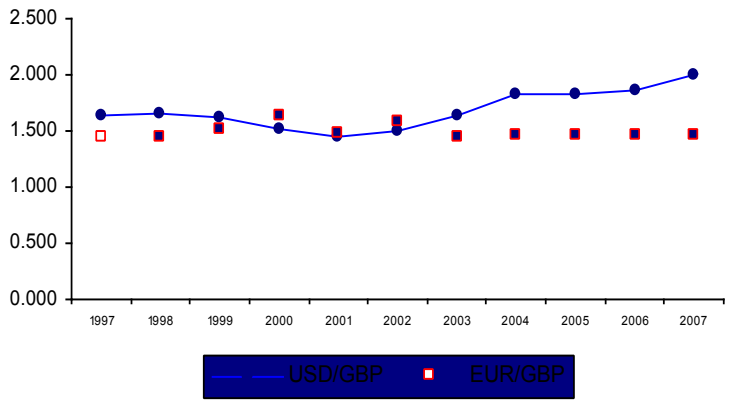
In the attempt to find an answer to the question *Will the UK adopt the euro?* We will treat each of the five directions traced by the Tests by pointing out both positive and negative aspects.

Test 1 – Convergence. By this test it is verified the extent to which UK economy can align to that of the Euro zone in a durable and sustained manner. In order for the test to be passed, the UK economy must be flexible, to adapt to change and unpredicted economic events, to have a stable currency exchange rate and to prove sustained and durable convergence with the rest of the Member States of the EU. The study showed that the UK economy functions in a different rhythm than that of Europe since UK is cantered on oil production and industrial services, and less on agriculture.

Those who do not consider this an impediment claim that the UK economy started the alignment process to the EU economy in the late 90's, and the exchanges with Europe amplified with the establishment of the Single European Market. They consider it unlikely for the British economy to exit European rhythm

with the accession to the Euro zone, as long as trade and foreign investment will considerably increase. Moreover, the ups and downs of the economy over the past 30 years are due to either the volatility of the pound or to unsuitable internal policy, and both will disappear along with Euro zone accession.

Graph 4. GBP evolution during 1997-2007



To the opposite pole are those who consider that UK economy is based on a different proportion of industry/ industrial services as to the European one. Also, the largest part of the international economic relations takes place outside Europe, especially in the United States. The Great Britain is the strongest investor of Europe in the USA, while USA invests in the UK twice more than all the European states altogether. Therefore, the Great Britain economy is connected to that of the United States, as the strong commercial connections and the relatively stable USD/GBP exchange rate prove it.

Still, from Graph 4 we can notice that the evolution of the euro versus pound exchange rate shows more stability than that of the American dollar versus pound. In these circumstances, those who regard UK accession to Euro zone from an optimistic perspective may be right.

Test 2 – Flexibility. The Treasury affirmed that the success of UK accession to the euro depends on the flexibility of the labour force and of the economic agents, that is, the economy's adaptability to change. The test can be passed only if there is flexibility regarding price setting and companies' business strategy, if salaries are correlated with productivity and economic agents are connected to labour market transformations. We will continue by referring to the most important aspects such as: interest rate, exchange rate, taxation.

The problem of the interest rate is extremely important due to the effects it produces within monetary policy and economy in general. If the UK adopts the euro, then the interest rate will be that established by the Central European Bank and it will be a single rate for the entire Euro zone.

The argument in favour could come from the example of the US. The economy of the United States, one of the most developed and successful in the world, uses a single interest rate: this model could work just as well in Europe. Moreover, the interest rate imposed by the ECB influences the economies of the Member States in the Euro zone, but also has an impact on the European Union of which the UK is already part. In addition, if the Great Britain adopted the euro, then it would directly participate in the monetary policy decision-making process.

The arguments against come from the situation existing in the Great Britain - that is, the lack of convergence. Due to it, an adoption of an interest rate via the single currency would bring a sudden drop of the interest rate which would generate instability, especially since the UK is more sensitive to interest rate modification than the rest of the continent because it is based on variable mortgage rates. Also, the adoption of a too low single interest rate gives way to inflationary phenomena.

As to the exchange rate, the stability of the national currency versus euro is a preliminary condition for the Euro zone accession. The Great Britain must demonstrate that the pound is stable relative to the euro, which can be observed in Graph 4. An argument in favour of beginning negotiation is the fact that conversion exchange rate will be negotiated, not imposed. As a result, in the case when the conversion of the pound to euro is not convenient, the UK can refuse Euro zone accession.

An important problem is that of taxation, those who accept the euro as a single currency claim that taxation can remain a national decision, basing their opinion on the current situation in the Euro zone, while

the sceptics argue that it is only a matter of time before the Union takes control. Taking into account that taxation in the Euro zone is higher than in the UK, there will be immediate negative effects on the British economy.

Test 3 – Investment. Through this test there were underlined and pointed put the advantages of accession concerning investment: billion pounds funds for the small business, capital and export access facilitation, low exchange risks. Still, this test is not yet considered passed. The study reveals that the safest, most profitable and qualitative investment will take place only if the convergence criterion is passed. The debated aspect is that regarding foreign investment, as it is well known the fact that the UK is on one of the leading positions in Europe as to foreign investment.

A few major foreign investors claimed that they wish for UK accession to Euro zone and they would leave if that would not happen, leading to an increase in unemployment rate. In November 2002, the executive manger of Ford in UK declared that the GBP/EUR exchange rate had a negative impact on the companies' profits. What scares the foreign investors is the exchange risk due to its permanent fluctuation, so, in order to continue to attract direct foreign investment with a beneficial effect on the whole economy, the UK has to accede to the Euro zone.

At the opposite pole are those who believe that the accession to the Monetary Union, the more flexible interest rate, the loose rules and the superior qualified labour force are much more important to the investors, rather than Euro zone accession. In addition, most foreign investors are American who bring their contribution mostly to the high-tech industry, which is less sensitive to the exchange rate fluctuations. Only the large scale industrial production (the machine production branch), characterized by a relatively low profit, is preoccupied by the Great Britain accession to Euro zone.

Test 4 – Financial services. This test debates the impact and advantages of the single currency on the financial sector and whether it is ready to face the challenges. The "Wall-Street" of Great Britain is represented by the City of London, the zone under focus for this test and its analysts. The question answered was Will the City of London develop within Economic and Monetary Union, as well? The answer was an affirmative one, the test concerning financial services being the only one passed.

In the context where the City generate huge profits for the Great Britain, anything that could possibly disturb the activity and the position of this financial centre on the planet, must be avoided at all costs. Some analysts believe that if the UK had acceded to the Euro zone, the location of the European Central Bank would have been in the City, which would have strengthened the position of London as a financial centre. In addition, if the UK does not adopt the euro, most of the foreign banks with subsidiaries in London, will take into account emigrating to the Euro zone.

Other analysts do not see any danger for the financial activity in London. The euro was introduced in the UK starting in 1999 – scripturally and 2002 – cash: at no time until the present was there any alarm that the position of the City would be affected on a global level. Analysts consider that foreign banks located in London at the present will stay in place first of all out of inertia, and secondly because relocating involves high expenses without any clear benefits. Also, the UK offered them all the support they needed, allowing them to work in euro, without having to relocate to Frankfurt for that. At any rate, the percentage of persons employed in the financial services sector in London is higher than that of Frankfurt. In order for Frankfurt to become a real threat for London, it would take sustained investment. A final argument would be the fact that comparing with Germany, Great Britain's time zone is more convenient for Japan and USA transactions.

Test 5 – Employment and economic growth. Within this test, the most difficult to measure were costs and benefits. Even if significant benefits were envisaged after euro adoption, just like in the case of investment, in this sector there were not enough convergence and flexibility in order for the test to be passed. According to the Treasury, this is the fundamental test, euro adoption having the greatest influence on labour force employment and economic growth. There are several key aspects to be debated, as well. We will continue by referring to three of them: to what extent is the adoption of the euro advantageous and what its effects on commerce and employment are.

There is the fear that outside the Euro zone, the economy of the UK will remain behind, marginalized and uncompetitive, while the rest of the economies will change, will become more flexible and will lower or even remove currency exchange costs. In essence, the arguments for euro adoption are the same with those justifying the accession to the European Union: greater offer and demand, increased number of transactions, cheaper goods and services, greater welfare, stability. Some analysts consider that the European

economy has a great impact on the British economy and the latter will lose control unless it accedes to the Euro zone. Also, adopting the single currency will only increase the role of the UK within the EU.

Those saying the opposite rely on the fact that UK is the fourth largest and most developed world economy. Inflation and employment reached recently the best levels of the past 40 years, determining a long term stability that could be affected through Euro zone accession. Moreover, foreign investors are attracted by the low taxes, the flexibility of regulations, reduced bureaucracy and qualified labour force of the Great Britain.

As to commerce, Euro zone accession will allow the UK to enter a new market where the British buyers could choose from a wider range of different products and services (the prices in the UK are presently 12% higher than in the rest of Europe), but the trust in trade with other states will only increase after exchange rate fluctuation was removed and there was a price transparency. What is more, the existence of several national currencies acts as a barrier on the way to an efficient trade. It was demonstrated that the countries using the same currency tend to buy more from one another. The Canadian provinces buy and sell more among them avoiding trade with the adjacent American states, even if they are part of a Custom Union.

Those who disagree with euro adoption consider that the Great Britain is already part of the EU and therefore, has access to the Single European Market. The change of the pound to euro through Euro zone accession would not bring a significant change. In addition, more than half of the trade of the UK is outside the Euro zone and is expressed in dollars. Euro is more unstable regarding the American dollar, than the pound, a fact with unfavourable consequences on the UK in the case of Euro zone accession.

The employment level is an important factor in decision-making. Euro zone accession will attract a large number of direct foreign investments as long as the investors have easy access to European markets without assuming a currency exchange risk, more investment generate more jobs. Thus, if the Great Britain will accede to the Euro zone at an optimal exchange rate, then there will be no repercussions on the employment level. Unemployment rate was a problem in Europe before single currency adoption. After adopting the euro, employment increased. Nowadays, unemployment has low levels in Austria, Ireland, and Holland while in the countries with high levels of unemployment; it is due to deficient government policies.

The arguments against accession are based on the fact that, even if it is outside the Euro zone, the Great Britain reached a maximum level of 6% in 2000, lower than that of the rest of Europe (10%).

As a conclusion, even though only one of the "5 economic tests" was passed, that of financial services, and flexibility and convergence brought into discussion do not have the required levels for Euro zone accession, it cannot be formulated a definite answer that will not leave room for interpretation. Thus, we cannot affirm or deny for sure that the UK is ready for the accession or that it will take this step in the near future, not as long as for each of the component areas of the tests there are pros and cons regarding accession, all supported by real facts and statistic data.

CONCLUSIONS

Euro adoption is a difficult decision to make, from economic, political and psychological points of view. Even if the benefits of euro adoption are well known, they are not strong enough reasons for Euro zone accession.

In order to answer the question *Will the UK adopt the euro?* and to other questions deriving from it, we begun our research with a short history of the pound sterling. We found that, unlike other European national currencies, the pound has an advance of over 500 years on birth and a continuous history of over a thousand years. Then the research moved to the idea that Eurosceptics are those opposing euro adoption and, therefore, we studied the main results of the Eurobarometer 67 survey. We draw two conclusions. The first refers to the openness tendency of the British towards the European Union manifested over the past years. In 2007, over only six months, the percentage of those considering UK membership to the EU increased from 39% to 43%. The second reveals the fact that the British are not very well informed regarding EU, only 40% gave a correct answer to the question about EU composition.

With the aim of finding out to what extent is the Great Britain prepared to adopt the single currency, we emphasized The 5 economic tests, a model that studies the following aspects: convergence, flexibility, investment, financial services and employment and economic growth. The study revealed that only the financial services category is ready to receive the single currency as a certain benefit. The other tests showed concerns as to the strong connection between the UK and USA economies, interest rate, exchange rate, unemployment rate. Still, for every one of these aspects, there are counterarguments: the connections with the EU, the growth of financial power, decision-making power at Euro zone level.

In this context, it is difficult to give an answer to the question. We, nevertheless, attempt one. The globalization tendency at international level and the strong connections within the European Union lead to

the idea that the path of the UK is towards the Euro zone. Besides, the pro-euro arguments seem to offer an answer to all Eurosceptics' questions. Thus, we are tempted to give the answer: *Yes, the UK will adopt the euro*. Still, in the researched models and the economic statistics the *psychological factor* cannot be quantified. The future will show us how strong it is, the future where we will find out if the UK will adopt the euro.

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PhD student Calin Negotiu
CEC S.A. – Sucursala Sibiu, Romania

CEC – PAST VERSUS FUTURE

Abstract: *The paper presents a brief history of CEC, from the initial historic conditions of establishing over the time, to our days, when CEC is starting to be a bank of Romania among other banks in the financial market.*

Key words: *CEC, history, banking, personalityes, Romania.*

JEL Classification: *G21*

„It`s only up to us to make it!"
(Eric Winterhalder – Economist, CEC`s first manager)

The young Romanian Principalities came after a controversial Phanariot century. The debate if the century was one of progress or stagnation didn`t deliver any result. Of course there have been over a 100 years marked by long periods of confrontations between neighbored powers, usually taking place on the territory of the Principalities, by foreign occupations, by requisitions. Another foreign occupation, the Russian one (1828 – 1834) would trigger of the process of modernization, through the Organic Rules. Synthesized after long debates, overseen by General Kiselev, the document outlined the new institutions of the modern state, but also keeping the feudal institutions, that were out of place in the new context, as well as, in the tax system, the privileges, the exemptions or monopoles. The taxes, a source of income that should go straight to the treasury, were generously leased to private persons.

The three years of the Crimean War (1853 – 1856), but especially the disastrous administrations of the country's finances by the caimacams that lead the Principalities until the Unification, left the country's treasury even emptier.

In the 19th century, the lack of a rich scientific literature, as well as that of valuable papers in this domain, was substituted by a rich activity promoting the spirit of saving, materialized in numerous press articles, politic and academic speeches. Doubled by a strong political desire wanting the modernization of the Romanian civilization and the economic development of the nation, this activity found it expression in establishing the first Romanian institution of public credit "Casa de Depuneri si Consemnatiuni" – "Deposits and Consignments House". Along the time, from the appearance of the first project for creating a savings house in Tara Romaneasca, Walachia, in 1845, presented in a very romantic style, typical for the first half of the 19th century and to the sophisticated promoting formulas from today – TV advertisements, web pages – the road was long, charged with achievements and failures.

As far as savings houses were concerned, the first project belonged to Costache Balcescu (Nicolae Balcescu`s brother) and it was published in 1845. This included the statutes of the savings and deposits house" which was due for establishment by "free private subscription in the city of Bucharest" being backed by a list of underlying reasons. It is worth mentioning that the project was inspired by the statutes of savings houses in France and by the statute of such a house already established in Brasov in 1835.

The credit organisation plan, which was released in 1864 in an annex to the government budget, referred to the financial institutions, which were listed according to the urgency of their being established. Thus, topping the list was "Banca Fonciara", followed by "Banca de Scont si Circulatiune" (Discount and Circulation Bank), "Casa de economie" ("Savings Bank"), "Casa pentru inlesnirea micilor agricultori si meseriasi" (The House for Small Entrepreneurs in Agriculture and Crafts), "Muntele de Pietate ("The Pawnshop"), and "Casa pentru depozite si consignatii" ("The Deposits and Consignments House").

The origins of CEC, date back in the efforts of political and economical elite when ruler Alexandru Ioan Cuza in an effort to put the young Romanian country's finances in order, resulted after the Union from 1859.

CEC is the continuation of the activities performed by the Deposits and Consignments House, the first public credit institution ever to be founded in Romania. Like that we can talk about a glorious history of CEC, a past on which is hard to pass over considering the fact that has lasted over years and years gathered up till now approximately 144 years of experience and sorrow.

To illustrate as better the image of the Deposits and Consignments House, we pass in review the principal years that hanged heavily and which had like basis events with special significances like:

The ad interim Minister of Finance, Nicolae Rosetti – Balanescu prepares a draft law for "the establishment of a deposits and consignments house" – which is approved by The Council of Ministers at 1864, 28 July, in the same year, 24 November – Alexandru Ioan Cuza, passes the law setting forth the establishment of the Deposits and Consignments House (countersigned by Mihail Kogalniceanu, Prime Minister, Ludovic Steege, Finance Minister, and Nicolae Cretulescu, Justice Minister), and at 1/13 December – The law on the establishment of the Deposits and Consignments House is published in Official Gazette of Romania No. 268, its activity started at 01 January 1985 being run by Enric Winterhalder and the institution's control and management body was formed by: Ion Ghica – chairman, Constantin Steriadi, Vasile Paapa, Scarlat Cretulescu, and George Platon – members. The institution is changing within years the content and form by sundries decrees, and at the same time we are talking about changes of name: The Deposits, Consignments and Savings House (1880, 16 January and 28 October, decrees published in Official Gazette No. 12 and 242).

Besides its usual activities, CEC was present in the great historical moments. Like this, at 12 June 1877, the Deposits and Consignments House was issuing different mortgage notes. The sense of this action was to allow to the Romanian state - in the absence of a bank of issue (being known that BNR was set up in 1881) – to get monetary instruments necessary to finance the independence war. They were, au fond, the first paper money issued and put in circulation in our country.

1897, 8 June – The cornerstone of the Palace of the Deposits, Consignments and Savings House is laid, in the presence of King Charles I and Queen Elisabeth, the palace being inaugurated in 1900.

After the First World War, the institution has participated to financing the process of remaking the destroyed economy and supported government's social activities to buy wheat and food-stuff for the population lack of nourishment. It had contributed then with the amount of 139 million lei to "Loan Union", launched in 1919.

CEC supported, from its own funds the restoration of the National Theatre at the end of the twentieth century, the attendance of Romania at the Paris' Universal Exhibition in 1900, the social actions of the welfare establishments started in 1867.

After the First World War, due to commerce development determined by the industrial growth, the premises of an economic revival had been born, numerous banks created, mostly with foreign capital in a state with disorganized public finances. There were numerous adjusting attempts with a growing stately interference, NBR being the main driver of the currency steadiness. The economic and banking crisis between1929-1933 amplified the amass, phenomenon which began to expand from 1931.registering a fall in the population's savings power.

1930 brings the parting of Casei de Economie, which becomes an independent public institution under the name of Casa Generala de Economii, private equity, under the authority of the Ministry of Finance (Official Monitor, part 3, no. 64 of 6 September 1930).

On 21st of October 1932 takes the name of Casa Nationala de Economii si Cecuri Postale, brief CEC. In 1934 the banking law was issued.

During the interwar period and in the early years of the Second World War the state received loans for the army endowment.

Thus the institution fulfilled it's purpose, being one of the few banking institutions which continued (within the limits imposed by the economic and politic system) which continued it's activity even after 1948.

The year 1949 brings another change in the denomination of the institution, therefore it is simply named Casa de Economii şi Consemnațiuni - the only population saving bank. Between 1950 and 1970 a series of changes occurred in the activity level, the institution started activities which opened it more to the public, carrying out operations like: letters of credit, CEC bonds with interest and savings with interest etc

Between 1949 and 1960 a reorganization stage took place, followed up by a development stage between 1961 and 1970 and a consolidation period reached it's peak between in 1971 and 1989.

Romania passed through difficult times. There are historians who discuss about a continuous 150 years long lasting transition. The message of history is optimistic: it can be done. It also contains an advice which doesn't allow us to endless ignore it, it can be done if we do the right things at the right time. Although the Romanian finances have been also submitted to the constrains of a centralized economy system, certain economic market criteria and rules needed to be followed.

Despite the 50 years of communism, the spirit of earnest and responsibility, that characterizes the banker's job, have been transmitted within the craft.

Along the time, CEC benefited of the support of some remarkable personalities from the political and economical life, including ministers of finance(Chancellors of the Exchequer) (Ion Strat, Petre Mavrogheni, Dimitrie A. Sturdza, Ion C. Brătianu, Menelas Ghermani, George C. Cantacuzino-Rafoveanu etc.), Presidents of the Board of Directors or members, general managers of the bank.

The Supervisory Board and the Board of Directors had as members some important characters of the time like prime ministers, managers of parties, senators, deputies, famous lawyers and businessmen that played an important role in the Romanian state and society: Ion Ghica (first President of CEC), Victor Slavescu (president between 1942 and 1947), Alexandru Tomoroveanu (General Manager between 1941 and 1948), but also Costache Balcescu, Colonel Nicolae Bibescu, Dumitru Bratianu, Dimitrie Cariagdi, Nicolae I. Lahovari, Alexandru Orascu, Alexandru B. Stirbei, Achile Zerlendi, Gheorghe Chitu, Ion I. Heliade Radulescu, Ion Poenaru-Bordea, Vasile A. Urechia, Ioan Vilacrosse, etc.

The year of 1990 brought social and economical changes which reacted on CEC too. The bank law no. 33/1991, that became out of date and had been replaced by the bank law no. 58/1998, brought CEC in the posture of seeing itself in the competition on the financial and banking market, both by according short, medium and long term credits for the banking societies, and by performing operations with government bonds. One of the most decisive years was the year of 2005 which brought the restructuring of CEC. The bank received a new statute, consecrating the restructuring of CEC on the model of commercial banks and paving the way to the bank's privatization. (The Government Decision no. 806 for adopting the strategy of privatization of Casa de Economii si Consemnatiuni CEC- S.A. is published on the 1st of June/ 19th of June 2005, in the Official Monitor no. 463 and no. 635, and in the 3rd of August 2005, in the Official Monitor no. 700).

The Commission for Privatization decided to abandon the privatization of the institution, taking into account the low price offered, that didn't represent the real value of the institution.

Annual General Meeting of Casa de Economii si Consemnatiuni CEC- S.A., congregated in session on 11th of May 2007, decided a new consistence of The Board of Directors of the bank, having Mister Radu Gratian Ghetea as President (President of RBA). Casa de Economii si Consemnatiuni CEC - S.A. is a universal bank, with a statute of legal entity, which offers products and services at modern banking standards, both to private individuals and legal entities.

Casa de Economii si Consemnatiuni CEC - S.A. is a bank under an unique shareholdings, that is the state, represented by the Ministry of Economy and Finance from Romania and it is a bank that has not participations on the shares market.

At the end of September 2007, CEC got a gross profit of 82.6 million lei, with 79% more than at the end of last year. During the first 9 months of the year 2007, the bank created new products or increased the existent ones, and some of them are already leaders on the market. They allow for Privilege Account, credit card, inhabitant's credits, credits for middle companies and for Local Administration. Therefore, the credits for clients that don't belong to banks raised more than 65% compared with last year, being at the end of the third semester of 2007 4,8 billion lei, and the drawn funds exceeding 7 billion lei, with 33% more than they were in 2006. CEC cards increased very spectacular into the bank's portfolio being more than 400.000 active cards. Mr. Radu Gratian Ghetea, the president of CEC, said: "The result at 30.09.2007 gave us the possibility, for the next period, to focus, mainly, in accomplishing strategic objectives establishes in the beginning, which are bringing up to date the bank and making it more efficient, till 2009. Very important will be rising up the quality of the services offered to the clients".

The registered capital of CEC increased to 649.7 million lei (191 million euro), after the raise with 500 million lei (151 million euro) done by Public Finance Ministry in 29 December 2007.

Financial results as at end-December 2007

(in millions of RON)	**31.12.2006**	**31.12.2007**
- liabilities to non-bank customers	5.682	8.458
- credits of non-banking customers	3.210	5.246
- total incomes	878	1.274
- gross profit	46	109
- net profit	40	91
- own funds	1.222	
- total assets	7.141	10.507
- share capital	650	650

Note*. Temporary financial data at December 2007*

Considering the vision, the mission and the bank's values, CEC wants to be a modern and efficient bank, which has new products and products of high quality, but in the same time accessible, simple and it wants them to reach and overstep the target segment of medium quality of the other banks. CEC wants to be the leader in financial operations for its target clients – the population of Romania and Small and Medium Size Companies from rural and urban area under 50.000 inhabitants – and also a long term partnership with all its clients.

The values of the bank are the Human Resources and Respect, the concern for the clients through: the bank products and services that are offered to clients should be different from the competitors through: quality, innovation, accessibility and simplicity; in its activity the bank must prove it's professionalism at higher standards, promptness, flexibility, responsibility, respect and confidentiality.

In it's activity the bank must adopt and promote principles and high standards of ethic as: trust, morality, integrity, honesty, honor and correctness, loyalty, confidentiality, upright behavior on the market, safety.

Casa de Economii si Consemnatiuni occupies, as the most recent statistic show, the ninth place in the Romanian banking system. CEC is a universal bank, which offers products and services according with a modern banking system, as well to simple persons as also to companies with big capacity to adopt the European standards. Having a history of 144 years, CEC has strengthen its position and it remained the most credible and trustful banking institution in Romania.

"A country goes and strengthens only when it has the conscience of its duty to the country Government and the laws" V. Slavescu

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PhD Lecturer Camelia Oprean
"Lucian Blaga" University of Sibiu, Romania

MACROECONOMIC INFLUENCES ON FINANCING DECISIONS AT COMPANY LEVEL

Abstract: *The highly important issue by which a company ensures its required capitals, both as volume, and as structure in due time and at low costs renders the financing decision an essential role in the administration and management process. Selecting the capital structure at company level implies both setting the extent of financing from own, respectively loaned resources, and considering the procurement costs of these resources.*
The weak financing of Romanian companies is one of the major causes of the deficient use of the owned production resources, therefore financial resources at accessible costs become essential to the respective economic agents.
Considering that the financing decision may be influenced by the manner the economic mechanisms operate on national level, in this report, we emphasize that financing resources must not be analysed individually, but in relation to the macroeconomic variables, e.g. inflation or the interest rate on the market.
In order to see how the evolution of the interest rates have influenced the trend of loans granted by the loan establishments, this report represents a structural and dynamic analysis of the evolution of the overall loans with an emphasis on the non-governmental loans.
The swift transition to a new economic mechanism at the beginning of the 90s occurred as Romanian enterprises were completely unprepared, whilst the continuance of most companies was conditioned by non-payment of debts and accumulation of arrears. Therefore, the final part of this report deals with the arrears, a sensitive issue in Romanian economics.

Key words*: financing decision, inflation, interest rates, loans, arrears*

JEL classification*: G3*

In the process of substantiating the decisions to demand an external capital stream, including the contribution of the owners, the financial indicator of the capital cost regarded as an essential restriction becomes increasingly important. In the process of financing, companies use both own and loaned capital, equally representing a source of costs for companies. Optimization of capital structure is a profitable activity only if it is designed, organized and conducted properly. Thus, it is important to determine the amounts of these costs due to the following reasons:

- ◇ to optimize the activity, the costs must be as low as possible;
- ◇ to select the optimum company structure, namely the optimum rapport between own and loaned capitals.

The structure and average costs of the capital represent a source of profit for companies, thus this is a profit arising from this specific source and not originating from exploitation, from financial or exceptionally traditional sources. Consequently, the cost of capital must be predicted and the company must design an appropriate strategy and tactical procedures in order to attain this desiderate.

The cost of capital represents the profitability ratios required by capital bearers, either shareholders, or creditors, namely the cost of capital is the financial effort undertaken by the company in order to obtain capital. As a last resort, the capital is the minimum profitability obtained by the investors, which is able to guarantee a profit to shareholders comparable to the one obtained on the market on the same risk level. In any case, the cost of a finance source, either owned, or loaned capital, cannot be accepted unless it is below or equal to the profitability ratios required by the entrepreneur.

The **inflation** has been a permanent reality of the Romanian economy after 1990. The development of a company within an inflationist environment is more difficult because it prevents a political stability to be achieved in due time. During the first part of the aforementioned period (1994 – 1994 or the year 1997), the inflationist phenomenon has grown to huge dimensions (exceeding by far the value of 100%). During the past years, the target has been an inflation rate below 10%.

The **interest rate** of the economy has also been a reference indicator for companies. The indicator is useful in estimating the costs of debts, and also as reference for shareholders who will compare the company's profitability with the interest rate on deposits.

Table 1[1] displays the evolution of the interest rates offered by banks and of the inflation rate during the period 2001 – 2007:

Table 1. Medium interest rates offered by the loan institutions (for operations in RON – non-bank non-governmental customers)

Year	Average active interest (%)	Average passive interest (%)	Inflation rate (%)[2]
2001	45,74	26,16	34,5
2002	36,65	18,39	22,5
2003	26,19	10,78	15,3
2004	25,81	11,34	11,9
2005	19,19	8,22	9,0
2006	13,90	6,51	6,56
2007	13,32	6,70	4,84

It is obvious that both the active and passive average interest rates, as well as the inflation rate have had a descending evolution during this period. It is only in 2004 and last year that the interest rates (active and passive) covered the annual inflation rate, and only the active one during the rest of the years. Due to the negative financial profitability rates obtained from bank deposits, from the perspective of the Romanian investor and on average basis, the deposit of temporarily available funds into banks during this period was not an investment more attractive than the purchase of stock.

In order to see to what extent the interest rate and the inflation influenced the trend of loans granted by banks to non-financial companies and to the population, we shall use the data provided by the Romanian National Bank (BNR) in statistics[3]. In this concern, the non-governmental loan in Romania during 2004 – 2008 (January), short, medium and long term loans in RON have evolved as follows: (Table 2 and Figures 1, 2, 3):

Table 2. The evolution of non-governmental loans in RON (million RON; end of period)

Year	Total	Short term			Medium term			Long term		
		Total	*of which*		Total	*of which*		Total	*of which*	
			Non-financial companies	Population households		Non-financial companies	Furnished to the population		Non-financial companies	Population households
2004	15683.4	7531.9	6264.2	870.1	7368.4	2021.6	5221.9	783.1	388.0	329.8
2005	27091.6	11379.0	9849.3	1361.5	10483.9	2952.1	7273.8	5228.7	1516.4	3312.9
2006	48637.3	17463.2	14920.1	2264.2	14015.3	5430.4	8233.4	17158.8	3500.9	12587.3
2007	67713.0	20804.4	16723.6	3327.0	19109.5	9378.4	9049.6	27799.1	6474.8	21196.2
2008 Jan.	69335.6	21664.4	17575.1	3381.6	19296.5	9677.2	8944.9	28374.7	6625.3	21617.8

The analysis of non-governmental loans in RON over the 2004 – Jan. 2008 period leads the following important conclusions:

◇ the yearly ascending evolution is clearly visible for loans granted in RON, especially after 2004 – following an analysis of the prior situation – and this evolution applies to all three types of the aforementioned loans. This fact may be interpreted as a sign of "recovery" of the Romanian economic environment;

◇ if the non-financial companies have benefited from the overwhelming majority of non-governmental short-term loans, the situation changes when referring to the long-term loans offered by banks to a greater extent to the population;

◇ from the structural perspective of loans obtained by non-financial companies, it is visible that these finance their exploitation activity mostly by means short-term loans, while the obtained long-term loans of these companies represent a lesser part from the total of loans.

[1] Source: Annual BNR reports; monthly BNR bulletins No. 12/2005 (pg. 15); No. 12/2006; No. 1/2008 (pg. 17)
[2] Source: Data provided by the National Institute of Statistics, www.insse.ro
[3] Source: BNR statistics sections, excerpts from monthly bulletins No. 12/2007 (pg. 31); No. 1/2008, www.bnro.ro

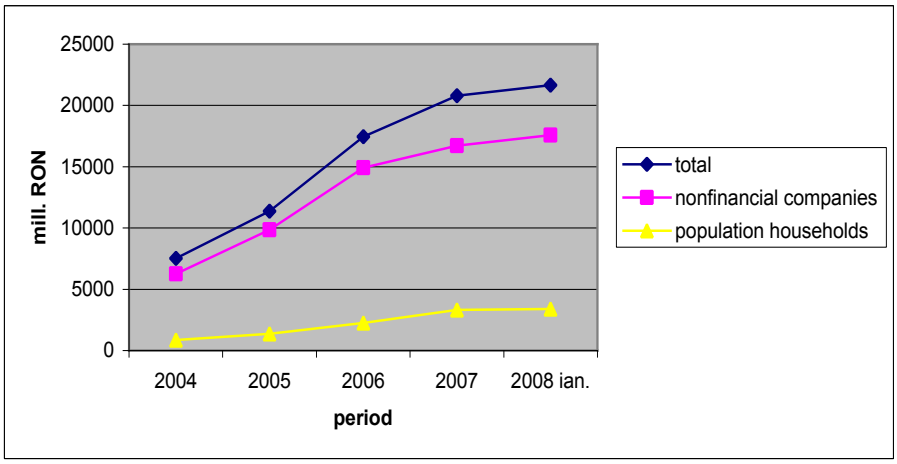

Figure 1. The evolution of non-governmental short-term loans in RON

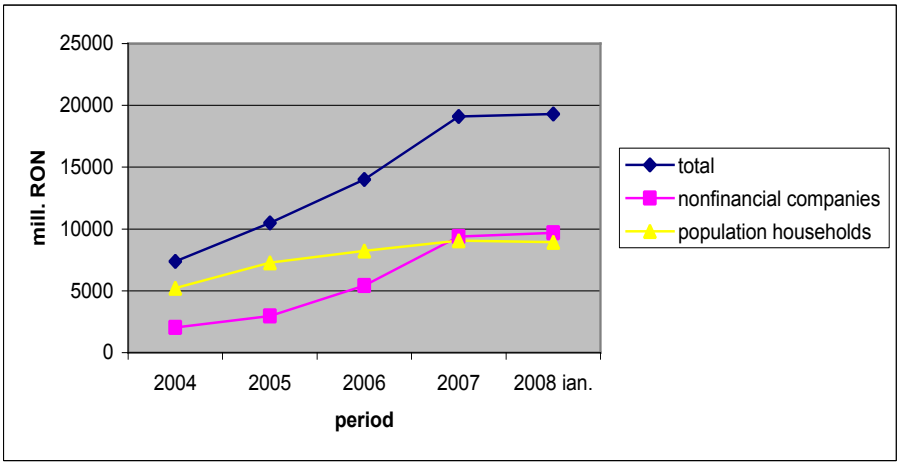

Figure 2. The evolution of non-governmental medium-term loans in RON

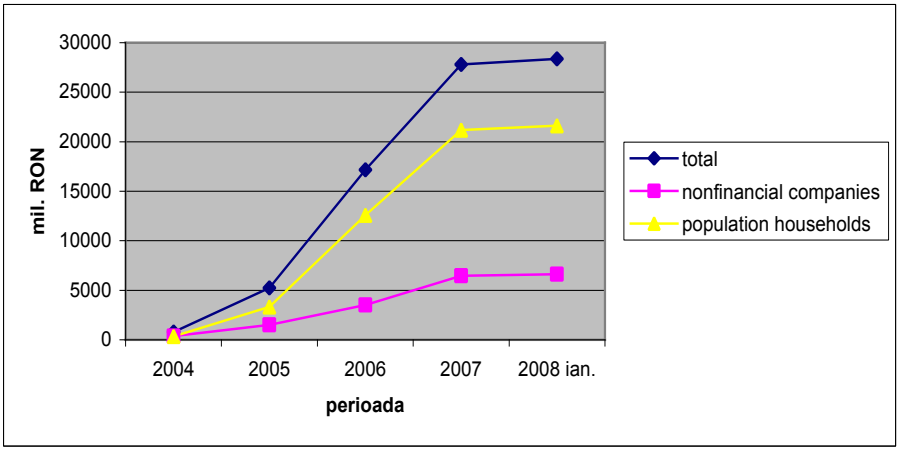

Figure 3. The evolution of non-governmental long-term loans in RON

We may also analyse the situation of loans furnished by loan establishments according to the beneficiaries' form of property, which had the following evolution during 2004 – Jan. 2008 (Table 3 and Figure 4):

Table 3 – Loans furnished by loan institutions according to the beneficiaries' form of property (million RON)[1]

Year	Total	Beneficiary's form of property						
		Private	State owned	Mixed		Cooperative	Natural persons	Public
				Company with foreign capital	Company with private and Romanian state-owned capital			
2004	46918	35246	4629	1192	1003	81	4012	755
	100%	75.12%	9.87%	2.54%	2.14%	0.17%	8.55%	1.61%
2005	65577	46393	5885	1313	1284	95	10298	309
	100%	70.75%	8.97%	2.00%	1.96%	0.14%	15.70%	0.47%
2006	105271	69811	8463	957	1841	151	23561	487
	100%	66.32%	8.04%	0.91%	1.75%	0.14%	22.38%	0.46%
2007	167958	102330	10474	1594	1957	198	50566	839
	100%	60.93%	6.24%	0.95%	1.17%	0.12%	30.11%	0.50%
2008 ian.	171030	103794	10514	1340	1893	198	52454	837
	100%	60.69%	6.15%	0.78%	1.11%	0.12%	30.67%	0.49%

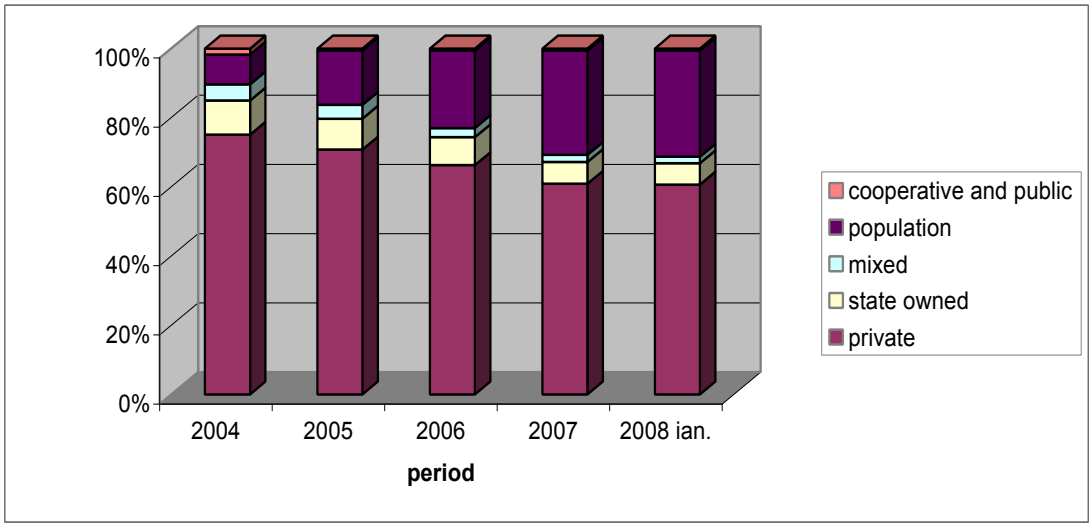

Figure 4 – Loans furnished by loan institutions according to the beneficiaries' form of property

It is obvious that the loans furnished by loan institutions were addressed especially to private beneficiaries. Therefore, the value of loans furnished to private economic agents exceeds by far the value of loans furnished to companies with state-owned capital (as expected).

The volume of loans furnished to private beneficiaries is ascending, from the structural point of view these are in total in a downward tendency in relation with the growth of loans obtained by natural persons. As far as the loan beneficiaries with state-owned capital, the loans in RON have had an almost constant evolution, slightly descending.

The structure of loans offered by loan institutions according to the activity sector of the beneficiary, Table 4 and Figure 5 indicate their evolution during the 2004 – Jan. 2008 period:

[1] Monthly bulletin issued by BNR No. 1/2007 and No. 1/2008

Table 4 – Loans furnished by loan institutions according to the beneficiaries' sector of activity (million RON)[1]

An	Total	Activity sector						
		Industry	Services	Constructions	Agriculture, forestry, pisciculture	Financial mediation and insurances	Public administration and defence, social insurance in the public system education, health and social assistance	Natural persons and personal households
2004	46918	17572	16704	2197	1160	2763	2510	4012
	100%	37.45%	35.60%	4.68%	2.47%	5.89%	5.35%	8.55%
2005	65577	19055	22226	3336	1518	4943	4202	10298
	100%	29.06%	33.89%	5.09%	2.31%	7.54%	6.41%	15.70%
2006	105271	25138	35072	6245	2770	6623	5862	23561
	100%	23.88%	33.32%	5.93%	2.63%	6.29%	5.57%	22.38%
2007	167958	32745	56480	9777	3783	6912	7696	50566
	100%	19.50%	33.63%	5.82%	2.25%	4.12%	4.58%	30.11%
2008 ian.	171030	34870	52634	13288	4095	7712	5977	52454
	100%	20.39%	30.77%	7.77%	2.39%	4.51%	3.49%	30.67%

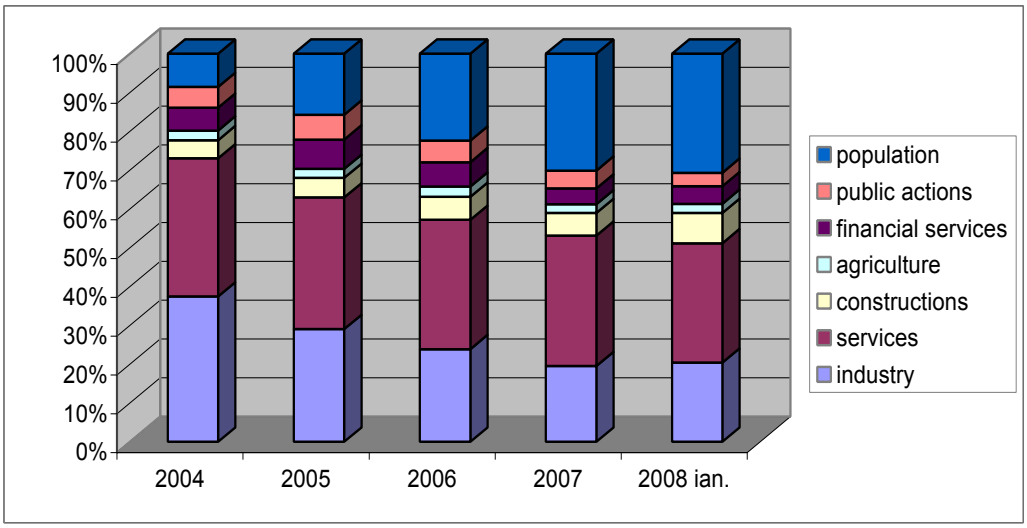

Figure 5. Loans furnished by loan institutions according to the beneficiaries' sector of activity

From the structural point of view and according to the aforementioned criterion, the service and industry sectors have had the largest percentages from the total of loans. As indicated by Figure 5, the situation changes from one year to another with the following tendencies:

- the percentage of loan beneficiaries from the service sector is relatively constant during this period;
- the percentage of the industrial sector indicates a descending tendency towards the analysed period;
- at the same time, the loan beneficiaries represented by natural persons is in a clear ascending tendency from one year to another, thus by 2007 and the first month of 2008, the percentage has grown to be equal to the percentage of loan beneficiaries from the service sector. The evolution is obvious, if we consider that in 2004 the natural persons have benefited from 8.55% from the total of loans, by January 2008 this percentage has grown to 30.67% from the total of granted loans.

[1] Monthly bulletin issued by BNR No. 1/2007 and No. 1/2008

According to the granting criterion, the loans offered by loan institutions during the analysed period have had the following evolution, indicated in Table 5 and Figure 6 :

Table 5 – Loans provided by loan institutions according to the duration (million RON)[1]

Year	Short-term	Medium-term	Long-term
2004	19577	17904	9437
2005	23800	20470	21307
2006	32752	29484	43035
2007	43325	40600	84033
2008 – Jan.	43469	41773	85788

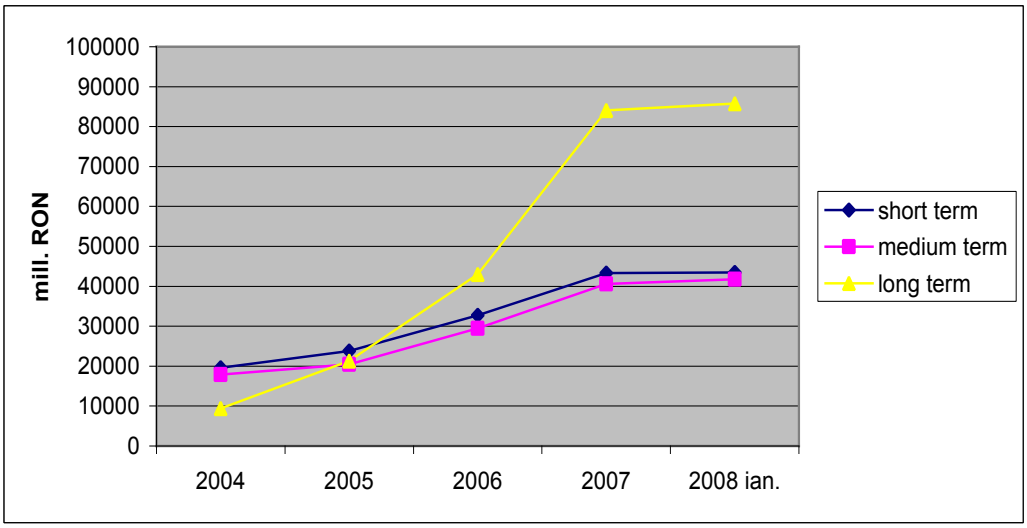

Figure 6. Evolution of loans provided to beneficiaries according to the loan duration

According to the analysed data, at the beginning of the analysed period, the three types of loans have been used in the same amount. We may assert that before 2005 the short-term bank loan has been the most important external financing source. Starting with 2005, the percentage of medium and long term loans are in a visible ascending trend. Therefore, medium and long term bank loans have become a more frequently used financing source for companies, fact that better corresponds to the financing objective of profitable investment projects.

We cannot finalise this report without emphasising the **arrears** issue, a sensitive problem of Romanian economy, though the descending tendency indicated during the last years stands as proof that the Romanian economy is restructuring and enterprises become more and more adapted to the market.

The swift transition to a new economic mechanism at the beginning of the 90s occurred as Romanian enterprises were completely unprepared, whilst the continuance of most companies was conditioned by non-payment of debts and accumulation of arrears. The evolution of arrears has also had subjective causes originating either in the quality of management, or due to the decision-makers' oscillations in applying an appropriate economic policy.

Even if these amounts thus accumulated have had a descending tendency, from 33.4% of the GNP in 2003, to 25.8% in 2004, 18.8% in 2005, 15.5% in 2006, slightly ascending in 2007 to 16.6% of the GNP, these still indicate high values. The frequent use of debt rescheduling and debt write-off have lead to a stock reduction, though with little effect on the improvement of financial discipline. The current efforts to speed-up the restructuring of enterprises that fail to pay, introducing a more strict obligation of payment of fiscal debts, as well as the decision of suppliers cu cut-off the supply to the enterprises that fail to pay have had results in the past period.

The structure of arrears on private sector level, based on the available data provided by balance sheets centralised by the Ministry of Economy and analysed by the National Statistics Commission, indicate that the arrears for suppliers are still maintained at a high level, followed by other back payments (Table 6 and Figure 7):

[1] Monthly bulletin issued by BNR No. 1/2007 and No. 1/2008

Table 6. The structure of arrears on private sector level (%)[1]

	2005	2006	2007
Total back payments *of which:*	100	100	100
Debts towards suppliers	56.8	62	61.4
Back payments owed to the state	11.0	8.7	8.4
Back payments owed to the bank sector (loans, interests)	3.3	1.8	2.4
Other back payments	28.9	27.5	27.8

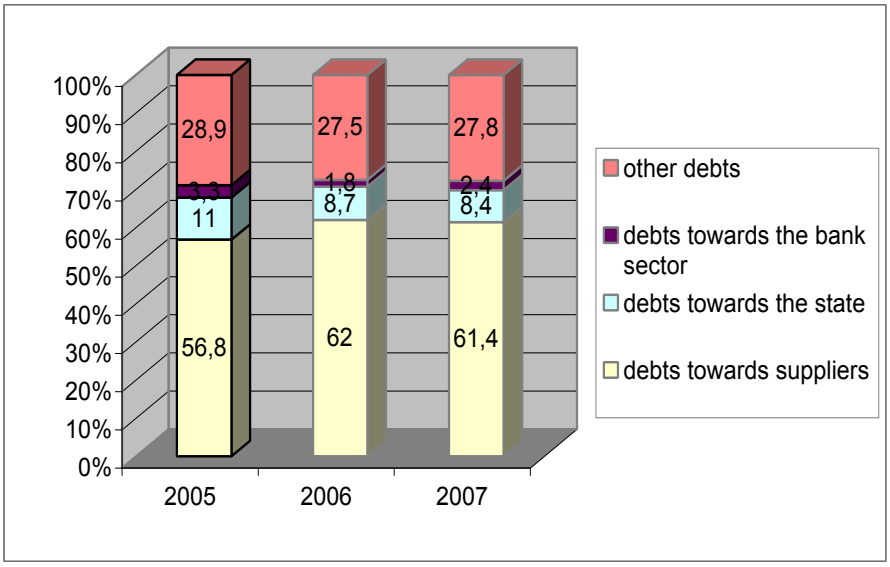

Figure 7. The structure of arrears on private sector level

The percentage of debts owed to the state and banks has had a slight decrease during the analysed period, to the disadvantage of arrears between companies. However, the debts owed to suppliers (commercial loans) represents more than half of the total of arrears. Nevertheless, the ascending tendency of arrears during 2007 is distressing, if we consider that a significant part of the companies function by accumulating debts owed either to the budget, or to suppliers.

If these data are interrelated with the structure of non-governmental loans granted on short, medium and long term, the descending tendency of arrears towards banks is accompanied by the ascending evolution of loans granted to economic agents operating with private capital.

Consequently, the reduction of the inflation rate, supplemented by the decrease of the average interest rate of the banks during the last years have risen the debt levels of Romanian companies. A negative interrelation with the inflation rate may be observed, thus the rise of the inflation rate would cause the decrease of the financing percentage through bank loans with interest (in Romania, during 1991 – 1994 and 1997, when the inflation rate has significantly surpassed the active and passive bank interests). As a negative aspect, arrears represent an important financing source mounting to 35%[2] of the financing sources of Romanian companies, of which more than half are caused by delay of payment of fiscal debts and debts affiliated to salaries. The diminished rhythm of implementation of legislative and administrative measures to reduce arrears will not prevent arrears from representing a risk for the Romanian economy by maintaining a constant pressure on the aggregate request, inflation and checking account.

[1] Source: National Statistics Commission, revisions of the National Statistics Commission of data from the balance sheets centralised by MEF

[2] Dragotă, Mihaela, Article: *Politica de finanțare a companiilor românești listate la BVB în conexiune cu modificarea unor variabile macroeconomice*, Vol. Piața de capital, nr. 1(4)/2006, Ed. Univ. de Vest, Timișoara, 2006, pg. 223

Drd. Ioana Raluca Pătru
"Lucian Blaga" University of Sibiu, Romania

ABSORBTION OF STRUCTURAL FUNDS – THE NEW CHALLENGE AFTER ROMANIA'S FIRST YEAR IN THE EUROPEAN UNION

Abstract. In this paper I have presented the main indicators of Romania after the first year in the European Union and the forecasts for this year. One of the most discussed subjects after Romania entered the family of EU is about the absorbtion and allocation of the European Funds allocated using the Structural Instruments. The forecasts show that the maximum level of absorbtion of EEU's funds is about 3.7893% from GDP. In Romania case the European Funds will be allocated for convergence, for cohesion fund and for teritorial cooperation, the largest amount being allocated for the convergence criterion. The structural funds are the main instruments of the economic and social cohesion policy that the European Union issued for filling up the differences in the economic development between the European regions. The funds are meant to increase economic competitiveness, improve transport and environmental infrastructure, develop and strengthen regional development, improve human resources development and strengthen administrative capacity, in order to speed up the economic convergence in the EU. Another problem that Romania has to face is related to the funds that it has to use for the agriculturalsector. This sector had at its disposal European funds worth 760 million euros last year, of which it managed to absorb just 20 million euros, i.e. only 3%.
One of the main issues in Romania is, beside tring to reach as soon as possible the convergence criteria, to find the easiest way in orther to absorb European structural funds, in order to provide growth in all the economic sectors.

Key words: cohesion;; allocation; contribution; co-finance; European funds for agriculture

JEL Classification: F43, F47, F59

Following the Commission's affirmative response to the Romania's and Bulgaria's accession to the EU in September, without any further delays, on January 1st 2007 was completed the broadest enlargement in the history of the European Union, which now counts 27 Member States.

Romania was the first country of Central and Eastern Europe to have official relations with the European Community. The relations between the two parties were initiated at the end of the 60s, in the form of bilateral trade agreements (they were suspended in the 80s). Romania was included in the Community's Generalised System of Preferences in 1974. After 1989, European Union membership has been the main goal of every Romanian Government. Romania signed its Association Agreement with the European Union in 1993 and submitted its official application for EU membership in June 1995, after Hungary and Poland. February 2000 marked the official start of these negotiations. The accession negotiations were closed on 14 December 2004. The Accession Treaty was subsequently signed in Luxembourg on 25 April 2005. Romania became a full member of the EU starting with 1 January 2007. Romania's accession was confirmed by the EU Monitoring Report released by the EU Commission on 26 September 2006.

AN OUTLOOK OF THE ROMANIAN SHORT TIME INDICATORS AFTER THE FIRST YEAR OF MEMBERSHIP

As an overview of the first year as an EU member, 2007 turned out to be another year of robust growth despite the drought affecting the agricultural sector, with real GDP anticipated to have surged by 5.7 %for the full year. The solid growth momentum of investment activity and continued fast growth in consumption will continue to support a healthy economic performance this year, with GDP growth projected to reach 5.4%. Inflation accelerated to 6.6 % at the end of 2007 mainly on the back of rapidly climbing food prices. The record-low inflation rate in the first seven mounths of 2007 will result in a higher base effect this year, pushing inflation above 8 % in Q1 2008. It is aspected disinflation to regain pace in the second semester, pointing to a year-end inflation rate of 5.8 % supported by a further tightening of monetary policy (by an overall 50 bp). The external gap continued to widen throughout 2007 and is expected to have topped at 14.5 % of GDP. High levels of demand-driven imports and a weak export performance will exert further pressures on the CA deficit, to reach 14.8 % of GDP at the end of 2008. 2008 is an election year in Romania, with both local and parliamentary elections expected to take place. Although there is not much time left, the parties are still discussing possible dates for the elections. A healthy political environment focused on the prosecution of structural reforms, improvements in the absorption of EU funds and proper management of

public spending will be crucial in order to minimize the country's vulnerability amid recently deteriorated investor confidence. Romanian real GDP growth accelerated to 5.7 % yoy in Q3 from 5.6 % yoy in Q2 in line with our expectations, spurred by strong construction activity (37.4 % yoy), which more than offset the damage to the drought-stricken agricultural sector (–23.8 %). Private consumption remains robust, up by 8.2 % yoy, posting only a moderate slowdown compared to the 10.7 % observed in Q2. Buoyant household consumption continued to be fuelled by improving conditions on the labour market supported by strong wage dynamics and easier availability of credit, which expanded by over 80 % yoy for the third year in a row. Growth was also backed by a sharp rise in investment activity, which benefited both from construction-oriented investments (39.3 %) and fast-expanding investments in capital goods (up by 26.6 % yoy). On the negative side, net exports deteriorated strongly, on the back of a 22.4 % yoy increase in imports and continued weak export performance, increasing by a modest 1.7 % yoy in Q3. Overall, the most recent trends provide evidence that 2007 was another year of strong growth, with real GDP expected to have increased by around 5.7 % for the full year taking into account the marginal slowdown anticipated in the last quarter due mainly to falling consumption growth. Despite strong growth, rising vulnerabilities have become increasingly visible in recent months and market sentiment towards Romania has deteriorated significantly. On November 5th, Standard & Poor's downgraded Romania's rating to 'negative' from 'stable', reflecting the difficulties faced by the government as it seeks to rectify foreign trade imbalances linked to worsening financing conditions at the international level. This move was followed very recently by Fitch's, which also revised the outlook to negative, citing the heightened downside risk of an abrupt slowdown in capital inflows. Given the current nervousness among international investors, any further deterioration in the country-specific risk could trigger strong negative reactions. A proper (and prudent) mix of macroeconomic policies is therefore absolutely crucial to restoring investor confidence in the Romanian economy, and to send a clear signal of political cohesion.

Short time indicators – in the first year of membership

	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07
Real GDP, yoy (%)[1]	7.7	-	-	6.0	-	-	5.6	-	-	5.7	-	-	-
Industrial production adj, yoy (%)	8.2	2.8	9.9	9.2	1.4	6.7	5.3	6.3	4.3	6.1	3.6	3.9	-
Inflation (CPI), yoy (%)	4.87	4.01	3.81	3.66	3.77	3.81	3.80	3.99	4.96	6.03	6.84	6.67	6.57
Unemployment rate (%)	5.2	5.3	5.1	4.8	4.5	4.1	4.0	3.8	3.9	3.9	4.1	4.2	4.1
Exchange Rate (EUR), eop.	3.38	3.41	3.40	3.35	3.33	3.27	3.13	3.16	3.27	3.36	3.34	3.50	3.61
1M interbank rate, avg. (%)	8.54	7.46	7.91	8.47	8.29	9.06	7.78	7.25	6.99	7.18	7.65	7.97	8.12
Export (Fob), (EUR) yoy (%)	7.6	15.9	9.4	12.3	16.8	6.6	9.4	18.6	8.3	11.9	23.8	11.0	-
Import (Cif), (EUR) yoy (%)	30.7	43.3	29.7	29.0	30.1	22.7	23.0	28.5	20.0	23.1	28.8	21.2	-
Trade balance, EUR mn	-2,105	-1,401	-1,414	-1,617	-1,643	-1,873	-1,787	-1,801	-1,802	-1,695	-2,210	-2,204	-
Current account, EUR mn[1 2]	-9,973	-1,072	-2,201	-3,429	-4,826	-6,280	-7,648	-8,713	-10,164	-11,533	-13,346	-15,290	-

1) Cumulated up to end of period; 2) Reinvested profit included.

Sources: Central Bank, Central Statistical Office.

The solid growth momentum of investment activity, backed by EU-funded projects, and sustained fast growth in consumption will continue to support a robust economic performance this year. These factors, together with an anticipated recovery of agricultural output, support our forecast for a full-year growth rate of 5.4 % in 2008. Investment growth is expected to continue expanding at a very fast pace, increasing by 19.6 % yoy, although moderating somewhat in comparison with the last two quarters of 2007. Some deceleration in construction activity is anticipated compared to last year, mainly on the back of declining growth in credit and the increasing cost of funding. Construction will anyway remain one of the best performing sectors of the economy backed by continued rising demand for high-quality homes, office buildings and retail outlets. Consumption might also moderate, given the impact of inflation on real incomes, as well as the negative impact on households of credit tightening.

After four consecutive cuts in the policy rate in H1 2007 by an overall 175 bps, rhetoric at the Romanian CB turned more hawkish in the second half of last year on the heels of a significant deterioration in the inflationary outlook and heightened macroeconomic risks. Following the record lows registered before June, pressure on prices rose significantly in H2 fuelled by private sector wage growth, a dynamic expansion in non-government credit and a rapid surge in volatile food prices. In an attempt to guarantee a smoother transition to a normal inflationary level and anchor inflationary expectations, Romania's Central Bank raised

its benchmark rate by 50ps at its October meeting, continuing to pursue a prudent management of financial market liquidity via open-market operations. Despite this change in the monetary stance, headline inflation ended last year at 6.6 %, much above the upper limit of the CB's target band (4 %+/–1 %). Moreover, core 2 inflation (which excludes administrative prices and volatile prices) also accelerated to 5.8 % yoy in December, signalling that demand-side pressures are still present. In light of the risks associated with a significant deterioration in inflationary expectations and rising economic disequilibria, the CB further raised its monetary policy rate by an overall 150 bps to 9.0 % and took new steps to reduce the excessively fast credit expansion by tightening the provisioning for FX denominated credits extended to unhedged borrowers. Given the strong possibility that the CB inflation target in 2008 will be missed again and the need to avoid capital outflows, a further tightening of monetary policy cannot be ruled out. This anticipate a possible further hike by an overall 50 bp in the first half of the year. Due to the stronger and longer-lasting surge in volatile food prices and a worsening in the short/mid term inflation outlook, we expect CPI inflation to remain high in the next months, peaking to above 8 % in Q1. The disinflation process is expected to regain force only in the second half of this year. In any case, risks remain skewed on the upside mainly on the back of rapidly rising wages, higher public spending in the run-up to the elections and strong depreciation pressures on the RON.

After having appreciated throughout 2006 and in the first 7M of 2007, the RON has depreciated by around 15 % against the euro since last August. Romania has actually been one of the countries in CEE that has been hit hardest by the international repricing of risk, amid its long term vulnerabilities and rather incoherent political debate. Negative market sentiment has also been reinforced by massive public spending in the last months of 2007 and by intensified speculative moves. Although, it has largely corrected its over-appreciation (coming back to the level observed at the end of 2005), the exchange rate risk remains and we expect strong volatility and sensitivity to market mood. The leu's drop might contribute to further pressure on prices as it raises the cost of imports and many local goods and services.

In line with the third budget amendment, the fiscal balance ended last year with a deficit of 2.4 % of GDP, according to preliminary data released by the Minister of Finance (2.6–2.7 % using ESA95 methodology). Nevertheless, the last two months of 2007 were characterized by heavy spending. The November deficit reached 1.1 % of GDP, while in December the local administrations managed to spend around 21 % of the total budget planned for the whole year. As a result, expenses reached 37.6 % of GDP calculated according to ESA95 methodology, while revenues ended up at 35 % of GDP, below expectations. Even more concerns are related to budget spending in 2008, which will be inflated by election costs and social spending aimed at achieving a greater degree of political consensus. The 2008 budget provides for a significant increase in spending in the areas of social security (11.9 % of GDP), education (6 % of GDP), health care (4.5 % of GDP), infrastructure (4 % of GDP) and agriculture (3 % of GDP). Encouraged by the budget surplus up tothe end of October last year, politicians already started to increase social spending in 2007. Pensions were raised in two steps: by 35.5 % in August–December and by an additional 7.5 % in January. The minimum wage has also been increased to 500 RON for 2008, while some public sector workers have received bigger salaries and bonuses. Overall, it appears that the 2.7 % fiscal deficit planned for 2008 (around 3.2 % based on ESA95) is based on a very optimistic budget plan that estimates revenues at the level of 39.3 % of GDP and economic growth of 6 %. There are serious concerns regarding the sustainability of current social spending levels. The European Commission has recently invited the government to make major corrections to the Convergence Plan drafted in December and to complement the tighter fiscal stance with appropriate public wage policy and further structural reforms to avoid risks of slippages.

Consenus Economics are forecasting economic growth in Romania of 6.3% for 2007, and a slightly slower 5.7% for 2008. The number for 2007 seems about right, although the final reading may even be slightly higher given the governent fiscal stimulus during the second half of the year, while the number for 2008 may be rather on the high side, depending on the pace and extent of the slowdown. Really everything here hinges on whether Romania has a soft or hard landing, and when. As long as things continue as is, then the consensus forecast looks about right, but will things continue as is? The IMF in their October World Economic Outlook came in with a similar figure of 6.3% for 2007 and 6% for 2008, the Economist Intelligence Unit is forecasting growth in the 5 to 5.5% range for 2008, while the EU Commission put the figure at 5.9% in its November forecast.More interestingly the Commission sugest that this rate is achieveable without producing any significant reduction in the unemployment rate (currently officially around 7% on ILO methodology), which suggests they feel it can mainly be achieved by increasing participation rates, and redeploying labour from non productive to more productive sectors. But - as in

Poland, where a large number of citizens are also known to be working abroad - it is very hard to know what credence to give the official unemployment data.

ABSORBTION OF STRUCTURAL FUNDS – THE NEW CHALLENGE FOR ROMANIA

The **structural funds** are the main instruments of the economic and social cohesion policy that the European Union issued for filling up the differences in the economic development between the European regions. The new cohesion policy, enforced starting with 2007, contains various changes with respect to the 2000-2006 period. The cohesion policy is characterised by a decentralised management: in fact, irrespectively whether the structural funds are European funds, their distribution is established depending on the various regions.

There are three new financial instruments:

- ✓ The **European Social Fund (ESF)** is implemented in compliance with the European employment strategy and it focuses on four goals: to increase the adaptability of workers and companies, to improve the access to employment and to the participation on the labour market, to reinforce social inclusion by fighting discrimination and facilitating the disabled persons' access to the labour market, as well as to promote partnerships for the reform in the field of employment and inclusion.
- ✓ The **European Regional Development Fund (ERDF)** promotes public and private investments with a view to reducing regional disparity inside the Union; supports programmes of regional development, economic change, strengthening competitiveness and territorial cooperation throughout the European Union territory. The financing priorities include the following fields: research, environment protection, prevention of risks and investments in the infrastructure, especially in the regions of delayed development.
- ✓ The **Cohesion Fund** intervenes in the sectors of environment and transeuropean transport networks; it is activated for the Member States that have a GDP below 90% of the community average. However, the Regional Development Fund does not include Feoga, the instrument dedicated to the rural and agricultural activity. According to the financial perspectives, agriculture has a distinctive place, apart from the cohesion. Urban and Leader community initiatives have ended and have been absorbed in the normal course of the Funds' activity.
- ✓ **European Agricultural Fund for Rural Development (EAFRD)** and the European Fund for Fisheries (EFF) to support the Common Agricultural Policy and the Common Fisheries Policy.

Three objectives are set, at European level, for the 2007-2013 programming period:

1. Convergence;
2. Regional competitiveness and employment;
3. Territorial cooperation.

The entire Romanian territory is eligible for the Convergence objective and benefits from financing from the European Social Fund (ESF), from the European Regional Development Fund (ERDF) and from the Cohesion Fund (CF) and for the Territorial cooperation objective, for which it received financing from the ERDF.

Considering the financial perspectives 2007- 2013 which were approved in December 2005, the Member States which have a medium gross domestic income/ inhabitant in 2001- 2003(PPS) under 40% from the average of EU – 25 are justified to receive Structural Instrument transfers with a maximum value about 3.7893% from their GDP. Taking into consideration the European Council decision and the financial package for 2007- 2009 which accompanies the Romanian Adhesion at EU Treaty, the European Committee communicated to Romanian authorities, in August 2006, the allocation of Structural funds and of cohesion for Romania, for each objective and for each year, for the period 2007- 2013, such in the next table:

Structural and Cohesion Funds allocated to Romania for objectives and years, 2007 - 2013

- Euro. Current prices –

	2007	2008	2009	2010	2011	2012	2013	Total
Convergence	830.134.320	1.215.884.555	1.654.845.782	1.997.008.836	2.154.259.932	2.319.190.285	2.489.289.974	12.660.613.684
Cohesoin Fund	444.944.443	638.417.107	858.507.216	1.030.210.429	1.109.470.097	1.192.582.076	1.278.291.660	6.552.423.028
Territorial cooperation	59.945.093	61.338.333	62.961.549	64.827.348	66.742.596	68.498.164	70.297.257	454.610.340
TOTAL	1.335.023.856	1.915.638.995	2.576.314.547	3.092.046.613	3.330.472.625	3.580.270.525	3.837.878.891	19.667.647.052

The total sum of structural and cohesion funds which were allocated to Romania is about 19.668 billion Euro, from which 12.661 bilion Euro will be allocated through the Structural Funds as part of onvergence objective; 6.552 bilion Euro were allocated through Cohesion Fund, and 0.455 bilion Euro will be allocated for the European territorial cooperation objectiv. The separation of the cohesion finances on thematically priorities in subsidiary on Operational Programs and Funds was established based on several items:

- ✓ The development stage of Romanian economy;
- ✓ The general and regional disparities in comparison with the EU levels;
- ✓ The integration of Lisbon Strategy, revised in the Romania development model;
- ✓ The huge value of the investments necessary for the basical substructure;
- ✓ The necessity to increase the economy competitiveness;
- ✓ The correlation for the competitiveness growth with the development of some human resourcessufficient and well qualified;
- ✓ Adherent costs according with communitarian acquis after the adhesion (the environment pledges, especially, involves a high costs level, distributed on transition periods established within the adhesion negotiations).
- ✓ Models of structural instruments allocation in EU, especially in the new Member States, whose development level is closer to the Romanian situation;
- ✓ The 1/3 allocation of Cohesion Fund from the financial tyre.

Thus, the following allocation of EU funds on thematically priorities of National Strategic Environment of Reference has been made:

- ➢ The basical substructure development at EU standards: ~60%;
- ➢ The improvement of competitiveness, on the long term, of Romanian economy: ~15%;
- ➢ The development and the utilization more efficient of Human Capital from Romania: ~ 20%;
- ➢ The consolidation of an efficient administrative capacity: ~ 5%.

<u>The procentual distribution of Romanian National Strategic Environment of Reference allocations on</u>

Considering the lowest financial capacity of many local authorities to assure this co-financing, the Romanian Government decided to reduce as far as possible the local budget contribution. Thus, the principle which will be applied in the operational programs tell us that the personal co-financing which the local authority need to assure for a project will be in general 2% from the eligible value, a major exception being the projects which generates incomes. Consequently, the approved contribution of the local authorities is under 5% from the total of national co finance. Although we must mention that the introduction of the tax unique quota of 16% from January 2005 generates supplementary incomes for the local authorities, which should improve their capacity for financing development projects. On the other hand, a major rule was approved in 2006 to facilitate the access to the financing of that local authorities which haven't enough personal resources for projects co-financing.

The private co-financing will be necessary for the projects applied to the private beneficiaries, such as the enterprises. For the operations implying state grants, the maxim intensity of the public support (EU funds + the contribution of the state/local budgets) will be respected. The intense promoting of the financing opportunities appeared as the result of the structural programs contributes already at the preparation of a

substantial portfolio with private projects and will give time to the private beneficiaries to plan the financial resources, so that they can assure the necessary co- financing.

During the 2007- 2009, Romania will get like prefinancing 7% from EFARD and ESF allocations for 2007- 2013 and 10.5% from the allocation of the Cohesion Fund, according to the Council Rules nr.1083/2006. The others experience from the new Member States showed that, often, the projects promoters couldn't find the necessary financial resources to assure the projects cash flows.

The funds are meant to increase economic competitiveness, improve transport and environmental infrastructure, develop and strengthen regional development, improve human resources development and strengthen administrative capacity, in order to speed up the economic convergence in the EU.

The use of structural instruments (ERDF, ESF and CF) is based on programmes. Potential beneficiaries can propose projects and apply for funding through Operational Programmes (OPs). Each OP gives orientation about the type of projects it will finance. Hence, potential beneficiaries need to identify the OPs which would best fit their projects.

Once a project is selected, its implementation becomes the responsibility of the beneficiary. This organisation has to provide the co-financing for the project, to meet the project objectives, to deliver the outputs, to report and document the expenses and deliverables and to observe the programme's rules and constraints (which will be detailed in the relevant Applicant Guide). The beneficiaries of the CF are public authorities, NGOs, businesses (companies, professional associations, chambers of commerce), research institutes, universities for ERDF and ESF, and the Romanian National Company of Motorways and National Roads, the National Railway Company, etc.

Parallel, but not part of the Structural Funds are the European Agricultural Fund for Rural Development and the European Fund for Fisheries. The document that will clearly indicate the way these funds will finance investments in Romania is the National Programme for Rural Development (NPRD) for 2007-2013 and the Operational Programme for Fisheries.

Romanian situation regarding absorbtion of European agriculture funds

The agriculture sector had at its disposal European funds worth 760 million euros last year, of which it managed to absorb just 20 million euros, i.e. only 3%. The post-accession funds for 2007 were dedicated to the launch, the submission and the approval of projects, so that a first appraisal of the absorption will possible only at the end of 2008, or even in 2009.

The degree of absorption of European funds after the first year since Romania's accession to the European Union is half that of countries such as the Czech Republic, Poland, Hungary and Slovakia, according to a study published by the National Bank of Romania in March 2008. Therefore, the absorption rate for Romania stood at 21.7%, compared with 42.9% for Hungary and 42.8% for Poland. Structural and cohesion funds were 32.7% absorbed, while only 3% of those destined for the agriculture sector and for rural development were used. The allocation procedure for the funds on a reimbursement basis is one of the factors behind the low absorption rate this year.

For 2008, Romania has at its disposal European funds worth a total 2.9 billion euros, out of a total of 17.6 billion, which it should absorb in the 2007-2011 period.

Last year, the value of the funds amounted to 2 billion euros, 1.28 billion euros of which were structural and cohesion funds, and 760 million euros funds for agriculture and rural development. The best absorption rate, of 100%, was for the European Fisheries Fund, while for structural funds, the absorption rate is of around 30%.

Out of the 2.9 billion euro non-repayable funds, the biggest amounts allocated for 2008 will go to the European Regional Development Fund (ERDF), which is used to narrow the gaps between various regions in the EU and the European Agricultural Fund for Rural Development (EAFRD), that is 0.86 billion euros, 0.16 billion euros more than last year and 1.02 billion euros.

One of the main issues in Romania is, beside tring to reach as soon as possible the convergence criteria, to find the easiest way in orther to absorb European structural funds, in order to provide growth in all the economic sectors. Beyond the immediate effects of aggregate demand (income rises in the beneficiary regions), those on aggregate supply become decisive on a long time. Thus, the modernization of the infrastructure, the rise of education levels as well as subsidies of research and development activities permit the increase of potential growth in of the economy (as in potential GDP). In these conditions, shock absorption on the demand or the structural sides will be faster in the countries/regions which benefit from structural and cohesion funds.

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Graduand: Ec. Anca Daniela Popescu
Bancpost SA, Bucuresti, Romania

CONSIDERATIONS REGARDING THE STRUCTURE AND EXECUTION OF BUDGET REVENUES THROUGH ILFOV COUNTY TREASURY

Abstract:*The main role of treasury is that to offer an organized frame for proceedings of public funds. Record of all transactions is done through accounts in revenues, expenses, available and outside balance items.*

Treasury book keeping is organized at each level of this one. Both operative treasuries (municipal, town and commune) and the county ones and the central treasury organize their own accounting in compliance with the legal regulations in force. The account plan is unique for all treasuries, but there are accounts running only to one level of treasury (for example, the revenue accounts of the state budget runs at operative treasury only).

This work deals with the review of revenue collection and ordering system on budget types and with accounting of budget revenues. For this purpose we introduced and defined the methods of collection of revenues from companies, public institutions and natural persons, both in cash and transfer.

Collection of fiscal debts consists in exercising of actions whose aim to annul the fiscal debts. Collection of fiscal debts is done on the ground of a debt title or of an executory title, as appropriate. Fiscal debts are due on the expiration date stipulated by the Fiscal Code or other laws ruling them. As per the differences of main tax liabilities and for accessory tax liabilities, set by laws, the payment term is set depending on the date of their communication

Annulment of tax liabilities may by achieved by payment, compensation or repayment

Key words: *budgetary revenues, budgetary classification, collection of budgetary revenues in cash, collection of budgetary revenues in account, repayment of budgetary revenues, compensation of budgetary revenues.*

JEL Classification*: H21*

Budgetary revenues are the money resources due to the budgets composing the consolidated master budget on the base of some legal provisions.

The revenues of the state budget are made up of:

- Duties, taxes and contributions collected from companies and contributors;
- Payment of public institutions;
- Other revenues yearly approved by Parliament through the budget law.

Revenues are forecast in budget by chapters and sub-chapters in compliance with the budgetary classification sub-divisions approved by order of the Ministry of Economy and Finances.

The liability to calculate and pay on due date the duties, taxes, contribution to social security and other payments due to the state, belongs to companies, irrespective of owning form and public institutions. The natural persons pay the duties and taxes due on the base of notification of fiscal bodies regarding the debts set for that fiscal year.

The budgetary revenues are collected in the treasury account as follow:

- in cash, directly at the Treasury pay desk, and through taxers as well;
- By transfer at the initiative of companies, public institutions from their accounts open with commercial banks and treasuries as well, in the Treasury account in the area where the company has its fiscal domicile.

The revenues collected through Treasury are followed up and highlighted distinctly, on budgets, namely:

- revenues of state budget ;
- revenues of the state social security budget;
- revenues of local budgets;
- revenues of the autonomous public institutions;
- revenues of public institutions, totally or partially funded by the state budget, budget of state social security and budget of special funds, as appropriate;
- revenues of public institutions integrally funded of their own revenues;
- revenues of budget funds coming from external credits contracted or guaranteed by state and whose payments, interests and other costs are provided from public funds;

- revenues of external irredeemable fund budget.

Collection of revenues due to public institutions is done through treasuries and these revenues are separately highlighted in their available accounts open with treasuries. Collection flows for special funds are carried out also by treasuries and they are recorded into their accounts.

The record of revenue performance on revenue sources – chapter and sub-chapters from budgetary classification and on payers also is provided within every budget.

Delimitation and order of budgetary revenues collected on budgets and sub-divisions is provided by means of the accounts open with the territorial treasuries. Hereby, the codification information system enables knowledge of collections depending on the requirements of revenues achievement.

The transactions achieved through the Ilfov Treasury are the following:

1. Cash transactions
2. Transfer transaction
3. Repayment and compensation transactions.

1. Cash transactions – are done through the treasury cash desk, and the compartments involved into collection through the treasury cash desk are: Department of Expenditure Audit and Settlement of Public Institution; Compartment for Revenue Collection and Record; Compartment of Pay Desk Treasure, Informatics Compartment

The work procedure includes three steps:

- step of deposit and audit of documents which at the basis of cash collection through TREZOR and TAXEDIV programs;
- step of cash collection;
- step of closing the collection cash;

With the state treasury are done cash collections for the following categories of contributors:

Public institutions may order the following cash collection transactions:

- deposit in the appropriate accounts of budgetary revenues or availabilities, as appropriate, the amount representing such revenues collected through their own cash-desks
- deposit on the appropriate accounts of budgetary expenditures or availabilities, as appropriate, of the sums withdrawn from these accounts and unused;
- deposit of sums exceeding the cash ceiling level set by the treasury for every public institutions

The procedure for achievement of these transactions is the following: for deposit in the appropriate accounts of budgetary revenues or availabilities, as appropriate, the amount representing such revenues collected through their own cash-desks, the representative of the public institution submit to the account inspector/reviewer working in the Compartment of Revenue Collection and Record, the deposit slip (model annex 1) filled in a single copy. The account inspector /reviewer working within the involved compartments, checks the deposit slip, monitoring:

- existence of the contributor - public institution in the data base for which the collection is ordered
- legal base ruling the collection achievement
- conformity between the payment object and the account where the deposit is achieved;
- representative's signature.

After verification of all aspects mentioned above, the account inspector/reviewer within the involved compartments, acts as follows:

- enters in the TREZOR program, the collection of the sum through the account item:
  10 "Cash" = budgetary revenue account or
  availability account, as appropriate
- fills all fields requested by the informatics program, number and series of the Receipt / note form for collection of duties, taxes and contributions to be printed, included;
- check on the computer screen the correct taking over of all elements requested by the form above mentioned.

The Companies may order cash collection transactions for payment of: budget duties, formation of guarantees for expediting the payment of the budgetary duties.

In order to pay the budgetary duties, the companies attend the desk open for cash collection within the Compartment of Revenue Collection and Record. They may express their intention to pay, verbally and by deposing the deposit slip form.

The natural persons may order the cash payment of budgetary duties.

For this transaction, the natural persona attend the treasury desks open for cash budgetary collection within the within the Compartment of Revenue Collection and Record. They may express their intention to

pay, verbally or submitting the documents released by the competent public institution or fiscal body of which results the payment duties.

The account inspector/reviewer within the Compartment of Revenue Collection and Record checks in the treasury data base the existence of the personal numerical code of the natural person for which the payment of duties with fiscal record is done, respecting the territorial principle stipulated by the norms in the case of budgetary duty payment. When the personal numerical code of the natural person in the treasury data base for which the payment of duties with fiscal record is done, cannot be found it is created in the customer list.

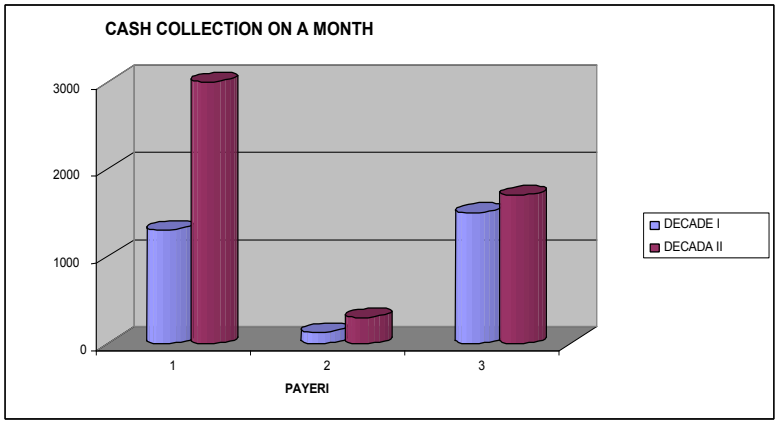
At cash collection the weight of collection on one month results from Table no.1 and the Chart no.1 below:

Table no. 1

Week	Companies	Public institutions	Natural persons
Decade I	1300	125	1500
Decade II	3000	300	1700
TOTAL	4300	425	3200

Data source: Ilfov DGFP

Chart no. 1



2. Transfer collection transactions

The documents for the payment of revenue by transfer (money order, order, cheque with limited sum) – these are documents drawn up by the duties and taxes payers with account open with the commercial banks.

The collection by transfer of public institutions and companies budgetary revenues and availabilities is done by electronic settlement system.

Processing of orders to be settled in electronic payment system is carried out as follows: entering of the orders into the electronic system; validation of orders; formation of payment files and their forwarding to the Ministry of Economy and Finances – General Directorate of Public Accounting and System of Settlement in Public Sector.

Starting with 10 February 2006 it was passed to the automate reading of orders with bar code, this bar code being read by means of a code mark reader. In the next period, the reading of bar code deposit slips shall be done also using the code mark reader.

Orders are classified in two groups:

- orders to be settled in the electronic payment system;
- home orders, in the case when the beneficiary account is open with the same treasury.

In the case of home orders, the account inspector / reviewer working within the involved departments who received the orders, after their checking, acts as follows:

- signs, dates and stamps every order in the box “receipt/acceptance”;
- groups the home payment documents, in packages, on beneficiary services;
- enters exactly into the informatics system the data written on order;
- edits a control tape through totalizing the sums related to the orders in package;
- checks on the computer monitor the compliance between the sum taken over by the program and the sum written on the control tape.

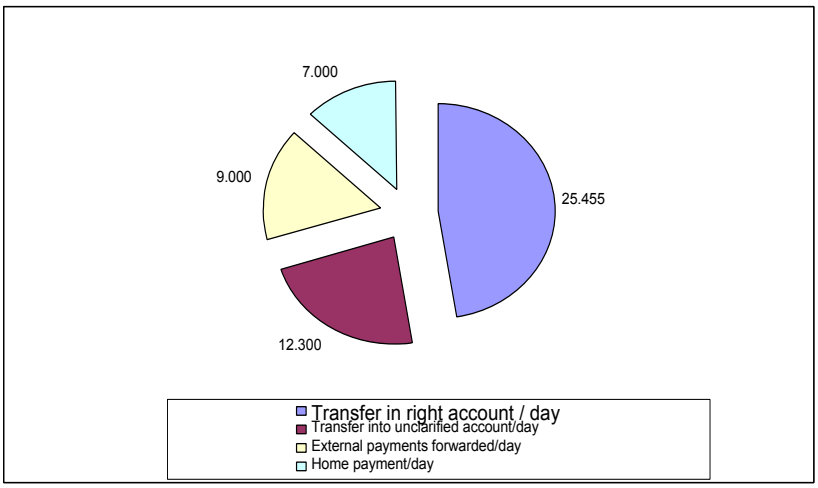
At the collection by transfer, the weight of collection through electronic payment system (SEP), correct drawing up of orders and their automat entering in the respective accounts is of 25.455 entries per day; order that are not correctly drawn up enter into a unclarified account (6199…) and they are in a number of 12,300 payments per day, as it results from Table no.2 and Chart no.2.

Table no. 2

Transfer in right account / day	25.455
Transfer into unclarified account / day	12.300
External payment forwarded/ day	9.000
Home payment / day	7.000

Data source: Ilfov DGFP

Chart no. 2



The unidentified collections are recorded in the unidentified collection journal, daily listed by the server of the informatics system and forward to Revenue Department, Expenditure Compartment for correct restoration of sums or their giving back (as the case may be). They are grouped as follows:

- large sums (619902) – sums over 50,000 RON
- small sums (619901) – sums up to 50,000 RON
- sums coming from treasuries (619903.)
- sums settled between local treasuries (619904 ex. Buftea)

By the end of the day, the account sold above must be 0. The inspectors within the Revenues and Expenditures Compartments – enter again marked with NC, into the appropriate budgetary accounts, the sums from this unidentified collection journal (sums appeared as unidentified) for the following reasons:

- non-concordance CF – account code (created for every compartment in PJ list)
- non-concordance between explanations – CF –IBAN CODE
- wrong CF etc.

The sums which cannot be identified (not identified CF, IBAN CODE, account blocked) are given back.

3. Repayment and Compensation Transactions – Repayment / Reimbursement of Sums from Budgetary Revenue Accounts

The debtors may ask repayments of sums; paid without an existent debt title; paid additionally to the fiscal duty; paid as a result of calculation fault; paid as a result of wrong application of legal provisions; rules by decisions of judicial bodies or other competent bodies according to the law; resulted from sale of sequestered assets or by holding back by assignment, as appropriate, on the base of the judicial decision through which the forced execution is abolished.

Through compensation, the debts managed by the Ministry of Economy and Finance are extinguished with the debtor claims representing sums to be reimbursed or repaid from budget, up to the lowest sums, when both parties acquire each other both the quality of creditor and debtor, unless the law provides otherwise. The fiscal debts managed by the administrative – territorial units are extinguished through compensation with the debtor claims representing sums to be repaid from the local budgets, up to the

lowest sum when both parties acquire each other both the quality of creditor and debtor, unless the law provides otherwise.

Involved compartment:
- Compartment for Revenue Collection and Record;
- Compartment Management and Accounting of Treasury Current Account;
- Compartment Cash - treasury

Repayment/ reimbursement of sums from budget revenue accounts are done within the Compartment Revenue Collection and Record for:

A. Legal persons;
B. Natural persons.

A. Repayment/ reimbursement of sums from budget revenue accounts for legal persons:

Repayment to contributors of the sums additionally paid to budget and the VTA and excise reimbursements are ordered to treasury by the competent fiscal body where they are entered as duty, tax and contribution payers. The document through the fiscal body orders the repayment / reimbursement transaction is the "Note regarding the repayment / reimbursement of some sums", forwarded to treasury with the justifying note signed by management.

The note of the fiscal body along with the Note of repayment / reimbursement: are recorded with the secretary office in the book of numbers and it is allotted by management to the Compartment of Revenue Collection and Record.

On the basis of the report approved, the inspector:
- makes up , in compliance with the order of the Ministry of Finance no. 246/2005, the order through which the repayment / reimbursement are initiated filling the its boxes with the data from the approved report;
- signs and stamps the order in the box "Receipt/Acceptance"
- submits the order (along with the approved report) to the persons appointed to apply the second and the first signature;
- dates the order and gives it a running number in the book with numbers for order record open with the Compartment Revenue Collection and Record;
- processes in informatics system the order data (in the package given by the head of compartment for initiated small/large interbanking transactions, as appropriate);
- prints in two copies the list accompanying the payment document;
- renders to Compartment Administration and Accounting of Treasury Current Account together with accounting note a copy of the list and the order processed in the informatics system with the view of validation in compliance with the procedure of this transaction.

After electronic settlement of the payment document, this one, on paper support, is returned together with the accompanying note to Compartment Administration and Accounting of Treasury Current Account and Compartment Revenue Collection and Record for archiving.

Making up of the report regarding compensation – the inspector within Compartment Revenue Collection and Record makes up the report regarding the compensation ordered by the fiscal body that has to include the following elements:
- identification data of the note and compensation note through which the fiscal body ordered the compensation transaction;
- contributor's identification data;
- acknowledge of sum collection of which the compensation is ordered (sum, account code, payment document, date in journal) or as appropriate , the acknowledgement released by the treasury that collected the amount is mentioned;
- proposal regarding the debts compensations with the contributor's obligations;
- the accounting item related to accounting note that shall be made up after the approval of the report, through which is debited the budget revenue account of which the fiscal duties are compensated and the revenue account is credited representing fiscal duties extinguished by compensation. When the fiscal duties are extinguished in other treasuries, the account item that will be at the basis of order making up, respectively the budget revenue account is debited of which the fiscal duties are compensated and the appropriate treasury account is credited;
- ; fiscal code and the beneficiary IBAN code in the case of extinguishing the recorded duties with another treasury;
- record number of payment taken over from the compensation note.

B. Repayment/ reimbursement of sums from budget revenue accounts for natural persons – repayments to natural persons in cash are done at the payment desk of the treasury on the basis of the identity document in original (CI, BI, Passport). The Compartment Revenues makes up the repayment order in cash in three copies. The repayment order in cash is made up on the basis of the following documents:

- the list of repayments IVG made up by the inspectors of the two Administration (Voluntari and Bragadiru) - Compartment Natural Persons
- reports of repayment of CEC or Treasury receipts unused with the approval of the competent body (stamp, signature and mention "Not used") (Ex: passport taxes, criminal record taxes etc).

In the case of cash repayment it is released a repayment order OP, for natural persons with the fiscal domicile within the territorial area of the county or district on the basis of reports made up by the Compartment Natural persons within the Revenue Office. Then the treasury releases cash through its own cash desk on authorized signature basis.

Unique account

In compliance with the Ordinance 1314/2007 and 1294/2007 starting with September 2007 the payment of contributions into a unique account may be done only by the contributors that do not have debts to the consolidated budget.

Payment is done in two different accounts:

- 20.47.01.01 – for the state budget , account of which the competent fiscal body (Compatment Payer Record) discharge electronically in percents the duties due to the state budget with retention at source (Ex. revenues from wages) then the other taxes (Ex. Tax on profit and other.) depending on statement of each contributor (statement 100)
- The fiscal debts that are transferred in this account are : tax on wages, tax on profit, tax on incomes from dividends, interests, tax on revenue of micro- enterprises, tax non-residents natural or legal persons etc.
- NOTE: the VTA is paid in the old account 2010010101.
- 55.02 –available at the social security budget, health social assurance, unemployment fund , account where are paid contributions to social security, health social assurance, employee-employer unemployment fund

The fiscal debts that are transferred in this account are: CAS employee and employer, fund for work accidents and professional diseases, CASS employee and employer, holidays and indemnities, medical leaves (diseases or child care), employee-employer unemployment fund, fund for guaranteeing wage debts.

In **conclusion**, the unique account needs a better clarification because by the end of months troubles related to electronic transfer of sums form the unique account into the budget contributions occur, with the risk that undistributed sums appear in sold. The sold of the unique account by the end of month should be 0 for every institution. On the other hand, another issue would be the scanning of transfer notes at the cash-desk because is a supplementary effort and this method is not always effective but the work volume reduced due to scanning. In exchange, the program have been revised and the yield is greater, work volume has been reduced and the payment through Internet Banking is an extremely simply method, that does not need person immobilization.

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Lecturer Iuliana Predescu
Lecturer Mihai Nedelescu
Lecturer Cristina Stanescu
Romanian-American University, Bucharest, Romania

THE ADVANTAGES CONFERRED BY SHARE BUYBACKS AS A WAY OF RETURNING CASH TO SHAREHOLDERS VS. PAYMENT OF DIVIDENDS

Abstract: *Due to the fact that the firm have more means to return cash towards shareholders (share buybacks, payment of dividends, debt refunding, implementing invest programs), I considered adequate to present in this paper the first two alternatives forementioned, especially the advantages confered by share buybacks vs. dividends payment.*

Key words: *Share buybacks, dividends, shareholder*

JEL Classification*: G 35*

An essential point of interest, for any company, is the destination of the available cash-flow, managements' ability being proven by the capacity of capital allocation into projects or activities that supply the shareholders with maximum profitability.

There are multiple ways of allocating what available cash there is, the most important of these being: dividend payments, share buybacks, debt refunding, implementing investment programs or other types of expenses.

From all the choices listed above, many companies prefer the share buybacks, from the same reason one decides becoming a shareholder, this being the opportunity of obtaining a long term profit. The shareholders think the use of cash excess for the implementation of investment programs offers decent but uncertain investment profitability, while stock buybacks has to offer a safer profitability.

The management has to decide what the best use – with the highest yield – of capital consists of, evaluating and comparing what choices the have. If the management will invest in the existing lines of business the company is dealing with, it must be able to prove reinvestment will lead to a growth of owners' wealth *status quo*, by maintaining or even raising the return on equity or the profit per share.

Although the propensity to cash yields moved towards buybacks, and the dividends lost their initial importance, at the beginning of the 21st century, for the first time in several years, dividends began to gain ground, the scientists arguing the cause of this rise in dividend value is to be found in the general maturity of all companies.

If share buybacks and dividends are algebraically equivalent, management, on one side, and investors, on the other, see them differently. The management has other motivations for share buybacking, part of those motivations risking to contradict with the principles of value creation.

Very few managers view returning capital to shareholders a part of business realization, but this very perspective doesn't take into account the fact shareholders can reinvest the cash they receive into other companies or projects, gaining, in this manner, more than the company they are shareholders of.

While management opportunities are limited to the business or the line of business the company is focused on, shareholders are not restricted in this manner. Although the investment opportunities of the management may be a lot more capable in creating value for the companies' shares, those opportunities are frequently replaced by exogenous investment opportunities, much harder to asses.

It was determined[1] payments to shareholders have dramatically declined in the last two decades, while the dividends payment rate has declined, also, on one side, and stock buybacks have increased rapidly, on the other side, the latter one being generated in the detriment of dividends distribution to shareholders.

Share buybacks can be undertaken in multiple ways, each one of them being characterized by distinct advantages and disadvantages:

1. Open market purchases – is the method of stock (listed on the capital market) buybacks most oftenly used, method which consists of the acquisition of its own shares, by the company, on the open

[1] Fama, E.; French, K.;(2001); Disappearing Dividends: Changing Firm Characteristics of Lower Propensity to Pay?; Journal of Financial Economics 60, 3-44.

market, at the current market price of the share, like any other investor[1]. This method has the highest degree of flexibility, in spite of certain existing legal restrictions, like limitations in daily amount of shares that could be repurchased. The drawback of this method could be materialized, however, in the fact open market purchases generates weak signals about the state of mind of the management.

2. The Dutch auction, method which implies the fact the firms' management determines the amount of shares it intends to purchase, the date of expiring and the range price it intends to pay. The stockholders can offer shares at any price, to the limit of the range price, and, starting from the base of this range, the company will add a cumulative number of shares, required by the buyback program. The Dutch auction sends, generally, good signals, and, because of the limit in offered prices, is characterized by a risk of subscription lower than the offered price.

3. The fixed offered price is a method based on the fact company's management will repurchase some shares, at a fixed price, a date of expiring being involved. Fixed price offers are, generally, strong, with positive signals to the market, the stockholders having the possibility to chose whether the offer their shares or not. The drawback of this method is the chance the management will not reach its goals, if few shares are offered.

4. Private transactions give to the companies the possibility to choose to buyback their shares directly from certain investors.

No matter what the method put into practice, powerful companies, with a surplus of liquidity and with an increasing owners' wealth goal, will support the managers into applying share buybacks, rather than paying the dividends.

A first motivation of stock buybacks is the desire of returning cash excess to the shareholders, followed by the management's decision of spinning off or selling of a division, and the redirection of the profits to the stockholders, and, also, the will of modifying the firm's capital structure.

Unlike current dividends, which force the companies in continuing paying in the next periods, the companies undertake share buybacks, essentially, as a first return of the cash. Companies with surplus of cash, about which it cannot be offered a safety of generating cash-flows, will apply stock buybacks, rather than paying the dividends. Companies might choose to pay special dividends, rather than enforcing stock buybacks, because the special dividends are not demanding similar payment being realized in the future.

The decision of enforcing stock buybacks offers the company more flexibility, the company being able to adopt the decision of undertaken the share buyback during a period of time, and in the state of paying the equivalent special dividends.

In terms of cash payment terms, a share buyback is much more selective; that is, shareholders who need cash can offer their shares to the company, while shareholders who do not need cash can keep them further.

The buying back of the capital can be considered, also, a way of boosting internal control in the companies, as long as the number of stockholders declines. If the insiders don't put their shares in line, they will possess a larger part of the company's portfolio, and, because of this, the elements of a higher degree of control.

One who undertakes a stock buyback expects a rise of the net assets per share, or the Earning per Share (EPS)[2], as well as a rise of the shares' price (this is the product of the market, being independent of management's control). There are companies that request permission, from the shareholders, to buyback the shares; this is compelled by the existence of a limit of the number of shares which can be buy baked, as a percentage of the total number of issued shares, and by a minimum price, which cannot be smaller than the nominal value.

One of the major advantages of share buyback is the fiscal advantage conferred to the shareholders: if the dividends are taxable at a high tax rate, the increase of price determined by capital buyback is taxed at the rate corresponding to the capital gains. As such, the investors who choose to sell part of their portfolio, generating a yield similar to the dividend, will pay taxes levied only on the difference between selling price and cost, while the dividends are taxed for their entire amount. Furthermore, the shareholders have the option of keeping for themselves the shares issued by the company, and, because of this, of not making any capital gains, while in the period of capital buyback; it is known time is one of the reasons which confer to the

[1] It cannot be considered a stock buyback the operation of stockholders selling shares to one another, where a major stockholder purchase the shares of the other stockholders, or the simple change in stockholding structure, or the operation of selling the entire business.

[2] Earning per Share

buybacks more efficiency: stockholders have the option of keeping, furthermore, the shares, rather than selling them, and, thus, to postpone the paying of their income tax until the selling is accomplished.

As for the discretion conferred by these two methods of returning cash to shareholders, we are able to say that, while dividends are awarded to all shareholders, who must stand to all the consequences related to taxation and the reallocation of their funds, share buyback confers more discretion to the shareholders. They have the option of either be taxed or not to be taxed, building up, as such, the timing of their treasury needs.

A dividend affects all shareholders the same way. But if the company buys back stock, the shareholder who decides not to sell ends up with a higher percentage stake in a more valuable company, provided the stock proves to be undervalued.

In spite of the theoretical equivalence, as for the companies themselves, the management views dividends and share buybacks differently, on average holding the dividends being *ad pari* with investment decisions.

The differentiated tax rate suggests the fact buybacks are, significantly, of a greater profitability, compared with individual taxation. Shareholders who choose getting a higher yield of dividend like cash can sell part of their portfolio, but they don't have to pay taxes levied on the capital gains generated by the difference between selling price and cost; contrarily, dividends are fully taxed.

Share buyback is proving its efficiency both by the delay of the tax payment, as for existing shareholders, until the selling of their shares (virtually, an infinite period of time), and by the increased proportion of the business held by the shareholders which remain linked to the company; in this way, share buyback is proven fruitful not only from the point of view of fiscal benefits, but from the point of view of tax payment timing.

Companies grow by using share buybacks as a means of profit and capital distribution, towards shareholders, the advantage of buying back from certain shareholders, compared to regular dividends, residing in the fact the amount received from share buybacks is considered to be a combination of taxable dividends and taxable capital gains. The part which will be distributed in the form of dividends will be included in the shareholders' assessable income and will be, usually, taxed as a part of the gross profits.

For shareholders, the fiscal implications of share buybacks are materialized in the following: as for the open market purchases, the amount received by shareholders it is not treated as a dividend, while in the off market buyback the amount received by shareholders produces a certain capital profitability and a dividend (as the difference between the acquisition price and the part of the acquisition price due to the company).

The program of share buyback is proven to be an attractive one when certain principles as observed. One of these principles assumes the existence of sharebuyback only in the case the shares are traded on the capital market, under the expected value; the management will, then, act as a good investor, who buys stocks when the price is smaller than their value.

If the market value of a share is greater than its price, the buyback will be followed by a wealth transfer, from the shareholders who sold their shares to the shareholders still owners of the company (those who still own company's shares). This growth, materialized in the expected value per share, corresponds with managements' goal of maximizing the wealth of existing shareholders.

Another principle is about the opportunity cost, telling that no better investment opportunity is available at that particular moment. The share buyback must be more attractive than investing in the very business and the management must resort to buybacks only if their profitability is greater than the profitability of investing in the business.

The profitability rate of a buyback depends of how much a share is undervalued on the market; if a company buybacks undervalued shares, the remaining shareholders of the company will benefit from profitability greater than the capital cost. The profitability rate of a stockholder is based on the capital cost, related to the rate of expected value price of the share, the management having available the possibility of comparing this profitability rate to the other choices of capital use. The buyback of undervalued shares has the goal of raising the value per share for the remaining shares.

The reaction of the capital market to the announcement of stock buybacks is, usually, favorable, the impact of share price, in the long term, on the shares, after buybacking, being significantly better than that of the price of a comparable share, whose company does not undertakes buybacks[1].

[1] Ikenberry, D.; Lakonishok, J.; Vermaelen, T.; (1995); *Market Underreaction to Open Market Share repurchases*; Journal of Financial Economics, 39, (2-3), 181-208

Shares react, in general, favorable to buyback programs, given the positive signals which they transmit to the market. The economic science states there are several types of determinant factors of the signals of the capital market, as follows:

1. the percent of the shares withdrawn from the market in the total amount of the shares put forth on the market
2. the premium companies intend to pay versus the last transaction
3. the percent owned by the insiders, a high percent denoting an alignment of both managers and shareholders' scopes

The net profit of stock buybacks, unlike the dividends, depends on the sustainability and stability of cash excess; as we have put it at the beginning of this paper, if the company has a temporary or unstable cash excess, it is preferable to buyback the shares, and, if cash excess is predictable and stable, the company could pay dividends, because it generates a more powerful signal of yield.

Share buyback depends, largely, on the anticipation of future needs of investment. In this manner, companies that don't reflect opportunities of certain future investment will use stock buyback as a means of returning the cash to stockholders.

Share buybacks have to offer to the companies more flexibility, as opposed to paying the dividends. This buyback can be accelerated or slowed down, depending on the intervening changes of company's cash-flow, whilst once the paying of dividends is initiated, the investors wait for payments to be put into practice, and so with the periodic growths.

Buybacks imply smaller costs, being cheaper to undertake for the companies, whilst dividends must be paid to all shareholders, and, from the administrative point of view, too, imply larger expenses.

The management has more than one option to choose from, in what company's shares are concerned: payment of dividends has the effect of lowering the price of the share, whilst share buyback has the effect of decreasing the number of shares, and of increasing their value.

The dividends make a large part of returning cash to shareholders, but they always generate a decrease of the level of the share's price. On the other hand, share buybacks pays the same amount to the shareholders, but does not generates a decrease in the market price of the share, this difference being an advantage for choosing the option of stock buybacks, as a means of returning the cash, instead of dividends.

It must be said, however, that, if the company buys back a large number of shares, it might appear a certain type of risk; this being the risk a certain price of a share is targeted, and this only for the price to decline after the transaction is fulfilled. This might be considered just as a bad management of the buyback, doubts being raised about the abilities of this management.

There are series of buybacks followed by drops in share's price, because of the fact this depends on the demand/offer ratio. The price of the share is, of course, able to move to a higher value, if a significant number of investors exist, who think this buyback was well engineered, and the improvement in net asset value and/or earning per share is, in the long term, sustainable.

The buyback has the effect of dividing the total profits of the company to a smaller number of shares, profits which, nevertheless, are diminished because of the smaller financial funds and the mounting debts for which the company pays a higher interest. Anyway, the Earning per Share (EPS) of the company remains constant, because the smaller profits of the company relate to a smaller number of shares.

In what dividends paid to shareholders are concerned, these are taxed as a regular income, whilst capital gains are, in general, taxed at a lower tax rate, so that, for individual shareholders, the effective income tax rate, be this income a dividend, is larger than the capital incomes tax rate.

Some institutions, though, consider that, if the dividend tax is lowered, paying the dividends could become much more attractive for the companies, this change being able to promote a more efficient allocation of capital and, similarly, to confer to the shareholders, rather than to the management, o higher degree of resources use control.

It is noted lowering the dividend tax rate exists in the shape of raising the dividends paid to the stockholders. If the companies pay, inefficiently, small dividends, in order to obtain a cash excess surplus or to maximize the value of the share based options the management possesses, increased dividends should boost efficiency.

Also, empirical studies show the share price, for a given company, will rise whenever its current dividends rise, too, and will fall in the periods when current dividends get diminished or are not paid at all.

It is noted[1] companies that did not pay, on a large scale, dividends, in the long term, and which are characterized by a large proportion of individual shareholders, accumulated gains from the share price as an effect of an existing tax rate cut.

If, until recently, many of the followers of the principle "dividends are bad" conceived capital buyback was preferred to both current and special dividends (given the flexibility and the fiscal advantages), now, they wonder if the value growth, consequent to a capital buyback, will be smaller than the value growth caused by a current dividend payment.

If a stock buyback will cause the share price to rise or fall, this would be just a question of whether the company receives any yield from it; if it does, then the price will rise, and if it does not benefits from it, the price will fall.

Or, as the famous economist Eugene Fama put it, "people think because growth stocks are good companies, their stock returns will be high. But in fact, their prices are pegged so high by the market that their returns actually tend to be low".

As a conclusion of the ideas stated above, in my opinion, no way of returning cash to the stockholders – stock buyback, dividend payment – is characterized by nothing but advantages or disadvantages (this, even if one way is, apparently more suitable than another), so that no any given strategy of this kind can push aside another strategy.

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Magdalena Radulescu
University of Pitesti, Romania

THE HARMONIZATION OF BANKING STRATEGIES AND MANAGEMENT OF BAKING RISKS IN THE EUROPEAN CONTEXT

Abstract: *It is well-known that at the beginning of the transition period to the market economy, the banking systems of the Eastern and Central European Countries faced fundamental changes. As a whole, reorganizing the banking and financial systems continued inside the national boarders and implied a rise of the number of fusions and acquisitions, so the importance of the trans-boarders activities remained limited, especially regarding the banking services for the population. This accent that laid on the national fusions can be explained by the existence of a rising efficiency stimulant by adopting some defensive strategies as well as by the cultural proximity that played an important role.*
The national fusions and aquisitions are obviously easier managed than the trans-boarders ones. This tendency determined an alarming rise of the market share for the most important national institutions. This determined some difficulties for the prudential supervision and the neccesity of the legislation armonisation in this area across the European Union region. As a result, the banking institutions entered on the insurance market in order to modernize the financial services sector for a better satisfaction of their consumers' needs as well as to reduce some increasing banking risks.

Key words: *banking strategy, banking risks management, European integration.*

JEL Classification: *E44, F36, G32, G33, G34.*

1. Introduction

Certain countries in the European Union have attracted more acquisitions than the other foreign banks. Thus, Italy and Spain, because they did not have products and techniques as efficient as the ones owned by the German, Belgian, British and French banks, offered the foreign banks in these countries opportunities in the development on certain market segments which were not served by the national banks in the best way. As a matter of fact, Italy, unlike Spain, was more attractive for the foreign banks because they have many inferior banks as compared to the other European countries. Certain Italian banks proved to be more receptive to implanting some banks abroad, whereas the Spanish and Belgian ones turned especially to the national market. The countries that really had a European development strategy are Germany, France and England.

By enforcing the European Union integration norms, the approval of the legal framework in the case of foreign banks is no longer necessary. Thus, competition intensifies. Liberalization allows that a banking institution can settle on any market in the European Union without other supplementary approvals. The control will be made at the "parent bank" (the central bank), the foreign banking institutions enforcing the banking norms in their country of origin with few exceptions. But liberalization also increases banking risks.

In general, the reorganization of the banking and financial systems has continued in Romania and involved an increase of the number of mergers and acquisitions, and the importance of the cross-border activities has been limited, especially those regarding the banking services for private persons. This stress laid on the national mergers can be explained by the existence of an efficiency increasing stimulus by adopting some defensive strategies. At the same time, cultural proximity has an important influence. The national fusions and acquisitions are obviously easier to be managed than the cross-border ones. This tendency has generated a worrying increase of the market quotation of the most important national institutions.

2. The harmonization of the banking strategies and management of risks

It is a well known fact that at the beginning of the transition to the market economy, the banking systems in the Central and Eastern countries have been subjected to fundamental changes. The largest part of the commercial banks which separated from the central banks have been reorganized, recapitalized and privatized and many private banks have been authorized to function. But, because, there were cases when many private banks have been authorized to function without a rigorous control, especially at the beginning, and the surveillance process has been relaxed, a series of banking crises were generated. Subsequently, the surveillance activity of the commercial banks has been improved as well as the consolidation and liquidation

process of the insolvent banking institutions. All these have contributed to the increase of the financial stability.

The *bancassurance strategy* can be included in this context of improving the range of products and services. It consists in mergers between important banks and insurance companies by means of which the banks use the network of agencies and the information about clients in view of selling the insurance products the at a low price. In this way, the banks are less concerned about the insurance services, trying to remunerate the clients by means of the distribution commissions of these products. At the same time, in this way the banks find new sources of income, the clients become more loyal and the diversification of the products and services offered facilitates an advantageous position on the market.

Diversification is a strategy which assures a better allocation of banking risks. Thus, the banks can reduce the risks by diversifying the investments and orienting them towards sectors that are not connected. The diversification of the profit sources allows a better resistance of banks to the difficulties that may occur. Such a strategy may be adopted in accordance with the geographic criterion, in the case of a country, or at international or intercontinental level. Exemples of such banks are: Crédit Social de France, Crédit Commercial de Belgique, ABN AMRO.

The present progresses in the European Union banking systems show that they cover three main fields mainly: the improvement of the services and procedures; changes in the products range; strategic emerges and alliances. The first strategic solution takes various forms. The first form is to aim at a better quality of the staff's services and of the informational technologies. Secondly, the banks aim at improving the internal control systems and the risk prevention. Thirdly, they try to cut down the costs and to improve the efficiency. We can conclude that banks resort increasingly more to external resources.

The second strategic solution aims at providing a wider range of products and services offered to clients. The easier to notice are the following progresses: passing from the exploitation services to the consultancy ones, the attempt to find alternative sources of income, the reconsideration of the ranges of products.

Under these circumstances, the banks functioning in universal banking systems have not decided to withdraw from an activity field because of the European Monetary Union. In general terms, the *universal banking concept* can offer a series of opportunities regarding the more efficient use of resources.

The third line of strategic solutions includes the mergers, the strategic alliances and the cooperation agreements. There are various advantages, among which mention can be made of the following: improving the cost and efficiency, the diversification of the banking products (banking insurance).

In the Northern countries this solution is generated by the need to develop regional players from the European Union.

The most important structural developments which took place in the banking field in the EU are the following:

1. The consolidation of the project initiated in 1990 still produces cost reducing effects at local level, with a diminishing of the number of crediting institutions in 2005 from 2.8% to 1.7% in Euro area and in EU, respectively. At the same time, the declared banking capitals increased a lot (especially in the countries that are members of the European Union, where the increase amounted to 21.7% in 2005), when the number of the branch banks increased moderately.

2. The impact of aging on the EU banks aims at identifying the potential channels by means of which demographic changes such as the change of the life limit, fertility and migration could affect the retail banking activity in EU.

It is difficult to estimate the impact on the demographic changes since different factors could unbalance the incomes and profitability of banks. On the one hand, the demographic changes could influence the banking intermediary rates and the consumers' requirements of credits and mortgages, thus diminishing the income generated by the net interest. On the other hand, the answer of the banks under these circumstances could be to offer new products, available for the loyal clients, and the owners' management and consultancy services, which lead to an increase of the income without interest.

3. There has been a concern referring to the continuous change of the financing structure of the EU banks and to the influence this has on the activity of banks since 2000. The analysis suggests that the clients' deposits still form the financing basis for banks (about 33% in 2005), though this type of accounts have become more various. The new and more complex account instruments may have different behavioral characteristics as compared to the traditional ones and thus they may expose banks to reputation risks. There is however an ascendant movement towards the short-term financing market. Thus, the development of the Romanian banking system is included in the globalization tendency that dominated economy in the last decades because

the financial services represent, together with informatics, one of the fields in which this phenomenon took place.

It is expected that new financial products expand and break into the market much faster due to the supplying effects. It is also expected that a banking system with two up to three levels to develop in the European Union with national, regional players from the entire European Union. A major advantage of the Euro area for the banking systems in the European Union is that it allows banks to separate and regroup the risks only in the case of internal banking perspectives.

The *bancassurance* concept, defined as a new strategic orientation of the financial institutions towards clients, differs a lot from one country to another, especially as regards the capacity of banks and insurance companies to use their distribution channels reciprocally. The capacity of the banks to break into the insurance market successfully depends on both the general state of economy and on certain specific characteristics of the banking environment.

The severe economic conditions and the disintermediation phenomenon generated by the non-banking participants diminished the banking profitability. On the other hand, the banking world has been permanently subjected to a profound revolution: deregulation, the opening of new frontiers, eliminating sector barriers and the diversification of the payment means used. Therefore, are continuously in search for new opportunities on all financial markets depending on the types of consumers. From the point of view of the breaking of banks on the insurance market, they have the advantage of some distribution channels that have already been created, of a stable clientele, they are able to manage money and have technologic experience.

The breaking of banks on the insurance market took place first in the Low Countries, then in Spain and generalized in France and Germany, then in the entire Western Europe in the "80s in the last century. Banks are interested in *bankassurance* especially because they want to expand their operation field, whereas the insurance companies want to take some of the traditional clients of banks. This system is a way to placing the available money in an economy, which ended up in a collaboration. The *bancassurance* phenomenon has started by cross distributing of products to benefit from a reciprocal discount of the distribution expenses. The main form of manifestation was the selling of life insurances by means of the teller's offices, together with a rather limited cooperation in general regarding the damage or other financial services insurances. As a result of the banks' initiative, this phenomenon has expanded to other network owners, too- that of the post office and that of the savings banks. In Europe, this phenomenon generalized and amplified in the '90s because the part played by the financial markets became more important, they internationalized and tried to manage more efficiently the large active portfolios. Thus, an industry of services including life insurances, the pension funds, the persons insurance, the consumer credit, the management of the assets in the third parties' account, is being shaped.

The increasingly important part of *bancassurance* is also supported by the fact that over 70% of the incomes obtained from premium insurances made at insurance companies specialized in life insurance policies in Spain (about 17 millions USA in 2001) come from the *bancassurance* field, and in Belgium and France this field holds a share of 56%, that is 62% out of the total of the insurance premiums on the internal insurance market. In the bellow table, one can notice the share of the market held by each type of distribution channel in the main countries in Europe in *bancassurance* system.

Table no.1 Detained market quota by each type of distribution channel in the main European countries, within bancassurance system (%)

Country	Bancassurance	Traditional channels	Direct distribution channels
France	62	32	6
Spain	72	21	7
Italy	63	28	9
Belgium	56	30	14
United Kingdom	12	86	2
Germany	17	77	6

Source: www.bis.org

Developed by means of alliances between insurance companies and central banks, this modern channel of distribution didn't have the expected success, similar to that in countries such as Grand Britain, where the market of life insurance is structured around brokerage companies, or Germany, where the role of traditional distribution channels is still dominant, about 77% of premiums come this way.

But the banks and the insurance companies are going to collaborate even more. At European Union level, bank's transition from traditional bancassurance deposits is, nowadays, generated by the competition exerted by life assurance packages and programs offered by private pension funds. Still, this phenomenon also happens in countries where banks don't traditionally get involved in insurance activities. This collaboration, put across throughout agreements of cross distribution of the products, creation of mixed companies, avoidance of direct competition, by offering derivate products by the banks, using them as dealers, or performing expertise in collaborating with reassurance companies; purchase deed of insurance companies by banks- depends on the character of legal settlements, which can be more or less favorable for long periods and in a not at all neglected way by complexity of offered products, mentioning that the simple ones have more success, especially given the fact that it addresses to less sophisticated clients.

The most important changes took place in Germany, where first three commercial banks adapted their organizational structure in order to integrate completely bancassurance activity. One of the best known partnerships is represented by that between Alianz and Dresdner Bank, whose goal was to become a true bancassurance trust. But other banks and insurance companies follow the same path, pooling together their forces in diversifying the range of services delivered, and this circuit will become important in Central-Eastern countries also during the development of financial sector, as it is already happening in countries members of European Union.

Strategic alliances with different traders and insurance companies, together with alternative distribution channels, not only diversify delivering banking services, but also modify the costs structure. As long as a bank manages to walk this way it will be better prepared for the future. Banking services are more or less comparable; the most important criterion of competitiveness remains the price. The better a bank keeps under control costs, the solid its position on the market is. Taking into account the severe competition for customers, usage of new channels of distribution is utterly needed so that banks enhance the quality standard of delivered services, extend their share of market, diminish costs and increase profit.

The strategy of Romanian commercial banks must adapt to the nature and major transformation caused by the globalization of banking activity, as an effect of banking activity's globalization. When elaborating a development strategy one has to take into account the present circumstances and the future trends, as well as certain permanent factors: continuing the development of mechanisms characterizing the market economy; improving legal framework for these mechanisms; promoting financial and structural policies destined to: reducing inflation; increasing the annual volume of foreign direct investments; gradually diminishing the deficit of commercial balance of trade; accelerating the process of economic integration in the European structures, etc.

The involvement of foreign capital in Romanian banking system, represents, in our opinion, one of the most powerful tendencies which will affect the activity of commercial banks under all forms. The global character of the banking activities in Romania can be analyzed in a simple, eloquent manner that is by the effective penetration of foreign banks in Romania. Effective penetration refers to an increased number of banks that have come to Romania (by means of taking over, buying, mergers) and to an increased involvement of multinational banks in Romania. This process was accomplished on the background of economic and political liberalization after 1989 in Romania and in the largest context of foreign banks extension in Central and Eastern Europe.

One of the main directions of the central bank, as we previously mentioned, regards the harmonization with the legal, institutional and surveillance framework of the European Union, which is characterized by the large liberalization of circulation of commodities, services, capital and (to a smaller extent) of labor force. The successful enforcement of European regulations depends on the existence of the conditions previously established by the Basel Committee and which has an increased relevance for Romania too: healthy and sustainable macroeconomic policies; developed public infrastructure; efficient market discipline; appropriate proceedings for efficient resolving of bank issues; mechanisms of systemic protection.

Taking into account these circumstances, according to the Financial Stability Report made by National Bank of Romania, the implementation of Basel II involves a series of important challenges for the credit institutions – adjustment of risk management and of informatics system, personnel training, assemblage of data bases etc. – and also for the National Bank of Romania – the accommodation of surveillance process, elaboration of a new settlements frame, personnel training etc.

The impact of frame regulation which transposes Basel II over credit institutions and economy financing is hard to estimate. The difficulty pointed out by the banks in restructuring data bases on categories of exposure provided by Basel II made impossible the unreel of a study of quantitative impact in year 2005 in order to fundament the choosing of national options.

Harmonization of standards and their correlation with those included in Basel II Agreement (Directive No. 12 from 2000, reviewed and updated), will lead to, on one hand, assuring of a more flexible frame in establishing the demands of adequacy of capital, given the risk profile of credit institutions, and by the other hand, on creating the premises for stabilizing the financial system. The settlements within the three pylons of Basel II Agreement concern exactly these demands regarding necessary funds for covering the main risks (credit risk, market and operational), for surveillance of proper capital and for straitening of market discipline.

Usually, the approval of an internal pattern of risk credit imposes the usage of rating system during at least three years. The National Bank of Romania exerted the option which allows reduction of this period to at least a year if the credit institution wishes to apply basic internal patterns before December 31, 2009, respectively to at least two years in case of applying advance onset until December 31, 2008.

Therefore, according to declaration of chief of services of macro-prudential risks of National Bank of Romania, only four of the 39 banks in Romania apply starting with 2007 the settlements of Basel II system, the rest has the possibility of postponing the adoption of this system until January 1, 2008. The other banks will "go" on Basel I for on more year. Basel II regulations will come to force starting with the beginning of the following year, but they will be compulsive for all the Romanian credit institutions only in 2008.

Hereby, *consolidation of Romanian banks in spirit of Basel II Agreement* is a sine qua non condition of integrating to a European banking community and to participating to globalization of banking activity, which can take place only in conditions of promoting an outstanding management.

Given this context, *expected changes will generate indubitably profound mutations in Romanian market bank architecture* and, naturally, the consistence of national banking system with systems specific to those of state members of EU.

Therefore, throughout the promoted policy, National Bank of Romania created a sector formed by banks which are getting stronger and stronger, capable of assuring a financial intermediation based on efficiency criteria, in which the private banking system becomes predominant.

The first major package of measurements refers to reorganizing banking activities in Romania, throughout adopting Laws regarding banking activity and Laws regarding the statute of National Bank of Romania, afterwards followed by a series of attempts from National Bank of Romania of setting the bases of a real frame of banking regulations, in accordance with the regulations imposed by European Union. Ever since 1995, National Bank of Romania bear considerable efforts in this matter, therefore adopted, continuously perfected and completed prudential regulations regarding the capital and its settlement, high exposures, currency exposure, participation of banking society to corporate funds of a non-banking corporation, participation of a banking society to corporate funds of another bank, classification of given loans, general reserve for credit risk and provisions for risk matters, rules regarding further training and professional experience needful in quality assurance and efficiency of the activity of bank's manager etc.

Another direction followed by National Bank of Romania in harmonizing its regulations with the European ones and permanently enhancement them, is that concerning conditions in which modifications can be performed in case of Romanian legal persons banks and abroad branch offices, regulations adopted in 1999 after the pattern of French settlements. Taking into consideration the accounting and prudential rules provided by Accounting Plan for banking societies, as well as the necessity of assuring conditions of implementing settlements of the Program for adjusting private sector – PSAL and of the program of institutional development of private sector – PIBL (Government Decision No. 374/1999), there were elaborated Regulation No. 2/2000 and methodological rules for its appliance.

A main objective targeted by National Bank of Romania was that of a more clear definition of risks in crediting activity, unitary treatment of those according to EU directive, but to faithful reflection of financial situation of Romanian legal persons banks in order to prevent occurrence of similar situations like in previous years, when a series of banks, not including losses of crediting activities throughout financial-accounting reports, didn't assure proper provisions for them, situations which led to entering in payment standstill (given that, significant is Bancorex case, Bankoop, International Bank of Religions).

The delay of legislative harmonization and of prudential regulations in financial-banking system imprinted the health of banking system. Afterwards occurred certain situations brought it by the avoidance of prudential previsions by some banks (Dacia Felix, Credit Bank), being registered flagrant violations of the law of operating inside banking system. Subsequent, the conditions and the procedure of authorization by National Bank of Romania mark out more and more the qualitative side, so that authorization will be achieved only by those banks which meet the entire exigency enforced by National Bank of Romania. This way the appearance of a smaller number of banks was wanted, provided that they have financial solidity and

breaking into business environment force, banks which would keep the steadiness of banking system overall.

Rendering the authorization of operating to a bank, takes into account the fulfillment of minimal criteria established by normative agreements, including those regarding capital, as well as the results of elaborate analysis of documents laid-down when soliciting setting up of a bank which should include human resources, comes to straiten up the measures of prevention from National Bank of Romania in appearance and propagation of some negative effects inside banking system.

A particular aspect was that of assuring the central bank's independence towards state administration, concerning elaboration and appliance of monetary policy regulations.

By updating the basic legislative acts in this field, (in 1998 banking Law No. 33/1991 was replaced by Law No. 58, and The Law regarding The Statute of National Bank of Romania No. 34/1991 by Law No. 101/1998 and afterwards by Law No. 312/2004), National Bank of Romania is presently disposing, in juridical scheme, of that degree of independence asked by the imposed conditions of the new monetary policy role which is manifesting nowadays throughout the world.

Furthermore given the conditions of a banking system dominated by abroad banks, the involvement of central bank in monitoring, analyzing and evaluating financial national systems and principles of international markets and efficiency of these interventions are decisive for system's stability.

Finally, let's not forget foreign banks have a higher movement liberty outside country boundary, and a series of measurements taken by the central bank can turn out to be inefficient. A very recent example is supplied by restrictions imposed by National Bank over credits in different currencies, which actually represent one of the major risks in banking system. Indeed, because of these restrictions, enlarged banks part of external groups, continued to give credits in foreign currency, externalizing one share by registering them in balances of mother- banks or sister-banks inside the group. The other Romanian banks, no so many, couldn't enjoy these competitive advantages.

When it comes to Romanian banking system, its restructuring must take into consideration the predictions regarding ensemble economic evolution, as well as the levels possible to reach for certain periods.

1. Romanian banking system is a sub-ensemble of national economy which functioned coherently and evolved visibly in this field to achieving modern structures, in accordance with European and world-wide levels. Importance of banking system for a national economy is marked out by technical and informational progress, and by new monetary and financial instruments which banks use in fulfilling the three main functions (financial intermediation, transfer and implement of monetary policy of central bank).

In Romania, the market of financial placement instruments is still in inception faze, currently existing only one category of credit titles, that of treasury bonds with a maturity date under one year, with predetermined and negotiable interest in restrictive conditions. The issuing of these bonds (basically, constituting the public debt) is exclusively made for covering the budgetary deficit and not in the name of a financing plan of state budget through extra-fiscal ways and in with the purpose of materializing some governmental investments.

Secondly, capital investments in Romania are, as well, in a starting stage, autochthonous capital being in present at a reduce level, dispersed and any way not competitive relative to the potential of foreign capital, and the last one insufficiently motivated through legislative guarantees to break into our intangibles markets.

2. Romanian banking system is the main financer of budget deficit, as well as giant economic structures in state's property.

Throughout crediting activity, important financial resources from the population and economic entities which run efficient activities orientated to state economic unities which, because of inefficient policies in the field, lack of coordination and activity control, inactive and co-interested free management, joined one by one the group of economic unities with losses, which had non-vendible production, at high costs and reduced quality comparing to those from import. So foreign markets were lost, and the competitiveness of import items, strongly supported by measures of currency policies, got to loss of home market of inland products and services.

Add to this the visible and even supported process, in the name of privatization, of parasitizing of state productive companies which concentrated important financial, material and human resources, in the advantage of small and medium companies which took over at law costs, products made by mother companies.

The first consequence of the process of sustaining the industrial giants through crediting means was that of making a downer flatten out of the economy, given the conditions of decapitalization brought by

negative level of real banking interest. Another consequence was the record of losses throughout redundancy at national economy level due to maintaining on functioning firms with losses and accumulating scriptural debts bigger and bigger to not repaid credits, which affected first of all banks and secondly solvent customers of banks. On the other hand, keeping in function companies becoming non-lucrative, determined the supplementary money issue in the economy through nonperforming credits, without the existence of a counterparty concretized in material values tradable on the market.

3. By monetary policy which is being implemented throughout banks, central organisms of regulation monitories the level of essential indicators of the macroeconomic equilibrium. The inflationary phenomenon is perceived as being of monetary essence, taking into consideration that the upper variations of the prices are or must be submitted under central bank's control, which is the organism of money issue and which throughout monetary mass control can influence by specific means the level and the speed of price increases at a certain moment.

4. The alterations which are going to happen in banking system concern all the aspects of the activity in this specific field of economy: regarding the structural changes influencing the organization of banking system as implementing factor of monetary policy of central bank, and those regarding organizational structure of the Romanian commercial banks; operational changes which refer to organizing the operations of commercial banks by modernizing payment system, accountancy system; operational transformations within the banks by accumulation of technical and computational means which would accelerate the speed of deductions and allow the implement of modern products and services, at the level of European standards; alteration of capital structure according to criteria of Maastricht Treaty; passing to the stage of qualitative accumulation by elaborating, at banking level, of profitability patterns which marks out the efficiency of each activity or of each unit within banking network.

Further more, risk exposure in banking system can be dignified by the evolution of main financial indicators and of banking prudence, presented in Table no. 2**,** which revel the following aspects:

- → The substantial improvement of the two profitableness indicators ROA and ROE, during 2001-2006, maximum being reached in 2001. In 2004 and 2005 the actives profitableness was smaller than in the previous year, profit being generated by existence of a hexogen factor, intervention interest rate of BNR. Also the increase of bank's profitableness was stimulated by an aggressive process of capitalization which allowed the extension of business segments, (including of those extra balance) and of treasury products and increment of modern solutions for the management of risk of customers;
- → The solvency knew a slight downing starting with 2002, which didn't cause the problem of crediting slackness, but, the reduced oscillation among 20% value that could be determined by the influence of BNR regulations which persuade the banks to be more attentive in the process of population crediting;
- → During 2001-2006, nonperforming credits pertained to total actives, is at normal levels, sub unitary, specific to any banking system;
- → According to BNR governor, *banking liquidity in Romania is high,* much over the compulsive minimum levels. "The sector of non-banking financial institutions (NFI) is underdeveloped, but possesses a growing potential which is considerable. Systemic risks are low, taking into consideration the reduced dimensions of the sector".

Table no. 2 The evolution of the capital ratios

	INDEXES	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
1	Solvancy ratio 1 (>12%)	28.80	25.04	21.09	20.55	20.97	17.25
2	Solvancy ratio 2 (>8%)	26.21	22.93	18.11	-	-	-
3	Equity ratio	12.11	11.60	10.89	8.88	9.13	8.26
4	General risk ratio	39.73	42.90	50.57	46.83	47.48	52.73
5	Arrears and doubtful credits / Total credits	0.72	0.43	0.31	0.29	0.20	0.18
6	Arrears and doubtful credits / Total assets (Valoare	0.32	0.23	0.22	0.18	0.12	0.14
7	Arrears and doubtful credits / Equity	2.66	1.97	2.04	2.05	1.35	1.64
8	Credit risk ratio	2.54	1.10	3.37	2.87	2.62	2.82
9	ROA (Net Profit/ Total assets)	3.10	2.64	2.21	2.04	1.65	1.35
10	ROE (Net Profit / Equity)	21.79	18.27	15.64	15.58	12.64	10.83

Source: National Bank of Romania, Romanian Banking System, 2006, p.83

Knowing that appreciatively 30% of the net banking income is generated by investments to BNR is obvious that the ensemble profitableness of the banking system and of banks in general is going to be

threatened by radical changes in revenues structure. So, banks will also have to grow the "productivity" not only by increasing loans, but by diminishing expenses.

The dynamic of crediting activity and the quality of credits, prudence indicators – high solvency rate, administrated level of nonperforming credits (under 1% of the banks credit portfolio) – indicates a reduced credit risk at banking system level and a considerable resistance of it to shocks.

Therefore, even though banking system registered notable progresses and is *moderated exposed to credit risks*, there are still *some neuralgic spots*, as:

- *reduced intermediating level.* Factors which *favored* the obtaining of this reduced level of intermediation could be:

- Gradual liberalization of currency market;
- The lateness of capital account liberalization;
- The bankruptcy of some banking institutions which amplified the population's lack of trust in the banking system;
- Gradual reform of monetary policy which had still notable results, consistent with national economy and Romanian financial market were immune to shocks;

According to Governor Mugur Isarescu, the degree of financial intermediation of Romanian economy was of approximately 25% from the Gross Domestic Product (GDP) at the end of 2006 and represents les then a quarter of financial intermediation degree in EU, which was of 103,9% of GDP in 2005.

- *the reduced access of commercial banks in rural environment* although half of the country's population lives in villages and not fructifying by the banks at least two potential resources: financial transfers of Romanian seasonal workers and non-repayable funds injected by EU;

- *the reduced value of customers bank deposits* of which pertained to GDP value reaches only 26%o/GDP, much below the value of this indicator in the other EU countries (90%), Central and Eastern Europe (45%) or even Bulgaria (40%) and Albany (5%). Therefore, corporate deposits reach in Romania 15% of GDP, relative to EU countries where this indicator registers an average of 30%. According to some UniCredit estimations, the deposits of economic agents majored in 2005 with 25%, their percentage in GDP is expected to reach 19% in 2008 comparative to 15% in 2005. This situation is the consequences of preference for consume which was stimulated by the inflationary phenomenon that powerfully wears down the population's savings, as well as the degree of poorness.

Operational risk is becoming more present in banking activities, being generated especially by informational system shortages, in the red monitoring of clientele, high fluctuations of personnel or lack of total reporting of information regarding suspect transactions, with possible repercussions over the image of respective bank.

Interest rate risk is relatively minor given the fact that short term credits are preponderant, and medium and long term ones are being accorded with a variable interest. Therefore, the interest rates practiced by banks are sources of financing of the interest rate risk, in the eventuality of its occurrence. We think that, the vary of given credits in favor of those on medium and long term, as well as the reduction of interest spread will determine another dimension of this type of risk. According to specialists the most powerful straitening of spread between interests will take place in 2007 when this indicator will be reduced with 4,5 percents because of tempering the crediting activity.

The risk of contamination on interbanking market is insignificant as interbanking investments were orientated to central bank, and the adjacent risks (currency risk, interest rate risk and credit risk) register a low level.

The gradual improvement of banking prudence indicators is the result of central bank concentration on qualitative side of surveillance and on sustained economic growth starting with 2000. Positive trends of these were also supported by the increase of level of capitalization within banking system (capitalization degree of the banking system grew in real terms with 12,5% in 2004 comparative to 2003) and by the consolidation of foreign capital banks position inside the structure of the banking sector, although the profitableness of actives was in 2004, 2005 and 2006 much low than in previous year, the profit being generated by the existence of an hexogen factor – intervention interest rate of BNR.

We can conclude that, after the restructuring of the fond of banking surveillance activities started in 1999, BNR followed with propensity the enhance of its efficiency which led to *step by*

step reduction of risk exposure in case of banking institutions, creating a healthy banking system and the improvement of population's trust in this institution.

3. Conclusions

The dynamic field of banking risks determines the rapid modification of the procedures, techniques and used models in efficiently managing them, underlining in the same time that this can not eliminate the risk, but it can only predict it and diminish it.

From this perspective, no matter what patterns we use in the surveillance process, the monetary authority won't be able to prevent banking insolvency or swarm up an aggressive banking crisis. Its role is that of assuring the legal frame where risk can be observed and administrated.

Therefore, the dilemma, the same as in the other communitarian banks, is: are the Romanian banks strong enough to cover their implementing costs from gained profits? Of course, is hard to define a rigorous answer in the absence of a rigorous research. Still, given the evolution of indicators defining the state of our banking system, we believe that our banks made important steps in direction of meeting the restrictions imposed by Basel II Agreement.

The above mentioned aspects sets off the fact that the European integration process is, in Romania's case, identified in the present with the general process of restructuring society on democratic grounds and European civilization, throughout strategic measures which take into consideration the specific particularities of our country at the moment. This process is already started with the modifications which took place in December 1989 and involves not only the economic development, but also all the other existence aspects of Romanian people, the finality being the making off of institutional and cultural environment, European kind, which will bring back Romania to the justified place of continental membership and historical arguments.

The evolution of global economy in the last fifty years determined the increase of the role and importance of banking systems in economical- social development of the nations. Romanian banking system, much advanced in our opinion because of the reform, has to assure the healthy circulation of money within the economy, of implementing regulations and measures of monetary policy and realizing the necessary conditions of picking up the process of economic growth of the country.

Situated, because of present conjuncture and in the circumstances of substance modifications which take place in continental and global economy, in centre of restructuring and economic development processes, efficient functioning, on modern bases, of Romanian banking system is one of the fundamental issues in our country's adherence process to European Union standards.

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Ec.&Ph.D Student, Director Marinel Rizea
DGFP Ilfov, Romania

IMPLICATIONS OF THE FISCAL EVASION PHENOMENON

***Abstract**: Phenomenon with multiple negative implications on financial, economical ans social plans, the fiscal evasion needs to be eliminated. Fighting against fiscal evasion envisages it's maximum reduction, as well as it's negative effects, on two plans, one of prevention and the other one of repression. Fiscal evasion is almost inherent to the market economy and it will exist as long as will exist a market for it, the exchange of goods and relation goods-money typical to this kind of market. Thus, one can state that a reasonable 10% fiscal evasion is accepted within the taxation circuit. However, an effective attitude towards the phenomena would be to correctly administrate the identification, prevision, control and value this, in order to ensure the planned budgetary revenues.*

The evasion phenomena should be evaluated as a whole, taking into account the fact that, aside it's negative connotation, it has also big impact on sums attracted as identification of cases of evasion. It also needs to be performed a profound analysis of the internal mechanisms of this evasion phenomena that would permit to develop tools able to keep this phenomena under control.

The financial control and fiscal inspection should identify instruments and indicators that would ensure the functioning of the economic system within legal parameters, more under the impact of the imminence of the control rather than the effectively realized control.

This phenomena has a dynamics determined by several factors that act in concert : dynamics of the real economy, of the monetary economy, of the inflation, of the legislation and institutional sectors etc. Plus, this phenomena makes "cycles" that do not go over the budgetary or calendar year.

***Key words:** fiscal evasion*

***JEL Classification**: H21*

The modern State uses taxes as means to collect contributions. For this, it creates the legislative framework able to constraint citizens to pay those contributions, in order to have available the means necessary to satisfy the functioning needs, as well as the ones resulting from the common life of it's society. An interesting fact one must state is that, due to the global process and tendencies, a new approach appeared as from some State' collecting process resulted funds (the wealthier ones), are being established communitarian budgets or international aid transfers, destined to help citizens of other States. Such a deviance was knowns also in the past, under names as tribute and war reparations.

A definition given by Alain Euzeby in his book "Les prélevements obligatoires", is considered as being the most appropriate as notion of the tax. He states that taxes represent a material participation collected from people, by means of authority, definitively and without any direct compensation, in view to covering public and social expenses of the public authority. Therefore, there appear to exist three elements related to taxes, the public force, transfer of wealth and volume.

Concerning the element of authority, this is the most present characteristic of the tax. It is foreseen by the tax-payer as an act of the authority, a constraining one. This criteria of obligation and constraint makes, in fact, distinction between the fiscal collecting process and the remaining tax collecting process (donations, public loans etc.). At the same time, according to the public power that decides the fiscal prelevations, one can distinguish the between taxes due to the local budgets of the local communities and the State (or federal) budget imposed by competent authorities (local authorities for the first category and Government or Parliament for the latter. The compulsory character of those taxes is based in Romania on the art.35(1) of the Constitution that stipulates the fact that all population must contribute via the taxes to public expenses.

Regarding the element of wealth transfer, tax is a prelevation from the contributors' personal belongings. This has a definitive character, the fiscal debt being impossible to reimbursement (a difference would be the fact that in Romania the tax on salaries is paid monthly and, at the end of the year, after recalculating, there can be some restitutions or in the VAT case, there can be request from the population to VAT recovery for construction works, repairs of constructions etc.). Those contributions do not give the right to direct counter-prestation (with some exceptions) and are allotted to covering some expenses that do not interest directly the payers.

Tax's wide function in the modern world is ensured by the State's fiscal policy, that added, gradually, to the traditional function of the tax (recovery for covering the collective and particular needs of the State), other functions, such as intervention in resource distributing within the economy, in order to stabilize the request, protection of natural resources and extension of the period of time for their exploitation, redistribution of wealth etc.

Following those different existing relations, the structure of a fiscal system is structured by the totality of fiscal measures, instruments, central and local organs for elaborating and applying the fiscal policy and managing the fiscal resources.

Implications (risks) at national level:

The political forces that led the country, as well as their governments, were conscious, at least at a declarative level, of the danger that fiscal evasion represented for the society. According to the Ministry of Finances' statistics, the tax evasion reached an alarming level in Romania. The internal implications are visible and can become at any moment source of important social issues. It seems, in fact, that lately people have begun to realize this more than ever. The rhythm of legislative modifications tries to put an end to this process and we assist to the development of new instruments, created for fighting this phenomenon. It is necessary, thus, to analyze what major risks can bring this phenomenon.

Accentuated reduction of mobilizations for the State's budget

This risk comes, principally, from the tax payer's psychology. It is within human nature, not only in Romanian people's concept, to tend towards equity. Nobody wants to contribute to social expenses and of other people, especially when the latter use means to escape to paying, even if they are beyond the law. This is how appears a phenomenon of discouraging and temptation to go towards the ones trying to escape to this obligation of paying taxes. This can only be limited in the case where the State finds adequate means to punish the ones trying to avoid paying taxes or refuse to do so. It is a fact well known that in several occasions, the public authorities, instead of stimulating people that paid taxes, simply encouraged the ones that avoid to o so, repeatedly, by erasing the interests on the sums unpaid on time (the legal condition being that one can benefit from this facility only by paying the taxes due), which will lead to catastrophic consequences, once the good payers, wanting to benefit from this system, will delay paying their taxes. This is confirmed also by the fact that there are very little laws that gave bonuses to tax payers for paying in time their taxes.

De-capitalization or bankruptcy of good payers

With the number of tax payers committing evasion acts increasing, also grows the volume of the fiscal evasion and phenomena with direct implication on the economic and financial stability of the good payers.

First, in order to compensate for the losses, there is an increase of the fiscal pressure. This affects all people not committing evasion, with direct consequence on their financial results. This increase of the fiscal pressure has normally reverse consequences than the ones expected by the budget, as it can generate the orientation towards the black economy or economical instability of tax payers, followed by de-capitalization or bankruptcy.

Second, the same consequences occur when a non-competitive system is created. The good payers cannot compete on the market with people saving throughout tax evasion and capitalize. No producer or importer can compete with products brought in by these people. There isn't any correct businessman that can compete with companies that benefit from the tax evasion. Therefore, in front of the option between bankruptcy and tax evasion (especially under the condition that "everybody does different and gets the same treatment"), almost any tax payer chooses the second option. The ones that do not do so, risk to capitalize very little or even to de-capitalize, under the condition they do not go bankrupt. The fear of bankruptcy replaces thus the pride of being a good citizen and tax payer.

The decrease of the sums collected to the budget implies external credits for a certain budget balance. More the budget is not balanced, the costs of those credits are bigger. At the same time, the internal loans made by the State, despite the relative balance on the short term, still carry interest related costs.

Decrease of budgetary expenses as effect (risk) of fiscal evasion

This phenomenon is related directly to the one described above.

Reducing expenses triggers a chain of social implications. Thus, reducing expenses for education will lead to an increase of the alphabetization and the decrease from a scientific and technological point of view; reducing health related expenses will lead to a descending evolution of the health state of the population and to consolidating the last position for Romania in Europe in this area and the examples can continue.

Decreasing budgetary expenses with salaries amplifies the evasion phenomenon, as the well trained people working within the budgetary area that deals with taxes and fiscal policy go exactly towards the area where this evasion occurs. It is impossible to even conceive a coherent fiscal system formed by people under-paid and under-dotted materially, and is also impossible to fight tax evasion. On the contrary, we assist in this case o an increase of the corruption and non-implication phenomena. At the same time, this would eventually lead to a blockage of the national economy mechanisms. They have a direct effect on tax-payers that serve in the budgetary area, which will reduce, therefore the fluidity of economical circuits and lead to chain blockages, unemployment due to un-occupation of the labor force and other negative social aspects.

Increase of the tax level

The level of taxes is a sensible liver in the hands of the State. Normally, an increase of the tax level is followed by a lack of control over the tax resulted funds, therefore to tax evasion.

The most eloquent case is in case of collecting contributions due to the use of labor force. Once the taxes for labor force use increased, most of the active population would not pay them, entering thus in the tax evasion area by a "work on the black" phenomenon. This lead, under the pressure of the social and health budgets to a cascade increase of taxes, with the above-described effect. Fiscal relaxation has an immediate effect of decrease of budget's cash-in, as the monetary mass out of fiscal control returns with difficulty to legality.

But, the chance of fiscal relaxation is to double it with very hard coercive measures against tax evasion, in order to increase the tax base by absorbing a part of the evasion, enough to cover the relaxation. At the same time, one must bear in mind also other sets of measures to fight the other causes of tax evasion : corruption, payment of personnel working in fiscal area, good material background etc.

Risk of generalized corruption; weakening and dissolution of State's authority

The wealth obtained throughout tax evasion under relatively easy conditions can lead to finance corruption. More important are the funds obtained, highest is the level where corruption can get. It is highly un-imaginable that a small businessman would corrupt a minister in order to be listed on a facility list or that a multi-national corporation would try to corrupt a poor tax inspector.

The most serious form of corruption is the one attaining the highest level of the society. As there is a relation almost of inter-penetration between tax evasion and corruption, the phenomenon of "corruption without corrupt people" is almost always doubled by the phenomenon of having "tax evasion without evaders". One can talk here about the big figures in the area, because of the little ones there are some examples that can be given on people and punishments performed. The fact that big corrupts and evaders (it is estimated that about one thousand of them represent about half o evasion at national level) do not support any consequences of their facts (with exception of losing parts of their wealth to corrupt), lead to a civil opinion that the State's authority is more and more reduced. Anyway, the population's level of trust on State institutions is decreasing, especially for those institutions dealing b law with creating the tax system, it's application and realization of justice.

The decrease of State's authority leads to a more antisocial behavior of the population, criminality becomes a national plague and social organization, starting with the small communities – family and neighborhood associations and ending with the society as a whole, is submitted to a modification of social values. The antisocial behavior of the society leads automatically to an increase of the tax evasion's level, triggering thus a progressive chain reaction.

Stagnation or economic decrease; reduction of investments

Tax evasion does not produce any capital that becomes active. Many of those capitals are taken out of the country, as the investments climate is not certain and safe enough. This happened with capitals made by foreigners that created companies for a few hundreds of dollars and then produced for them or other occult structures bigger amounts of money that were exported out of the country. The same thing happened to many Romanian people that gained lots of money and transferred the fund in banks abroad.

Other use of those funds is to finance antisocial activities (drug dealing, robberies, prostitution and people trafficking) that produce money as easily as tax evasion. Other capitals were used for financial schemes that increased exponentially the capital invested without having the possibility to tax it.

It is also his kind of capitals that funded corruption and gave birth to fabulous wealth and fortunes, over which the State could not make any taxation, but that allowed the economies of other States to increase. Many of those capitals are also used to increase that initial revenues, also within tax evasion area.

Under the above-described conditions, correct tax payers that supported the rigors of fiscal policy, ran clean and legitimate businesses and were competed unlawfully by tax evaders, do not have the possibility to invest enough to re-launch the economy. Thus, we consider that both State and correct investors could, once delivered of the evaders, have a bigger economical force that would lead to a major economical

evolution. If the economy cannot deliver itself from the evasion, the economical decrease and even collapse are easily predictable.

Political risk. Social convulsions and destroy of democracy

As the population gets poorer because of the above described facts, increase of unemployment and decrease of salary level for the budgetary personnel, with the same effects over the entire active population, the increase of taxation and non-satisfaction of social needs – health, education, social security, represent as many sources for social discontent.

Doubled by phenomena described, such as dissolution of State's authority, excessive polarization of wealth, generalized corruption as well as some good memories from the period before 1990, the population's discontent might gain aspects of social convulsions.

Such evolution would lead to major political risk, both on internal and international level, the most evident risk being the attempt on democracy. This fact is referred by the historic experience of populations that, based on the collective surviving instinct, considered accepting the loss of democracy as a facility and grouped next to extremist leaders.

A second major risk of social convulsions could even be the dissolution of the State, with terrible effects on national or even regional stability. This would result on the fact that population would not accept the political and administrative structures, the crystallization of a new political class being impossible under such conditions.

External Implications (International risks)

The internal risks are directly related to the international ones. This is due to the fact that States are more and more interdependent in the context of global relations and the States communities such as the EU and world economy.

Amongst those risks, one could enumerate:

Eccentric evolution of the national economy in relation to the tendency of unification at global level

Each State tries to position its own economy in the best possible way towards third countries economies. The lack of interest from decision-making structures within a State, or the poor performance in economical area simply put some distance between economies at international level. This is due to the fact that the good positions bring at their turn great advantages and economical benefits, strengthening the economical and political position.

Tax evasion is an obstacle very hard to overpass in the attempt to strengthen a good position. This because, as we have seen above, undermines the national economy's position throughout stagnation, recession, weak clean investment opportunities, serious lack of capital. In this way, the economy is even more marginalized and avoided within international relations.

By committing tax evasion acts, as well as corruption ones, in the world of big corporate business, that enters the international relations, acts on unlawful competitions appears also in this area. Thus, all developed States that have a good position within international relations, are very sensitive and apply coercive and long duration policies against those practices. At the same time, corrupt people and tax evaders are not very well received at the economical negotiating table, serious firms avoiding such individuals as it was proven that relations with such a person can produce massive image damage, almost impossible to overpass, in case of a State where the culture of tax paying is developed.

Te internal legislative instability leads automatically to social instability and therefore political. As consequence, the national economy of a State where such issues occur is avoided, especially in regard of long term investments. This leads only to establish contextual relations, that can create the impression of active involvement within economical international relations but without concrete and sold roots, that disappears as soon as a bad climate occurs. Once the economical relations disappear, also disappear the political ones, as the economy influences policy within market economy.

The blockages of a national economy, created also by tax evasion phenomenon, together with all the other bad phenomena that grow from it, lead to an isolation of those economies the capital fluxes and economical relations avoiding the gray or black areas of the world economy.

Therefore, one can conclude that tax evasion, as well as the phenomena it engenders, are factors that can lead to marginalization of a national economy at worldwide level.

Lack of consistent and long term foreign investments

This is a clear phenomenon under debate in Romania. When analyzing more carefully, one could see that tax evasion and its effects stand right behind this problem.

The saying that "good money is replaced by bad money in the monetary circle" (explained from the monetary point of view of their capitalization) one could extrapolate this idea to foreign investments.

By putting those in a "good" or "bad" category under the criteria of how they pay their taxes and analyzing objectively the conditions in which a good payer enters into competition with a bad one, we can see that the first category ha no chance to stand in a competition based environment. This is because they cannot sell their products for prices that would include all taxes as their competition sells without any taxes due to evasion. In respect of products submitted to the "special tax" obligation, this would represent even 50 of the price. This is the cause for which, excepting some strategic investors that took over important assets and who produce goods and services over which this phenomenon did not act in a serious manner (banking, communications, car production), almost every other foreign investment in Romania is represented by derisory capitals, insignificant, made only with the scope of producing tax evasion or to benefit from the legal fiscal facilities.

There are few foreign capitals that were invested in production, that tried to fight in the market products of contraband, pirated or false, that are offered by great evaders, such as tobacco, IT, beauty products and so on, big companies stopping at Romanian borders and doing investments elsewhere around. The capital investing companies complain not about the lack of absorption of the market, quite important in Romania and the surrounding area, but especially about tax evasion, the legislative hassle, corruption, abuse from State representatives. Very few worldwide investors, recognized as such, risk to enter into battle and be accused of tax evasion by State authorities, simply because of the fact that legislative ambiguities can generate abuses, or because of the fact that the non-comprehension of legal dispositions would put in danger the investment and the risk of committing tax evasion would be too important. Such a scandal, fructified by the unlawful competition, would create serious damage that would not justify the investment risk.

We consider that the evasion phenomenon should be evaluated as a whole, taking into account both its negative connotation and its impact over the multiplication of the sums attracted to the budget once the evasion was determined. The multiplier of tax evasion (considered to be the number of units attracted after discovering such evasion of a monetary unit) can be taken into account in order to cover the budgetary deficit, with all necessary precautions. At the same time, a profound analysis of evasion phenomenon is needed in order to allow the use of instruments and measures for maintaining this under control.

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Assistant Professor – PhD. Undergraduate Viorel Rotaru
Romanian-American University, Bucharest, Romania

AUDIT RISK MODEL - ACTUAL STATUS AND POSSIBILITIES OF IMPROVEMENT

Abstract: *In this work the author shall present the audit risk model recommended by SAS no. 107 „Audit Risk and Materiality in Conducting an Audit", that supersedes SAS no. 47, and being applicable beginning with audits on financial statements after December 15, 2006; this audit risk model is applied by professionals in a certain way and the author would like to present an alternative to the model by presenting the mathematical theory of evidence developed by Shafer (1976) that refers to uncertainty.*

Key words: *Audit risk models, SAS no. 107, risk assessment diminishing.*

JEL Classification: *M42*

Introduction

Risk assessments determine the scope of the auditing procedures and have important audit efficiency and effectiveness implications. This work extends prior theoretical work by soliciting component risk assessments of experienced auditors in contextually-rich experimental cases, combining the component risks for various probability-based and belief-based specifications of the audit risk model, and comparing the resulting test of details risks. Further, this research derives auditors' allowed test of details risk using a Big 4 firm's own rule for comparison with the results of those obtained from a literal application of the risk model described in Statement on Auditing Standards No 107 „Audit Risk and Materiality in Conducting an Audit" (American Institute of Certified Public Accountants 2008, AU Section 312) and from a belief-based approach.

This study also addresses prior concerns about the inability of the SAS No 107 risk model to capture additional dimensions of evidence beyond probability estimates. The findings also support, at least for one firm, claims by auditors that audit risks are not routinely understated in practice.

1. Audit risk models

1.1 SAS No. 107 audit risk model

SAS no. 107 presents an audit model that shows the relation between audit risk components, that isn't meant to be applied as a mathematic formula, but a lot of professionals use it as a mathematic formula. The audit risk model is:

$$AR = RMM \times DR$$

Or

$$AR = (IR \times CR) \times (TD \times AP)$$

Where:

AR = audit risk

RMM = risk of material misstatement (IR X CR)

IR = Inherent risk

CR = Control risk

DR = detection risk

TD = tests of details

AP = analytical procedures

The audit risk model described in SAS No. 107 „Audit Risk and Materiality in Conducting an Audit" (American Institute of Certified Public Accountants 2008, AU Section 312) decomposes the auditor's risk of incorrectly concluding that no material misstatement exists into three major components-client inherent risk (IR), client control risk(CR) and auditor detection risk (DR). SAS no. 55 – „Consideration of Internal Control in a Financial Statement Audit" clarified a twostage

procedure in which risk uncontrolled by the auditor is assessed before and after the results of tests of controls are known.

The consensus of the extant research is that this specification of the model is deficient. First, the target audit risk selected before is generally less than the actual audit risk achieved after when the target risk is used to determine the allowed test of details risk. The implication is that audit plans based on the model may not be as conservative as they should be.

Second, probability-based models fail to incorporate certain qualitative aspects (e.g., sufficiency and competence) of evidence. The advocates of probability-based inference argue that parameters capturing qualities of evidence can theoretically be elaborated within a Bayesian structure.

1.2 Firm model

1.2.1 Introduction

To date, little has been written describing actual firm practices in applying the audit risk model. Several studies have collected component assessments in experiments and combined them using specific rules from professional standards. However, there are no empirical studies demonstrating risk determinations made by auditors using firm-specific rules. Though practitioners claim to use the SAS model in a way that does not understate audit risk, this is one study that compare the allowed test of details risk derived using the SAS model with the risk derived using a firm's specification of the model.

During the past decade, audit firms have formulated applications of the audit risk model mostly based on categorical evaluations (high, moderate, low). The firm-specific model used here is the one used by the firm that provided the experimental subjects. A table associates an allowed test of details risk with several possible combinations of inherent, control and analytical procedures risk.

In practice, the auditors make assessments of very low, low, moderate or high for each risk component. Using the firm's table, they identify the allowed TD associated with their assessments. The allowed TD is combined with materiality considerations to determine the extent of substantive testing. SAS no. 107 presents an audit model that shows the relation between audit risk components, that isn't meant to be applied as a mathematic formula, but a lot of professionals use it as a mathematic formula. In that context, the author presents an example of using the audit risk model as a mathematical formula by applying the 5 percent rule, starting from the model recommended by SAS no. 107:

$$AR = (IR \times CR) \times (TD \times AP)$$

The audit risk model can be also represented as:

$$DR = \frac{AR}{IR \times CR}$$

This is how a risk model can be used for detection risk of an account:

1. The asses of detection risk at 5 percents, due to auditor's professional judgement, posible because the audit risk is assesed also at 5 percents;
2. The assesment of inherent ris at 60 percents, due to the auditor's professional judgement; this account is semnificative, the calculation is complex, a segnificant number of transactions are recorded in this account yearly;
3. The assesment of control risk at 30 percentege because the control strucuture proved effective in prior years and few misstatemens were detected with tests of control.

The detection risk is assesed at:

$$\frac{0.05\%}{0.6\% \times 0.3\%} = 0.28\%$$

1.2.2. Numerical versus linguistic expressions of uncertainty

Research comparing linguistic and numerical expressions of uncertainty can be divided into three major areas: 1) the interpretation of linguistic expressions, 2) information processing differences after receiving numerical versus linguistic information, and 3) judgment and decision differences between problems involving numerical versus linguistic uncertainties. Each of these may affect auditors' risk assessments, depending on whether linguistic or numerical assessment is

involved. Each is reviewed below. The logical conclusion after considering all three lines of research is that differences between numerical and linguistic risk assessments are likely.

1.2.2.1. The interpretation of linguistic expressions of uncertainty.

Both accounting and psychology researchers have documented wide variability in the interpretation of linguistic expressions of uncertainty. In accounting, for example, Chesley (1986) asked accounting students for numerical evaluations of a large group of linguistic expressions of uncertainty. His results showed significant variability, leading him to conclude that numerical assessments are preferable to linguistic ones. However, in a recent study of auditors and managers, Reimers (1992) found a surprising level of agreement among auditors with respect to the interpretation of linguistic expressions.

The results of several studies that investigated the cross-over points between remote and reasonably possible and between reasonably possible and probable indicate some disagreement among auditors. Even among the auditors who showed a high level of agreement with respect to the meanings of individual expressions, there was considerable disagreement about the ranges covered by the expressions used in the decision to disclose contingent liabilities.

Psychologists have studied the differences between numerical and Linguistic expressions of uncertainty much more extensively than accounting researchers. Early studies revealed a great deal of disagreement in the interpretation of linguistic expressions. Further, the variability was shown to hold even when the expressions were embedded in a context.

To summarize, prior research indicates that there is wide variability in the ways linguistic expressions of uncertainty are interpreted. Although within some homogeneous professional groups there is surprising agreement, the general conclusion from most studies is that disagreement is pervasive. The disagreement encompasses mean differences and variability differences.

1.2.2.2. Information processing differences.

Whether or not people agree on the interpretation of specific linguistic expressions of uncertainty, there exists the possibility that different cognitive mechanisms are accessed when words, rather than numbers, are used to communicate uncertainty. For example, using protocol analysis, Huber (1980) found that numerical cues in a multiattribute decision problem led to more direct comparisons (comparing two alternatives on an attribute measured quantitatively), while verbal (linguistic) cues led to more general, evaluative statements about an alternative. Stone and Schkade (1991) investigated this issue by adding manipulations concerning the number and similarity of alternatives to the manipulation of numerical versus linguistic attribute values. They found that words were associated with more alternative-based information search and less compensatory processing.

Hogarth and Einhom (1990) also found basic differences in the processing of verbal and quantitative (numerical) data. They suggested that numerical expressions result in evaluative processing, in which evidence is considered either negative or positive with respect to a hypothesis under consideration. In contrast, verbal expressions are processed using an estimation technique, in which information is integrated in a type of moving average. The moving average is adjusted in the direction indicated by the data.

One implication from prior literature is that linguistic information may require more complex processing than numerical data, possibly because a verbal expression must be translated into a number, or into a range, to be effectively processed. However, Zimmer (1983) suggested an opposite line of reasoning. He suggested that linguistic expressions of uncertainty are superior because human beings have been coping with uncertainty with language for hundreds of years and also noted that probabilities were not mathematically formulated until the 17th century. In a series of experiments, he showed that "subjects are more effective in reasoning with verbal expressions than with numerical expressions".

Zimmer (1983) also suggested that the response mode used to express uncertainty influences the kind of information used to form the judgment. Numerical risk assessments may result in more attention given to quantitative evidence, whereas linguistic risk assessments may encourage the use of qualitative information.

The evidence that linguistic-numerical differences in cognitive processing exist is important for the study of auditing judgments. If perception and interpretation were the only sources of differences, and if these differences followed consistent patterns, then audit firms could resolve any differences between the two response modes through training and scale conversion mechanisms to compensate. However, if linguistic and numerical response requirements affect cognitive information processing in decision making, then compensating for the differences may be more complicated or even impossible.

1.2.2.3. Judgments and decisions.

If there are differences in interpreting and processing numerical and linguistic information, then there may be differences in the resulting judgments and decisions. Few studies have addressed this important question. Consequently, the conditions under which a judgment or decision will be affected by the form of the incoming information or the form of the outgoing response are largely unexplored.

Again, most of the investigation in this area has been done by psychologists. Zimmer (1983) found processing differences and actual decision differences, suggesting that linguistic communication of uncertainty is preferable to numerical. In a prediction task, he found that students performed slightly better when the required prediction was requested in linguistic form. He also showed, in an abstract prediction task, that subjects' revisions were linguistically responds, compared to the more conservative revisions given by subjects when numerical predictions were required.

Budescu (1988) have done the most comprehensive work in the area. In one major study, they had subjects either rate or bid for gambles displayed linguistically, numerically, and graphically. They found that judgments resulting from numerical data were superior to those judgments resulting from the linguistic information, in that they were less variable both between and within groups. Further, he found that subjects attached more extreme values to the linguistic gambles than to the numerical ones. That is, subjects given linguistic uncertainty information gave more extreme bids--higher in the gain domain and lower in the loss domain--than subjects given numerical information.

In accounting, this research is in its infancy. Dilla and Stone (1992) investigated response mode judgment differences in auditors' inherent risk assessments. They found a slightly higher degree of auditor consensus in inherent risk judgments given numerically than in those given linguistically. They also found that auditors took longer to make numerical risk assessments than to make linguistic assessments. Their study provides the first evidence in the accounting literature that response mode may affect consensus; however, their study was not designed to assess whether the magnitudes of the inherent risk assessments were affected by response mode.

In summary, prior research on linguistic-versus-numerical information has documented differences with respect to interpretation, processing, judgment and decision-making. Much of the evidence discussed supports the notion that there are substantive differences between linguistic and numerical judgments. Based on the results of Budescu (1988), the linguistic responses should be more extreme than the numerical responses. In the context of audit risk assessments, which is in the loss domain, more extreme judgments are judgments that indicate higher risk.

In the absence of a criterion for the audit risk assessment, higher levels of agreement in one response mode or the other could be used as evidence of that method's superiority. As noted previously, in the psychology research in this area, Budescu et al. (1988) found less variability in judgments based on numerical cues. In contrast, in the existing accounting research in this area (Dilla and Stone 1992), auditors were found to have higher consensus with linguistic cues (pieces of information provided as input for a judgment) than with numerical cues, but higher consensus with numerical response representations (the decision output, here a risk assessment).

1.3. Belief Audit Risk Model

The belief function formalism is a mathematical theory of evidence developed by Shafer (1976). Beliefs and probabilities have been described as alternative languages for describing uncertainty by different authors.

Beliefs address the uncertainty of knowing what outcome occurred when the outcome is a completed trial. The chance that a completed coin flip observed by someone else and reported to be "heads" was, in fact, "heads" is not only due to randomness of coin flips. In addition, in a completed coin flip, the uncertainty about "heads" is due to imperfect knowledge of what happened. Uncertainty due to imperfect knowledge of a completed trial characterizes the auditor's situation that belief-based risk assessments in auditing warrant consideration.

A belief-based approach has attractive attributes for handling uncertainties due to shortcomings of knowledge. Beliefs incorporate dimensions of evidence in the assessment of chance, such as source credibility and sufficiency of evidence. Authors like Morton and Felix (1991) and Carmichael (1987) explored one instance of this problem in the framework of control risk assessments. They noted that the risk of errors, as defined for purposes of the audit risk model (using probabilities), lacks a reliance dimension.

Beliefs allow a portion of the outcome space to be allocated to ignorance of the outcome that has occurred. For example, due to deficiencies in the quality or quantity of evidence, an auditor could assess the risk that an error exists at 0.2, the risk that an error does not exist at 0.3, and leave the remaining 0.5 uncommitted. In contrast, probabilities require that the sum of the probabilities of incompatible outcomes in a two-outcome space sum to 100 percent. A probability of 20 percent that no material misstatement inherently exists implies a probability that there is an 80 percent chance that a material misstatement does exist. l

If the purpose of audit procedures is to remove uncertainty about whether the client's financial statements are fairly stated, the uncommitted belief part of the derived detection risk corresponds nicely to the auditor's judgment about how much uncertainty he/she can accept and still issue a standard audit report. In contrast, SAS No. 107 looks at detection risk as a probability that the auditor will not detect a material error. The latter interpretation implies that, for 10 percent detection risk, the auditor is willing to miss 10 out of 100 material errors. Conversely, under a belief approach, the auditor continues to audit until all but 10 percent of the uncertainty about the existence of an undetected material error is removed.

Beliefs have less restrictive information requirements than probabilities for combining risks. The normative combination rule for probabilities is Bayes' rule while the combination rule for beliefs is Dempster's rule.

In the two outcome space of audit risk assessments, belief may be partitioned into three parts called m-values: the belief that no error exists (ml); the belief that error exists (m2); and the belief that is uncommitted due to insufficient evidence (m3). In the audit risk model, the risks associated with each component of the model (i.e., IR, CR, AP) describe the same outcome space (is there a material error or not?). Thus, the beliefs from each component can be combined using Dempster's rule. This rule combines any sets of m-values (so long as two sets are not perfectly contradictory), and there are no requirements to distinguish priors from posteriors. In vector form, the belif based risk model at the planing stage is:

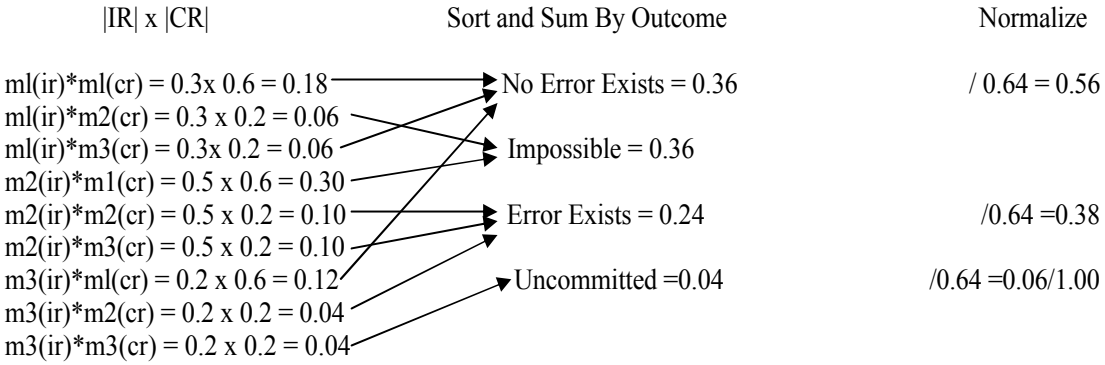
IR		CR		AP		TD		AR
m1		m1		m1		m1		0.95
m2	(X)	m2	(X)	m2	(X)	m2	=	m2
m3		m3		m3		m3		m3

The overall audit risk is fixed at 0.05, belif that no error exists to be 0.95.

To summarize, three models to derive the allowed test of details risk for planning the extent of detail testing are investigated: the multiplicative model implied by the auditing standards (SAS no. 107 model), a firm-specific model (Firm model), and a belief-function-based model (Belief audit risk model). The models vary in the conceptual nature of chance used to assess the component risks (probabilities versus beliefs) and in the rules of combination used to combine the component risks.

	Belifs	IR	CR	IR (X) CR
1	No error (m1)	0.3	0.6	0.56
2	Error exists (m2)	0.5	0.2	0.38
3	Uncommited (m3)	0.2	0.2	0.06

Illustration of Dempster's rule for combining Inherent and Control Risk



For the Belief model, auditors' beliefs are estimated from their usual assessments of the risk of an undetected material misstatement. The procedure was supported by experiments conducted to study auditor's risk assessments in untrained and belief-trained conditions 0.5

First, the linguistic assessment for each component was translated to the mid-point of the firm's range. The additional dimensions of evidence that can be captured with belief-based assessments were related to the quality of the evidence, rather than its substance. Professional Standards suggest that the auditor obtain sufficient evidence to support risk assessments. Measuring this dimension involved a straight-forward operationalization; subjects rated the sufficiency of the evidence on a scale from completely insufficient (responses will be random) to completely sufficient (no additional information desired) on a nine-point scale.

An auditor's risk assessment should be directly related to the sufficiency and competence of the evidential matter gathered. Professional Standards also direct that the auditor address the degree of assurance provided by evidential matter. The audit risk model, as defined in SAS No. 107, has been criticized for its failure to incorporate both the auditor's belief and a measure of evidence sufficiency. Recognizing this, SAS No. 55 directs that evidence sufficiency be considered in determining the assurance provided when developing control risk assessments.

2. Conclusions

2.1. Conclusions referring to the firm model derived from SAS no. 107 audit risk model.

Using several conversions of linguistic into numerical assessments of audit risk, linguistic responses resulted in categorically higher risk assessments than numerical responses. This finding indicates that different response modes have the potential to translate into different audit scope decisions when control risk is incorporated into the overall audit risk model. While the differences found in this study could be limited due to the specific cues available to subjects, the differences were consistent across a number of substantive auditing variables.

The vagueness of linguistic scales is attractive on certain dimensions. For example, quantitative assessments may communicate an unwarranted precision. Nevertheless, audit firms may want to address the potential for excessive conservatism induced by linguistic assessments. Understanding the implications of response mode choice should provide guidance for firms in the design of their risk assessment procedures.

Consensus, as measured by both pair wise correlations and coefficients of variation, was consistently higher for linguistic responses. While consensus measures often provide evidence regarding the comparative accuracy of two different methods or processes that may not be the case

in this study. Because the scales themselves may induce or diminish the potential for agreement, quite separate and apart from the issue of accuracy, this result should be interpreted with caution.

2.2. Conclusions referring to the belief model.

Beliefs incorporate dimensions of evidence associated with reliance into the assessed risk. Belief-ratios were constructed using subjects' judgments of evidence sufficiency and assurance as a way to estimate beliefs. The empirical results suggest that sufficiency of the evidence and the evaluator's judgment of provided assurance (confidence in the assessment) can be combined with the substantive value of audit evidence to assess risk.

The belief ratios varies significantly with the client risk environment for both accounts and for both the first and second assessments for accounts. This has intuitive appeal in that the reliability of identical data for judging inherent, control and analytical procedures risk reasonably might be superior in the case of a lower-risk-environment client and this dimension may be better captured by a belief-based approach.

This article shows that a belief-based approach admits an influence from the quality of evidence that is different from the mean content of the evidence. It suggests that the use of sufficiency and assurance ratings successfully captured, to some degree, fundamental aspects of a belief-based version of the audit risk model.

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Ph.D.Lecturer Raluca Sava
"Lucian Blaga" University of Sibiu

PAST, PRESENT AND PERSPECTIVES IN HUMAN RESOURCE ACCOUNTING

Abstract: *The paper starts from the premise that the added tax with which people can contribute in an organisation is emphasized by the human capital theory. The human capital consists of intangible resources which the employers provide for their employees. The sustained competitive advantage is accomplished when the company has a wide variety of human resources which can not be copied or substituted by its market competitors. These reasons lead us toward the necessity of emphasizing the importance of the use of human resources accounting as a way of identification and measuring of human resources and their performances. The paper presents the past, present and perspectives of developement of human resources accounting, dealing with the companies' internal and external motivations as well as with the international rules and standards applied for reporting.*

Key words: *human resource, human resource management, human resource accounting***,** *standards of international reporting practices*

JEL: *M41, O15, J51*

Human resource accounting (HRA) is not a new issue in economics. Economists consider human capital as a production factor, and they explore different ways of measuring its investment in education, health, and other areas.

The development of HRA as a systematic and detailed academic activity, according to Eric G. Flamholtz (1999) began in sixties. He divides the development into five stages. These are:

First stage (1960-66): This marks the beginning of academic interest in the area of HRA. However, the focus was primarily on deriving HRA concepts from other studies like the economic theory of capital, psychological theories of leadership-effectiveness, the emerging concepts of human resource as different from personnel or human relations; as well as the measurement of corporate goodwill. Likert R. (in 1960) defends long-term planning by strong pressure on human resources' qualitative variables, resulting in greater benefits in the long run. The 1960s was a period of basic academic research to develop and assess the validity of models for the measurement of human resource cost and value.

Second stage (1966-71): The focus here was more on developing and validating different models for HRA. These models covered both costs and the monetary and non-monetary value of human resource. The aim was to develop some tools that would help the organisations in assessing and managing their human resource/asset in a more realistic manner. One of the earliest studies here was that of Roger Hermanson, who studied the problem of measuring the value of human assets as an element of goodwill. Inspired by his work, a number of research projects were undertaken by the researchers to develop the concepts and methods of accounting for human resource.

Third Stage: (1971-76) This period was marked by a widespread interest in the field of HRA leading to a rapid growth of research in the area. The focus in most cases was on the issues of application of HRA in business organisations. R. G. Barry experiments contributed substantially during this stage. (R. G. Barry Corporation: 1971)

The American Accounting Association's Committee on Human Resource Accounting (1973) has defined ***Human Resource Accounting*** *as "the process of identifying and measuring data about human resources and communicating this information to interested parties". HRA, thus, not only involves measurement of all the costs/ investments associated with the recruitment, placement, training and development of employees, but also the quantification of the economic value of the people in an organisation.*

Flamholtz (1971) too has offered a similar definition for HRA. They define HRA as "the measurement and reporting of the cost and value of people in organizational resources".

Fourth Stage (1976-1980): This was a period of decline in the area of HRA primarily because the complex issues that needed to be explored required much deeper empirical research than was needed for the earlier simple models. The organisations, however, were not prepared to sponsor such research. They found

the idea of HRA interesting but did not find much use in pumping in large sums or investing lot of time and energy in supporting the research.

Stage Five (1980 onwards) : There was a sudden renewal of interest in the field of HRA partly because most of the developed economies had shifted from manufacturing to service economies and realized the criticality of human asset for their organisations. Since the survival, growth and profits of the organisations were perceived to be dependent more on the intellectual assets of the companies than on the physical assets, the need was felt to have more accurate measures for human resource costs, investments and value.

Reasons for developing HRA are :

1. *to improve human resource management*
   - HRA furnishes cost/value information for making management decisions about acquiring, allocating, developing, and maintaining human resources in order to attain cost-effectiveness;
   - HRA allows management personnel to monitor effectively the use of human resources;
   - HRA serves as a framework to facilitate human resource decision making;
2. *to offer valuable information to investors who want to know the capabilities of the human resource of the company*
   - HRA overcomes the difficulties in providing sufficient information to investors in traditional balance sheets. Investors make investment decisions based on the total worth of the organisation. HRA provides the investors with a more complete and accurate account of the organisation's total worth, and therefore, enables better investment decisions.
3. *to profile the enterprise and improve its image*
   - in a business environment where corporate social responsibility is rapidly gaining ground, HRA reflects the extent to which organisation contributes to society's human capital by investing in its development.

How to assess the economic value of human resources

Many people pointed out that it is very difficult to value Human Resources, to give different dimensions of HR costs, investments and the worth of employees. The two main approaches usually used for this are:

1. The *cost approach* which involves methods based on the costs incurred by the company, with regard to an employee.
2. The *economic value approach* which includes methods based on the economic value of the human resources and their contribution to the company's gains. This approach looks at human resources as assets and tries to identify the stream of benefits flowing from the asset.

1. The cost approach

Cost is a sacrifice incurred to obtain some anticipated benefit or service. All costs have two portions, the expense and the asset portions. The expense portion is that which provides benefits during the current accounting period (usually the current financial year), whereas the asset portion is that which is expected to give rise to benefits in the future.

Two types of costs are of special importance in HRA. These are original or historical cost, (Flamholtz, 1985; Sangeladji, 1977), and replacement cost (Flamholtz, 1985).

The ***historical cost*** of human resources is the sacrifice that was made to acquire and develop the resource. These include the costs of recruiting, selection, hiring, placement, orientation, and on the job training. While some of the costs like salaries, for instance, are direct costs, other costs like the time spent by the supervisors during induction and training, are indirect costs.

Sometimes, ***opportunity cost*** method (Hekimian & Jones, 1967), that is, a calculation of what would have been the returns if the money spent on human resource was spent on something else, is also used. However, this method is seen to be not as objective as desired. Hence its use is restricted to internal reporting and not external reporting.

The ***replacement cost*** (Likert, 1960) of human resources is the cost that would have to be incurred if present employees are to be replaced. For instance, if an employee were to leave today, several costs of recruiting, selection, hiring, placement, orientation, and on the job training would have to be incurred in order to replace him. Such costs have two dimensions- *positional replacement costs* or the costs incurred to replace the services rendered by an employee only to a particular position; and *personal replacement cost* or the cost incurred to replace all the services Expected to be rendered by the employee at the various positions that he might have occupied during his work life in the organisation.

Though replacement cost method can be adapted for determining the cost of replacement of groups, this method is used essentially to determine the replacement cost of individuals.

Other cost based methods that may be used are the **standard cost method and the competitive bidding method**. In the *standard cost method*, the standard costs associated with the recruitment, hiring, training and developing per grade of employees are determined annually. The total costs for all the personnel signify the worth of the human resources.

2. The economic value approach

The value of an object, in economic terms, is the present value of the services that it is expected to render in future. Similarly, the economic value of human resources is the present worth of the services that they are likely to render in future. This may be the value of individuals, groups or the total human organisation. The methods for calculating the economic value of individuals may be classified into monetary and non-monetary methods.

Monetary Measures for assessing Individual Value

a) Flamholtz's model of determinants of Individual Value to Formal Organisations

According to Flamholtz, the ***value of an individual*** is the present worth of the services that he is likely to render to the organisation in future. As an individual moves from one position to another, at the same level or at different levels, the profile of the services provided by him is likely to change. The present cumulative value of all the possible services that may be rendered by him during his/her association with the organisation, is the value of the individual.

Typically, this value is uncertain and has two dimensions. The first is the **expected conditional value** of the individual. This is the amount that the organisation could potentially realize from the services of an individual during his/her productive service life in the organization. It is composed of three factors:

- *productivity* or performance (set of services that an individual is expected to provide in his/her present position);
- *transferability* (set of services that he/she is expected to provide if and when he/she is in different positions at the same level);
- *promotability* (set of services that are expected when the individual is in higher level positions).

These three factors depend, to a great extent, on *individual determinants* like activation level of the individual (his motivation and energy level) and *organizational determinants* like opportunity to use these skills or roles and the reward system.

The second dimension of an individual value is the **expected realizable value,** which is a function of the expected conditional value, and the *probability that the individual will remain* in the organisation for the duration of his/her productive service life. Since individuals are not owned by the organisation and are free to leave, ascertaining the probability of their turnover becomes important.

The interaction between the individual and organizational determinants mentioned above, leads to *job satisfaction*. The higher is the level of job satisfactions, the lower is the probability of employee turnover. Therefore, higher is the expected realizable value.

b) Flamholtz's Stochastic Rewards Valuation Model

The movement or progress of people through organizational 'states' or roles is called a ***stochastic process***. The Stochastic Rewards Model is a direct way of measuring a person's expected conditional value and expected realizable value. It is based on the assumption that an individual generates value as he occupies and moves along organizational roles, and renders service to the organisation. It presupposes that a person will move from one state in the organisation, to another, during a specified period of time. In this model, exit is also considered to be a state. Use of this model necessitates the following information:

1. The set of mutually exclusive states that an individual may occupy in the system during his/her career;
2. The value of each state, to the organisation;
3. Estimates of a person's expected tenure in the organisation
4. The probability that in future, the person will occupy each state for the specified time.
5. The discount rate to be applied to the future cash flows.

A person's expected conditional value and expected realizable value will be equal, if the person is certain to remain in the organisation, in the predetermined set of states, throughout his expected service life.

The main drawback of this model, however, is the extent of information required to make the necessary estimates of the values of the service states, the expected tenure, and the probability that the individual will occupy the state for the specified period of time. However, if this information can be made available, this model emerges as one of the most sophisticated models for determining the value of individuals.

c) The Lev and Schwartz Model

According to this model, the value of human capital embodied in a person who is 'y' years old, is the present value of his/her future earnings from employment. The basic theme of Lev, Schwartz model is to

compute the present value of the future direct and indirect p*ayments* to their employees as a measure of their human resource value. While doing so, the common assumptions set by the Indian companies are *the pattern of employee compensation, normal career growth, and weightage for efficiency*. Moreover, companies adapt this model to their practical requirements by making necessary alterations. For instance, different organisations use different discount rates for ascertaining the present value of future cash flows.

This method of accounting is basically oriented towards measuring changes in the employees' value rather than employers' gains from the employees. Unless the employees' payments are directly linked to employee productivity or the company performance, the changes in the value of employees will not reflect the changes in the employees' contribution. As pointed out by Prabhakara Rao (1993) under the Lev, Schwartz model, the value of human resources will be more or less increasing, even if the organisations continuously incur losses/decrease in profitability. The attitude and morale of the employees, the contribution of the employees to the organisation, and such other factors are out of the purview of the Lev, Schwartz model.

d) Hekimian and Jones Competitive Bidding Model

In this method, an internal market for labour is developed and the value of the employees is determined by the managers. Managers bid against each other for human resources already available within the organisation. The highest bidder 'wins' the resource. There is no criteria on which the bids are based. Rather, the managers rely only on their judgement.

Along the cost approach and the economic value approach the non-monetary methods for assessing the economic value of human resources also measure the Human Resource but not in money terms. Rather they rely on various indices or ratings and rankings. These methods may be used as surrogates of monetary methods and also have a predictive value. The non-monetary methods may refer to a simple inventory of skills and capabilities of people within an organization or to the application of some behavioral measurement technique to assess the benefits gained from the Human resource of an organisation.

1. The *skills or capability inventory* is a simple listing of the education, knowledge, experience and skills of the firm's human resources.

2. Performance evaluation measures used in HRA include ratings, and rankings.

Ratings reflect a person's performance in relation to a set of scales. They are scores assigned to characteristics possessed by the individual. These characteristics include skills, judgment, knowledge, interpersonal skills, intelligence etc. *Ranking* is an ordinal form of rating in which the superiors rank their subordinates on one or more dimensions, mentioned above.

3. Assessment of potential determines a person's capacity for promotion and development. It usually employs a *trait approach* in which the traits essential for a position are identified. The extent to which the person possesses these traits is then assessed.

4. Attitude measurements are used to assess employees' attitudes towards their job, pay, working conditions, etc., in order to determine their job satisfaction and dissatisfaction.

Present in human resource accounting

About the existing regulations and standards on reporting practice

There are very few legislative requirements on the issuing of information and external reports on human resources and social performance, and those requirements refer only to financial statements in the case of enterprises or agencies. Legislative good practice initiatives are usually taken either by the EU and national parliaments or by industry and accountancy bodies.

The European Community's 4th Directive of 1978 (78/660/EEC) sets guidelines for the contents of financial statements for public or private limited companies, limited by shares or by guarantees, within the EU. The aim of the Directive is to ensure uniform reporting by enterprises within the EU, including the publication of information which influences the financial position of the enterprises. Concerning the personnel, the 4th Directive requires enterprises to provide information on their employees only regarding wages, salaries and social security costs. In most countries, these minimum requirements are supplemented by further requirements such as the employees number.

In 1991[1], the Swedish government proposed that organisations with more than 100 employees should be legally required to provide an account of personnel costs (e.g. personnel turnover, sickness leave, training and working environment) in their annual reports. Even though the proposal was withdrawn, it shows the interest of legislative bodies in this area. In Denmark, financial statements must include information on the

[1] Jens V. Frederiksen, Sven-Åge Westphalen, "*Human Resource Accounting – interests and conflicts"* - discussion paper: October 1998

average of employees' number, and the compulsory 'green accounts' (environmental reports) must include certain information about the working environment.

For companies listed on stock exchanges, the information requirements are greater; such companies usually have a wider range of owners and must therefore report more detailed information, in a uniform manner and simultaneously, to all parties outside the enterprise. In order to ensure uniform reporting for listed companies from different countries (both inside and outside the EU), audit and finance bodies around the world have established the International Accounting Standards Committee (IASC), which sets accounting standards. These standards are normally considered good reporting practice for listed companies. The IASC has issued accounting standards on the disclosure of information on Retirement Benefit Costs (1993) and on the disclosure of information on Retirement Benefit Plans (1994) and a standard on Employee Benefits (1998).

In some European countries, annual reports on government agencies are also prepared and published. In Denmark, it has been decided that all government agencies meeting certain criteria relating to size and appropriation should prepare annual reports which include detailed information on personnel and organisation, e.g. absence due to sickness, personnel turnover, overtime and additional work.

Present in human resource accounting

Accounting in general is keeping track of an organisation's affairs, records and files through systematic development and analysis of information so as to better understand those affairs, records and files or to be accountable to the organisation's stakeholders, including management. An account is a set of records of an organisation's actions or transactions.

Human Resource Accounting can be considered both an internal and an external discipline: internal as a management tool; external as a reporting tool. In HRA, human resources are viewed as assets or investments of the organisation.

HRA was originally defined as the process of identifying, measuring, and communicating information about human resources to facilitate effective management within an organisation. It is an extension of the accounting principles of matching costs and revenues and of organising data to communicate relevant information in financial terms. However, the process includes the concept of accounting for the condition of human capabilities and their value as provided by the measurement tools of the behavioural sciences[1].

The interests in HRA originate from different perspectives. The following six issues, although not exhaustive, are the ones dominating the debate, reflecting not only the potential of HRA but also the deviations from traditional demarcations within the wider economic and social context:

- the inadequacy of traditional balance sheets in providing sufficient information to potential investors
- the measurement problems associated with the valuation of intangible assets
- the redistribution of social responsibilities between the public and the private sector
- security versus flexibility in employment
- improved human resource management
- formal learning versus in-firm competences

In spite of all its diverse elements, HRA can be viewed as having two connected dimensions: the first is accounting, measuring and describing, which includes improved cost/benefit analyses of investment in human resources, notably vocational education and training; the second dimension is the policies or programmes which must be established and implemented in order to alter or improve a current situation at the level of the enterprise, the sector and society.

In establishing HRA and the consequent strategies, it is crucial to decide whether HRA is considered to be about improving balance sheets or supplementing traditional balance sheets. The former leads to a focus on measuring techniques and converting information on human resources into figures to be placed in the balance sheet, whereas the latter leads to a focus on human resource development and innovation in broader terms. These two views are not necessarily mutually exclusive, but will strongly affect the actual design of HRA and, consequently, have different levels of stakeholder involvement and consequences.

In supplementing balance sheets with HRA information, it may prove difficult to properly define and demarcate HRA in such a way that it becomes a regular concept alongside, for instance, green accounting, especially because the stakeholders have different perspectives on HRA.

Nevertheless, despite the advantages of the multiplicity of approaches to HRA in the initial phases, one of the future imperatives will be that of establishing standards of international reporting practices, even if this means adopting a minimalist approach upon which enterprises can develop individual models.

[1] Philips, 1996, p. 36.

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Ph.D. Senior lecturer Răzvan Şerbu
"Lucian Blaga" University of Sibiu, Romania
Ph.D. Senior lecturer Aniela Danciu
Academy of Economic Studies of Bucharest, Romania

ANOTHER TOOL TO SUPPORT FINANCIAL SERVICES - IN A MORE IMMEDIATE AND FLEXIBLE MANNER THAN THE INTERNET CAN AFFORD-

Abstract:*The adoption of new technologies and the improvement in human capital through knowledge have enhanced economic performance and increased factor productivity in many countries. At the same time, the fast pace at which new technologies are being developed, but also become obsolete, has profoundly changed the process of knowledge creation and acquisition, with sustained efforts being required for continuous upgrading of knowledge and virtually lifelong learning. In the end of the last century, the world economy witnessed an enormous increase in the generation of knowledge, resulting from the growth of research budgets and the availability of powerful research tools created by the rapid development. This process was supported by global opportunities, following the opening of borders to international trade and transportation and communication technologies. This paper offers the theoretical base and the pragmatic point of view about this category of mobile financial service. In the world of mobile financial services representatives from key banks and vendors are preparing for the next new gold rush for financial institutions after the rush into eCommerce services in the 1990s.*

Key words: *mobile banking, mobile payment, financial services*

JEL Classification: *G21, L81*

Juniper Research has a simple definition of a mobile payment as "payment for goods or services with a mobile device", and the definition for mobile banking is "the provision of banking services to the mobile device".

In the near future consumers will become more familiar with making payments, transferring funds and paying for bills through their mobile phones. An increase user familiarity and acceptance will be coupled with the increasing availability of mobile financial services applications and services. There are many forms of financial services and Juniper Research defines mobile financial services as retail banking services offered to customers on their mobile phones. There are two main categories for mobile financial services; mobile payment and mobile banking.

In the literature, we identify three principal processes in carrying out innovation projects: decision process (innovation strategies), executing process (organizing innovation) and diffusion process (confronting innovation and market). This innovation theory presented diffusion as a process of progressive communication between members of a social system. Referring to an epidemiologic model, the propagation of an innovation depends on the number of adopters and the importance of their communication with the rest of the population. The perception of costs and advantages of the innovations by potential adopters determines this process of diffusion. Thus, it is showed that this perception is closely related to intrinsic characteristics of innovation on the basis of which the product will be appreciated. Some authors define innovation by the existence of "creative attributes of value" .In service innovation literature, innovation is considered as a customer-oriented value creation process. Then, concepts like "innovation" and "value proposition" are dependent, interrelated and inseparable in analyzing and prospecting success factors in introducing a new product .

The capacity to engender assimilate, disseminate and effectively use knowledge to enhance economic development is crucial for sustainable growth and development, since knowledge forms the basis of technology innovations. In the circumstance of a global economy determined by technological innovations, it is important for emerging market to arrange proper foundations for building their capacity to acquire and create knowledge and technology in order to take advantage of the opportunities offered by globalization and, at the same time, to address emerging global challenges. Consequently, knowledge has become more important economically, in terms of investment in and production of knowledge-based goods and services.

Banks are now looking at mobile phones as their fifth channel to customers after branches, ATMs, internet banking and phone banking. The mobile phone is also being called the 'fourth screen' for the delivery of mobile financial services.

A combination of increased user demand and a desire from all sections of the MFS ecosystem to deliver intelligent applications and services has created an atmosphere that is both creative and pragmatic. Gone are the days when mobile operators, banks and handset manufacturers went their own separate ways and developed silo services that were bound to fail.

Mobile financial services, that include both mobile banking and mobile payment applications and services are already available in most regions in a variety of formats, and where they are being adopted, either in trial or commercial mode, the user feedback has been very favourable.

There is significant enthusiasm for mobile banking services among consumers worldwide, according to research released Sybase, the specialist in messaging interoperability and mobile content delivery. Surveys conducted in the Americas, Europe and Asia-Pacific regions are said to have shown a burgeoning demand for mobile banking among users, though this is tempered by concerns about security and lack of awareness.

Europe appears most eager to take advantage of mobile banking, with 61 percent of mobile users interested in mobile services if offered by their bank. This compares to 40 percent in Asia-Pacific, and 37 percent of those surveyed in the Americas (including Argentina, Brazil, Canada, Mexico and the US), who would like to be able to interact with their bank via a mobile device. In fact, in each of the regions surveyed, more than a quarter of respondents would consider switching banks if an alternative provider offered them free mobile banking.

Mobile banking services cater to this trend, offering the option to check account balances, transfer funds, and make payments or validate transactions, among other capabilities. Essential for the worldwide enthusiasm for mobile banking is a trend that has been coined by the survey of consumers that are managing their finances to the cent and by the minute. In Europe, 40 percent of those surveyed claim to know exactly how much money they have in their bank account at all times and 41 percent check bank balances on a daily basis.

It seems as if financial organizations are missing an opportunity by not promoting mobile banking services in an effective manner, which - given the high levels of interest among non-users - could become a lost opportunity. Mobile banking is an opportunity for banks to offer a value-added service as an incentive for new customer acquisition and customer retention, and promotion of mobile banking services will have a direct impact on consumer adoption of the technology. Of concern, nearly half (49 percent) of European respondents did not know if their bank offered mobile banking services.

Juniper Research thinks that by the end of 2008, the total transaction value for mobile payments will have reached $3 billion, and that by the end of 2011, fuelled by both physical and digital related payment, the mobile payments sector will be worth $22 billion. But the research company points out that in the overall payments market, where MasterCard alone generated $1.96 trillion in payments, mobile still looks like a niche service.

Even so, $11 billion is $11 billion and as it represents mostly new transaction value for the mobile industry, it is easy to see why there continues to be hype around the area, especially with that trillion dollar market to grow into.

There is now genuine opinion being formed that the phone really could now be on the cusp of forming a useful payment tool, for digital and non-digital items alike. But is the industry any clearer to working out how m-payment systems might be structured so that all partners are happy? And should the focus widen to included m-banking, given that many think that could be the application that unlocks the door to m-payment. A large majority of company ranked the Middle East, Asia and Central/Eastern Europe as most critical for their growth

Operators face real challenges in deciding how they will generate new revenue in a mobile payments ecosystem that could be dominated by financial services firms.

Operators will have to work collaboratively with financial institutions and other ecosystem players to build a compelling value proposition around m-payments in order to accelerate consumer behavior shift from traditional payment methods to mobile payments.

For instance, SK Telecom and leading banks in South Korea have teamed up to introduce the Moneta m-payment service, using Near Field Communication (NFC) chips inserted into mobile phones. Once activated, the mobile phone can be used as an e-money account, credit card, transit card, or membership and loyalty card. Moneta subscribers are able to hold multiple accounts from different issuers on a single mobile device (i.e., mobile wallet) powered by SKT.

The SKT Moneta service exemplifies a collaboration model between a mobile operator and financial services firms. Credit and account issuance is performed by the partnering banks, and payments are processed through the existing Visa and MasterCard networks. SKT develops new payment applications and is responsible for rolling out new POS readers to merchants. For those investments, SKT earns a portion of the transaction revenue from the payments.

For mobile operators it will be good to start working very closely with leading financial institutions and retailers to design an m-payments strategy that is aligned with the interests of the required partners to deliver a compelling value proposition and experience to m-payments users.

A survey conducted by Juniper Research shows a significant increase in activity across the advanced payments sector in Europe. Advanced payments enable consumers to transact through a variety of non traditional devices, such as their mobile phone, contactless cards and the internet. The survey encompassed 30 of the leading European new players and ventures in this fast growing industry, companies with an expertise and specific focus on advanced payments.

The survey found that 57% of companies in this sector expect to see strong growth over the next 12 months. Respondents were very confident that the advanced payments industry will make significant progress in 2009. This could be attributed to the increasing sophistication and cost effectiveness of the technology involved. This is particularly true of mobile phones, which the survey highlighted as the next big development in payments technology.

In developed countries, the industry in the near term will focus on competing for the most compelling contactless card payments solutions as well as mobile banking solutions. In contrast, contactless mobile payments will take a much longer time to evolve as they will require collaboration between banks and telecom operators.

Frequent announcements of new propositions and new trials, often launched by new non-traditional players, make this a confusing market to assess at present. The diversity of new players in this industry is highlighted in the report. Examples include Margento, a Slovenian company, offering a mobile payment system which requires no software or hardware change to the handset, and LUUP, a Norwegian company launched in 2002 enabling customers to pay, send and receive money via their mobile phones including international and domestic money transfers.

Europe's fragmentation means a lot of 'pretenders' are pursuing a niche strategy at present focusing on a particular geography, proposition or customer segment, and to a certain extent it's land grab time. However, lack of common standards implies that future profits are limited. In order to be successful, the players in the industry will need a sophisticated strategic marketing capability, a workable business model and clear approaches to interoperability. The winners will be those who can break out of their segments and constraints."

Taiwan for example is the first country in the world offering mobile debit and credit card services based on NFC. Of course, Taiwan has a head start over many other countries because contactless payment, with services from Visa and Mastercard, is already available and largely deployed in Taiwan - meaningt here is no need to deploy new contactless readers in points of sales specifically for NFC, and consumers are also already familiar with using contactless payments.

One thing that may boost consumer confidence in mobile payment could be increasing trust and usage of mobile banking. Here there are several initiatives. In Turkey, the country's biggest bank IsBank has just announced the launch of its mobile banking application "IsCep", which was developed in partnership with Turkish mobile technology firm Pozitron.

The "IsCep" (which means IsPocket) application uses Pozitron's java-based technology, and can be downloaded to a wide range of handset devices. Once customers sign up online for the service, they are able to download the mobile banking application along with "Is Bankasi" icon to their personal devices. Through the graphical interface of the "IsCep" application, clients are able to access their accounts, check account balances, transfer funds and exchange currencies. The service also covers investment inquiries and credit card payments.

"There are more than 2.2 billion mobile phones in the world. Turkey has more mobile subscribers than fixed-line. Additionally Internet penetration in Turkey is still limited. However, the potential of internet access through mobile phones is even bigger than the PCs due to widespread use of GSM technology. We believe that this solution will also benefit customers who have limited internet access and who are willing to do online banking. " says Pozitron CEO Fatih Isbecer

The "IsCep" application is also signed and Java verified by the UTI (Unified Testing Initiative). UTI's member companies are Motorola, Nokia, Orange, Samsung, LG, Sony Ericsson,Vodafone and Sun Microsystems.

The global advanced payments market is evolving fast and undergoing strong growth. However, we expect that many of these new species will have to be especially fit and strong to survive. Right now, it is unclear who the most profitable players in the industry will be, which makes this an exciting sector to watch.

One company looking to bridge the gap between the financial services world and mobile operators in the UK and Europe is Monitise, Rather than being merely a hook up between a particular bank and operator, Monitise's service is designed to be compatible with any bank or mobile network and is, it is claimed, available on 95% of the handsets currently available in the UK. The services connects directly into financial institutions using their existing payment processing connections, and is built on international banking standards.

Monitise has just announced a new range of functionality to be available this year. These include the ability to manage multiple accounts - including bank accounts, credit and pre-paid cards and loyalty card schemes - from a single application and a full range of payment services - including inter-account and peer to peer transfers, bill payment and international remittances. SMS alerts will also be available for weekly balances, accounts nearing their limit or notification of potentially fraudulent transactions. The system also introduces two-factor authentication for internet banking - providing an additional layer of security, through the use of unique passcodes and instruction confirmation to protect against internet fraud and secure payments transactions conducted online

The strength of this mobile banking and payments service is its ability to connect previously disparate functions into a single system, in turn delivering a consumer friendly application. Already we are seeing the number of transactions per user increase, as consumers habitually use the service as part of their daily routine. All of our research suggested that consumers wanted to start with basic and simple-to-understand services, such as balance enquires, mini statements and mobile phone top-ups."

Whether in a niche area such as web payments, or across the potential, m-payments and m-banking field, the keys are going to be useability and trust, and the business relationships between operators, merchants and financial services companies.

A couple of companies are seeking to branch out into Europe and the USA with an application which it says can re-launch banks' and mobile operators' appetites for mobile banking. Banks need to more actively promote mobile banking services by highlighting the benefits to their customers. There are a number of consumers likely to welcome another tool to support their financial fastidiousness in a more immediate and flexible manner than the Internet can afford.

Once banks realize they can control what is delivered, and how, and that they can use the mobile channel to differentiate themselves, and integrate it into their marketing and customer service functions, we could be looking at the next stage of development for mobile banking, an area that has often promised much and delivered little to date. It is importantly, that mobile operators can see the value of supporting mobile banking, not just through increased data and text revenues, but because anything that builds up trust around the mobile phone and money will be good for the operators.

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Ph.D.Titus Serediuc
"Romanian – German" University of Sibiu, Romania

THE FINANCES TURBULENCES ON THE REAL-ESTATE MARKET AND ITS ECONOMIC IMPLICATIONS

Abstract: *Undoubtedly, the strong oscillations on the real-estate market reflected on the financial-banking level, too, respectively on the banks' ability to handle the shock,* ***the boom****, oscillations created by the subjective, but especially by objective reasons, and which are harder to be handled. This situation is notable in the north-American, English and E.U. real-estate market, and less notable in the Romanian economic space, so far.*

As it is well-known, between august and September, 2007, but also in the following months, the USA financial-banking market in the real-estate segment faced a terrible recoil (see Business Standard, no. 90\2007), having as consequences the stagnation and even the decline of the profile activities, which raised serious question marks about a possible crisis. The entire financial-economic spectrum in the north-American space was the first one affected by this real-estate crisis, followed by the profile markets in England and Germany, therefore, the shares of the Northern Rolk English Bank, specialized in real-estate credits, faced serious go-downs, making Great Britain's government to announce that it no longer guarantees the storage costs for the respective bank starting with the 19th of September, 2007.

On the one hand, under the theoretical aspect, this decrease was determined by the extremely low economic-financial performances of this bank, reflected as so in the banking documents, and, on the other hand, because of the caution level theoretically and existentially reflected in Great Britain's financial-banking system. In Germany, the well-known Deutche Bank A.G., due to the registered losses on the highly risky loans segment, admitted its mistakes made before the so-called boom period of the real-estate-real-estate credits, among which stopping the process of new personnel hiring.

On a wider view and noticing the so-called top of the iceberg, we understand that the banks have been the only losers on the real-estate market and the important real-estate companies, together with those who produce construction materials, met serious decreases of their turnover, implicitly of their profit. Theoretically analyzing the situation, we are dealing with a serious decrease of the financial flows, a slowing down of the economic growth, the banks being more often asked whether they should continue with the same banking policies, or they should change them. As it is well-known, this signal is addressed to the banks in the USA economy, as the banks, knowing by intuition and even realizing the high profit figures of the real-estate companies, applied successive increases of the interest rate on the respective segment from 2% to 5,25% between a period of 2-3 years. Moreover, the USA's Federal Reserves tried to keep a constant interest rate, in order to maintain the index for economic growth. The initial scenario was rapidly assumed by the banks and the real-estate investment financial institutions from abroad, namely from Great Britain and Germany.

%

E.U	Hungary	Switzerland	U.K	U.S.A.	R.C.B
4	7,5	2,5	5,25	7,75	7,5

This description could have remained not without consequences: the real-estate investment companies by real-estate-hypothecary loans, have sold relatively easily lands, houses and buildings… easy to be sold, and gained important profits, with a high level of endurance for the loan, leaving the banks with significant mortgage packages. These were not safe as they have initially been considered, since the banks were not that highly specialized in the field as the profile companies. We must underline the fact that the respective transfer was a concentrated and correlated action of the real-estate investment companies, an action apparently not known by banks, as banks had the opportunity to react, but they chose not to. Undoubtedly, this was a coalition movement, which is punished when noticed by the legislation in the field on a worldwide scale, but in this case, since the national profile institutions have not noticed these facts, did not react in any way, as they have not been even informed, the banks being the only ones affected. We underline the fact that not even the most representative banks in the real-estate-hypothecary segment did not show an adequate caution, - when the phenomenon started to take proportions, they should have given the information to the national control organizations concerning this

market, but probably the banks' rightful behaviour towards the real-estate companies has not necessarily been the adequate one, and therefore they did not call for the profile legislation to be applied.

Therefore, the banks and creditor profile financial institutions found themselves with enormous real-estate assets, mortgaged, with which they did not know how to handle, at first. It has been tried to diminish those real-estate dimensions, but these attempts did not have as a result big profits, not even at a medium level, which determined the banks to rethink their credit policy about the real-estate and mortgages. It might have been a joint action of the real-estate companies, long before thought of, we can not state for a certainty this, but the fact is that banks could not find solvent clients for the enormous real-estate properties, in a reasonable period of time. Once again, it has been proven that the high level of specialization of the real-estate companies is impossible to be changed by introducing certain bank-like practices, even if the respective financial institutions have a certain experience in the field. Finding themselves in front of this situation and thinking over their credit policies, the banks resorted to a very important theoretical and practical element, that is the ***banking innovation.***

The first sign, the first attempt of reconciliation on the market was from the same banks that generated it, more specifically the banks in the USA, by launching the product called the fixed interest hypothecary loan for a medium period of time (5 years), followed by the oscillating interests, generated by the financial-monetary market. Therefore, a first protecting umbrella appears, offered by the banks to the real-estate companies, a very rare thing to happen, and for short periods of time. Moreover, because of a stagnation in house building for young people on the North-American territory, the USA president himself promised to re-launch the profile investments from the real-estate companies (e.g.: The Money Channel Show in November, 27th, 2007 – Briefing). This reveals a concern from the state institutions' part, the message relying upon analysis from both sides of the business partners, finding a way out of the dilemma being no longer exclusively private, because of the existence of sore implications for the public sector, that of the social-governmental policies. Could it be a new protecting umbrella, still favouring the real-estate companies! Or we shall be facing, in the near future, and immediately after re-launching the real-estate sector, a new proportioning of the banking strategies, in order to rebalance positions, considering that, at the moment, real-estate companies have a real advantage on the market, sustained also by the state. We consider that things will develop according to the banks' and real-estate companies' management; there will be no more disturbances if the management of the above-mentioned economic entities is competitive. Moreover, if the banking management in the real-estate sector continues to specialize in the field, and there is no other obvious intention to favour a specific economic sector, we shall see rebalances on the profile market – it is well known that one of the economy's laws states that the state must not interfere in the economy.

In the Romanian economy the first signals began to appear later, compared to the well-structured economies, when the antidote to the phenomenon has already been found, and, under this theoretical aspect, we mention L. Croitoru's statement – RCB's governor's counselor, who stated in Business Standard no. 26/2007, when asked about the phenomenon, that: credits (the real-estate ones, more specifically), have gradually been excluded from banking balance sheets and the bank's surveillance must be more delicately expressed. Without a doubt, we are expecting new exigencies as far as the wording is concerned and with which the commercial banks in the banks will have to deal with. We do not foresee an increase of the management-banking exigencies in the risk management field, different from the ones mentioned in the Basel II Agreement (RCB's Decree, no. 6\2007). I personally consider that the rise of the reference interest is more like a caution measure for the hypothecary loans, but which will suffocate the real-estate companies' financing in the future, and the result on the market will be continuation of the land and houses' rise in the price trend in towns.

Conclusions: Once the real-estate crisis is set, it can be stopped and its sore effects softened, but the existing unbalance in favour of the real-estate companies – the banks acting in this profile will not wait – they will rebalance the risk in the near future and a wider competition between the two actors in the field, everything generated by the consistent profits accounted in this sector.

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Antoneta Simen
„Lucian Blaga" University of Sibiu, Romania

EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT OFFICIAL CO-FINANCING

Abstract: *Through its activity, EBRD has the rol of a catalyser in attracting investment in the country where it operates. This is achieved by the guaranty which is given on one hand by its involvement in certain areas considered quite risky and on the other hand by co – financing with other banks or investors. Through this co – financing, the EBRD has averagely succeed a leveraging effect on the amounts invested and this tends to increase if there is noticed a larger involvement of the commercial banks on the market and a decreasing of the importance of international institutions and governments.*

1. Introduction

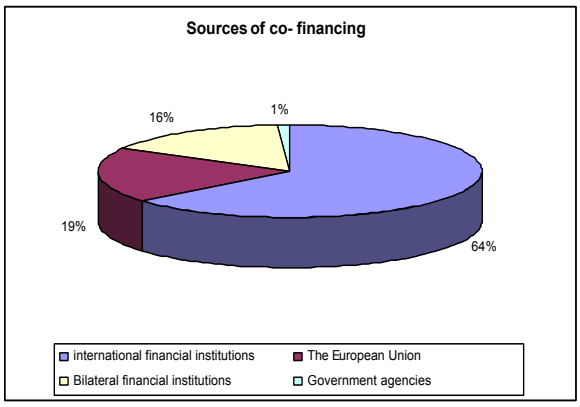
In conformity with the Agreement which created it, EBRD considers that is very important to encourage the commercial banks or other financing sources to participate in its operations and, in this way, the total mounts invested in the countries where it operates increase.

The sources of official co – financing are:

- International Financial Institutions: European Investment Bank, European Investment Fund, International Financial Corporation, Nordic Investment Bank, Nordic Environment Finance Corporation. They provide finance projects in the banking, micro finance, telecommunication and manufacturing sector. Funds are provided mostly in form of loans and equity
- The European Union provided co- financing through the EU Phare and Tacis programme and the Instrument for Structural Policies for Pre-Accession (ISPA). Most funds are in form of grants to support municipal environmental and infrastructure
- Bilateral financial institutions: Deutsche Entwicklungs Gesellschaft, FinnFund, Netherlands Development Finance Company, Swedfunf. Bilateral financial institutions co financed projects focused mainly on supporting micro, small and medium-sized enterprises, trade facilitation, telecommunication and manufacturing.
- Government agencies from Finland, Germany, Italy through the Local Enterprises Facility for the Western Balkans), Sweden (the Swedish International Development Cooperation Agency), Switzerland and the United States (US Millennium Challenge Corporation). The funding is in the form of grants and supported trade facilitation, infrastructure, micro and small business and equity finance.

In the last years the Bank's largest official co-financing partner was the European Investment Bank (EIB) with a contribution of 822 million euro. Many projects have been directly co- financed by BERD and EIB. The contributions of these agencies over the past nine years (1998 – 2007) are shown in the next chart:

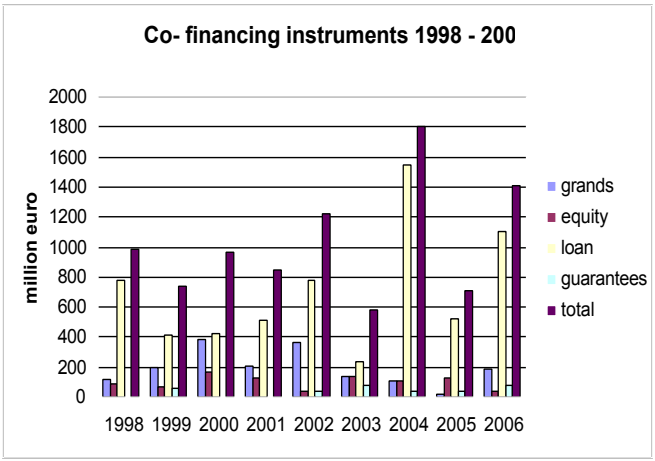
Chart: 1



The main forms of co - financing are: parallel loans, equity, investment grants, loan participation and guarantees. In 2006, co – financiers provided parallel loans of 1100 million euro, 82 million euro in equity

and investment grants of 192 million euro. The chart 2 shows the composition of official co- financing instruments since 1998.

Chart: 2



Investment funding provided by official co financiers was mainly in the form of loans. Investment grants are important in project implementation. The main sources of grant co – financing are: the European Union, and government agencies (the Swedish International Development Cooperation Agency, The Swiss State Secretariat for Economic Affairs for district heating system in Iasi, Romania).

2. Co – financing by parallel loan

Co –financing by parallel loan represents the most spread form, as it is very flexible and it can satisfy the requirements of any country. By this procedure, every co- financer is in direct relationship with the beneficiary and sets specific loaning and guaranty conditions, which can lead to multiple arranging variants.

The role of EBRD is that of main co – financer. The bank must find the other co – financiers and support the borrower in closing the loan agreements. To attract co- financiers, EBRD can facilitate guarantees or other rights, similar to the ones received. Flexibility consists in the fact that the two loans can be made in different conditions, as independent agreements or mutually conditioned loans, more precisely any failure of the contractual conditions by one of the side becomes automatically and equally failure by the other side too and, vice versa, any advantage granted to one of the sides is considered valid for the co – financing part too.

There is a case of co –financing when the co – financier is an agency granting for export loans. These agencies grant guarantees to the exporting enterprises for the supplier loans granted to the beneficiaries of investments on condition that the supplies should be made only from the firms in their countries. In other cases, the commercial banks are the ones granting the loans and the agencies guarantee them. No matter what variant is chosen, the relationships are established only between the loan beneficiary and the agency. These types of co- financing have extended in the last years due to the governmental policy of the developed countries for encouraging the export by facilitating it.

3. Co –financing by syndication

A syndicated loan is a large loan in which a group of banks works together to provide funds for a borrower. There are two groups of lenders in a typical syndicated loan deal. The more senior group consists of a small number of banks chosen by the borrower – usually from among its existing relationship banks – to put the deal together. These banks, usually known as arranger or lead managers, are responsible for restructuring the loan facility, including negotiating the pricing an terms and conditions. Most of the banks in this lead group would be involved in funding the loan and in larger deals, also responsible for underwriting and marketing the loan to other banks. This second group of junior participants simply provides funds for the loan. In addition to helping arrange the deal, one of the lead banks will usually acts as an agent, administering the loan after its execution and managing the ongoing relationship between the syndicated members and the borrower. The borrower could be a corporation, a large project, or sovereignty (such as a government). The loan may involve fixed amounts, a credit line, or a combination of the two. Interest rates can be fixed for the term of the loan or floating based on a benchmark rate such as the London Interbank Offered Rate.

The main goal of syndicated lending is to spread the risk of a borrower default across multiple lenders or institutional investors like pension's funds and hedge funds. Because syndicated tend to be much larger than standard bank loans, the risk of even one borrower defaulting could cripple a single lender. Syndicated loan are also used in the leveraged buyont community to fund large corporate takeovers with primarily debt funding.

Syndicated loans can be made on a ‚best efforts'' basis, which means that if enough investors can't be found, the amount the borrower receives will be lower than originally anticipated. These loans can also split into dual trenches for banks (who fund standard revolves or lines of credit) and institutional investors (who fund fixed rate term loan). Syndicated credits are a very significant source of international financing, with signings of international syndicated loan facilities accounting for no less than a third of all international financing, including bond, commercial paper and equity issues.

Investment special funds

EBRD investment special funds are an important source of official co financing. Grants made available through the special funds support micro and medium – sized enterprises through local financial intermediaries and risk – sharing participations in the Trade Facilitation Programme. Investment special funds are used to support the upgrade of municipal environment services and the rehabilitation environmental infrastructure. The main beneficiaries of this type of grant financing are: regional programmes such as the Trade Facilitation Programme in central and south – eastern Europe and Central Asia; Micro businesses and SMEs in Azerbaijan and Georgia benefiting from financing provided by International Cooperation and Development Fund and through the EBRD Financial Intermediary Investment Special Fund; early transition countries facing post reconstruction challenges.

At 31 December 2006, EBRD administrated 11 Investment Special Funds. The objectives of the Special Funds are as follows:

- Russia Small Business Investment Special Fund assists the development of small businesses in the private sector in Russia
- Financial Intermediary Investment Special Fund supports financial intermediaries in the country of operations of the Bank
- Italian Investment Special Fund assists the modernisation, restructuring, expansion and development of small and medium- sized enterprises in certain countries of operations of the Bank
- SME Finance Facility Special Fund alleviates the financing problems of SME in Bulgaria, Romania, Latvia, Slovenia and Slovak
- Balkan Region Special Fund assists the reconstruction of Albania, Bosnia and Herzegovina, Bulgaria, Romania, Serbia, Croatia, etc
- EBRD SME Special Fund assists the development of SME in Albania, Armenia, Azerbaijan, Bulgaria, Croatia, Georgia, Moldova, Romania, Serbia, Ukraine
- Central Asia Risk Sharing Special Fund provides a risk sharing facility for SME credit line, micro finance programmes, the Direct Investment Facility and the Trade Facilitation Programme
- Municipal Finance Facility Special Fund alleviates the financing problems of municipalities and their utility companies for small infrastructure investments
- Regional Development Initiative Programme Special Fund provides a long term contribution to sustainable socio- economic development across Azerbaijan and Georgia
- Romania Micro Credit Facility Special Fund improves access to finance for micro and small enterprises in Romania
- Accounting convention – Investment Special Funds.

The EBRD is one of the largest investors in Romania, having invested 3, 6 billion euro in over 230 projects and helped mobilise additional 6,4 billion from other sources.

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Lect. univ. dr. Cristian Socol
Lect. univ. dr. Marius Marinaş
Asist. univ. drd. Aura Gabriela Socol
Academy of Economic Studies of Bucharest, Romania

THE COMMON MONETARY POLICY – DECENTRALIZED FISCAL POLICIES MIX FOR THE EUROZONE

Abstract: *This paper is about what can be improved in the policy system of the Eurozone. It focuses on current challenges and makes proposals for change. The processus like fiscal discipline and policy coordination are the pillars for the new european model. What are the channels of policy interdependence in a monetary union? How should the policy system be designed to deal with externalities arising from this interdependence?*

Key words*: european model, coordination, monetary policy, fiscal policy*

JEL Classification: E61, F42

The introduction of the European model within the third integration stage – The Economic and Monetary Union – has made a change in the modality of conceiving the macroeconomic policies. There has been a transition from the "one for one" principle to the "one for all" principle. Within the Eurozone, all the member states may share both the benefits and the costs of a common monetary policy, which has to be combined with the national fiscal policies, elaborated by each state member to the zone.

The price stability, a low interest charge, sustainable public finances, the external equilibrium represent all benefits for the countries member to the Eurozone.

Referring to the Eurozone, there can be defined two types of coordination regarding the monetary and fiscal policies: the budgetary policies / monetary policy coordination between all the countries included in the Eurosystem (The European Central Bank + the central banks of the countries member to the Eurozone) *and* the coordination between the national budgetary policies of the countries member to the zone.

The relationship between the two macroeconomic policies may be analyzed from three points of view:

1. *on a long term, the monetary policy affects only the inflation rate (nominal variables) and the fiscal policy determines the degree of indebtness, the role and the importance of the public sector, the level and the structure of fiscality (and, through all these, the real variables)*

For example, let us consider the long term interaction between the monetary policy and the fiscal policy (in the case of two states which are member to the Eurozone). For the analysis, we use the Aggregate Demand AD – Aggregate Supply AS model. The AS curves are vertical for both countries and they are represented at the level of the potential GDP. We also suppose that the two countries have the AD and AS curves.

On a long term, The European Central Bank (ECB) can establish a certain level for the inflation rate for the entire area which forms The Economic and Monetary Union, without affecting the production level in neither of the countries and nor for the area as a whole.

Taking into consideration this target of The European Central Bank, a modification in the government expenses in one of the two countries influences the relative output, the prices and the distribution of production between the public sector and the private sector, but not the GDP level on a long term. The occurrence of a shock upon the Aggregate Demand in one of the countries, such as the increase of the taxes which distorts the financial system moves the AS curve to the left both for that country and for the entire monetary union. Nevertheless, The European Central Bank will react to this impulse (by increasing the interest charge), without modifying the output in another country member to the monetary union. Thus, it can maintain the same inflation rate without long-term consequences on the output of another country (figure 1).

The graphic analysis shows us that The European Central Bank – through its monetary policy – can obtain price stability on a long term without interfering with the fiscal policy, and the national governments can choose the extent of the expenses and of the taxes according to the national preferences. Thus, besides

the imposing of a constraint related to the budget deficit on a long term, it is not necessary to coordinate the common monetary policy with the decentralized fiscal policies of the member states.

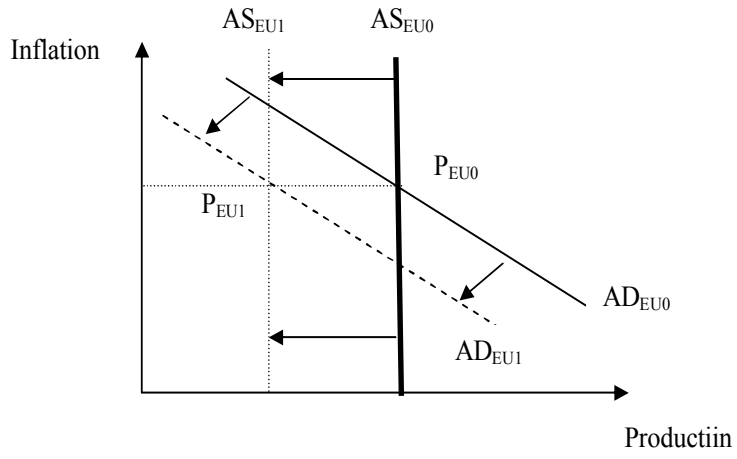

Figure 1 **Common monetary policy - national fiscal policies – a long run approach**

2. *on a short term, if The European Central Bank owes the complete control on the interest charge of monetary policy, we cannot say the same thing about other variables which provide the transmission of the effect of the monetary policy – the rate of exchange or the interest charge on a long term – which are influenced by the fiscal policy*

For example, let us consider the AD – AS model presented above. On a short term, the wages are rigid and the unexpected modifications of the prices have effects on the real output. The curve of the Aggregate Supply AS has a positive slope. The European Central Bank can determine the equilibrium interest charge and the level of the Aggregate Demand for the entire union.

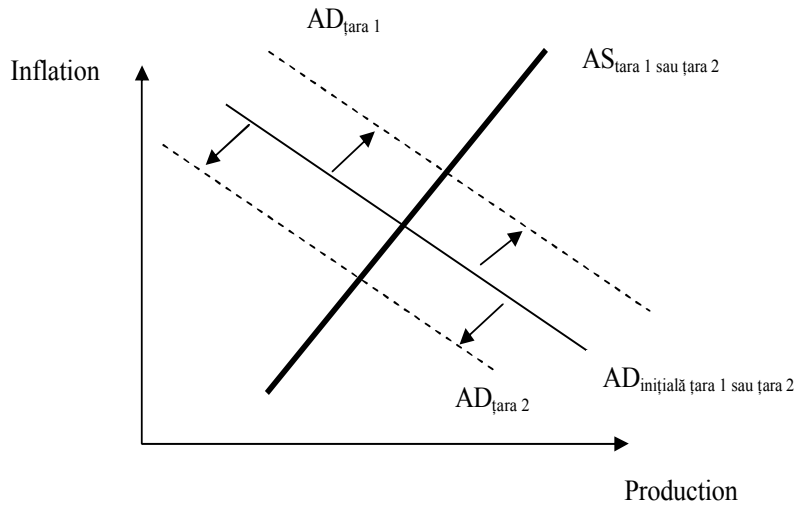

Figure 2 **The common monetary policy – national fiscal policies conflict - a short term approach**

Now, let us suppose that the Government of the first country wants to increase the output level by increasing the government expenses and thus, the budget deficit. The Aggregate Demand will get increased in that country, as well as the Aggregate Demand of the entire union. Inflationary pressures will appear. ECB will increase the interest charge of monetary policy in order to limit the inflation to the target level, thus taking the straight line of the Aggregate Demand AD back to the equilibrium point. But, by increasing the interest charge, the straight lines of the Aggregate Demand for both countries will move towards the left. The Aggregate Demand for the entire union will remain at the same level as the initial one, but the Aggregate Demand is higher in the case of the first country and lower in the second country (figure 2). Thus, there

occurs a conflict between the common monetary policy, at the union level, and the different fiscal policies, nationally founded. Depending on the slope of the AS curve at the level of each of the two countries members to the union, this interaction between the policies determine the level of the Aggregate Demand AD for the entire union and the way of distribution for this Aggregate Demand between the two countries. The inflation rate in the union is determined by the aggregate level of the output at equilibrium (*Von Hagen, J., Mundschenk, S,* 2002).

How can this conflict be solved?

a) If the Central Bank does not tolerate any deviation form the target regarding the inflation rate and it reacts to any modification of the union's Aggregate Demand, then the AD_{union} straight line will remain at the same level, being horizontal (figure 3). Thus, the national fiscal policies will have a conflictual effect of distribution for the demand (any deficit increase in a country will avoid the demand in other country). If the two involved countries do not recognize this conflict, they will try to increase the government deficit in order to reach the objectives related to the output. The public debt will get increased in both countries. On these conditions, the coordination of the fiscal policies is obvious for preventing the externalization of the consequences of the increased budget deficits.

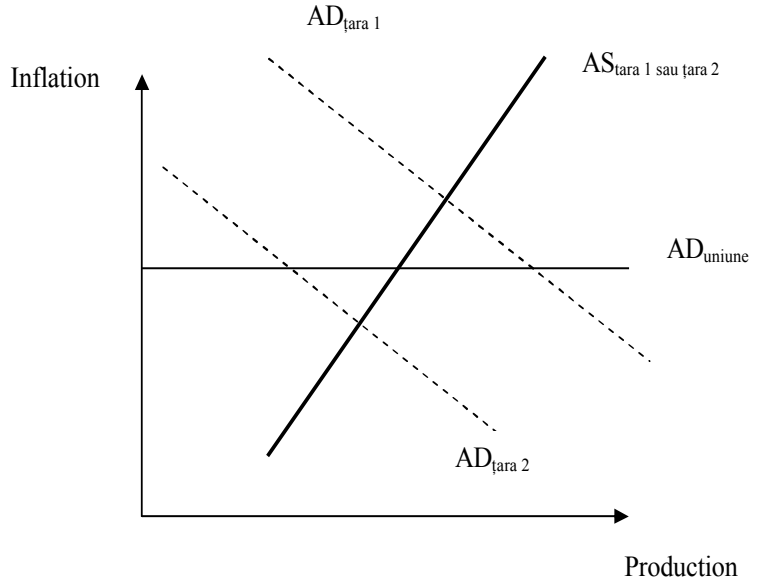

Figure 3 **The short term solving of the common monetary policy – national fiscal policies conflict. The need for coordination of the fiscal policies**

b) The European Central Bank tolerates deviations from the target level regarding the inflation rate, on a short term. Thus, the Aggregate Demand AD has a decreasing slope and it can be influenced both by the common monetary policy and by the national fiscal policies. Thus, a strong competition will manifest between the two countries with respect to the decreasing of the negative distributional effects and the obtaining of a low inflation rate. On the other hand, there is an obvious competition between the governments of the two countries and the Central Bank in order to determine the Aggregate Demand level of the monetary union. The governments fight for a strong increase of the Aggregate Demand in order to reach the desired level of the output and The Central Bank reacts by increasing / decreasing of the interest charge in order to obtain the inflation rate. The result is a combination between a "tight" monetary policy and restrictive fiscal conditions. Again, the cooperation between policies is necessary in order to develop a mix which leads to low interest charges and low deficits. The monetary and fiscal policies are completely interdependent when referring to the aggregate level of the output.

The analyses concerning the efficiency of the macroeconomic policies demonstrate that *the fiscal policies limitation to the action of the automatic stabilizers does not solve the problem regarding the policies coordination in the Eurozone.* **An active budgetary policy is necessary** (*Von Hagen, J., Mundschenk, S,* 2002).

Nevertheless, the government's choice in the field of the budgetary policy has to be made according to the preferences revealed by the results of the choices. The choices often prove to be difficult or inefficient. Let us give two examples:

a) If the degree of indebtness and the budget deficit are high, unsustainable and induce an exponential evolution of the debt and of the interest charge, the contra-cyclic policy or even the neutrality budgetary policy may be inefficient (because the snowball effect produces Ricardian equivalence effects and render the multiplier inoperative).

b) Within the Eurozone, because the interest charge is identical for all the countries in the area, it is efficient to complete the general action of the monetary policy with an active and contra-cyclic budgetary policy.

Depending on the existence of the political, economical and social constraints, the stabilization fiscal policy has to conciliate the relative weights of the main objectives related to the stabilization policies. These objectives are as it follows:

– Minimization of the conjunctural unemployment or of the production gap

– The price stability and the minimization of the variations in the budgetary costs related to the long term objectives (when referring to indebtness).

The budgetary policy is also founded according to the interest charge and, thus, according to the monetary policy. If the budgetary policy is neutral, the result will be the same objective as that in the Taylor rule, meaning that the GDP gap and the difference between the inflation and the rise in prices.

3. On a medium term, the level of the output and of the inflation rate results from the mix of the monetary-budgetary policies.

The interdependences between the monetary policy and the fiscal policy are numerous on the short (less than a year) and medium (from a year to three years) terms. These interdependences show that the process of coordination between the monetary policy and the budgetary policy is necessary. Nevertheless, there are several difficulties in the process of coordination between a single common monetary policy and 12 decentralized fiscal policies:

a) Technical difficulties:

- The monetary policy has a high internal lag and a low external lag (1 year – 3 years) and the fiscal policy has a high internal lag and a low external lag.
- The monetary policy has a slow reaction time (1 – 3 years), rhythm which corresponds to the cyclic fluctuation of the GDP and of the Inflation rate.
- In the case of the budgetary policy the delay gap is low (less than 1 year). Moreover, the effects of the monetary policy can be well estimated, process which does not occur in the case of the budgetary policy. The effects of the budgetary policy on the variables which represent an interest for the central banks (interest charge and rate of exchange) are less known.
- A coordination process based on an incomplete knowledge of the transmission mechanism is contra-productive.
- It is efficient to act with the monetary policy as a stabilization policy. It shows that the fiscal policy is necessary only when the monetary policy instruments have been exhausted.
- There is a break between the objectives of the monetary policy, which are easier to reach, and the reaching of the objectives of real economy growth.
- The rules imposed to the countries which join the ERM III are much more drastic than those imposed to the countries when they exit the system.

b) Political difficulties:

- They refer to the conflicts of interests between the Government and the Central Bank. The government institution confers importance to the decrease of the GDP gap, of the occupation etc. being under the „magnifying glass" of the public opinion, and The Central Bank has as exclusive objective the decreasing of the inflation rate.
- We may assert that the public debt is the long term consequence of the Government's action.
- The Central Banks always consider that an increased public debt represents the source of instability for the financial markets and for the rate of exchange, which are the transmission channels of the monetary policy at the same time.
- The Government is not interested in the Ricardian equivalence (the higher public debt will be paid by the future governments) but it is more concerned with the current GDP and the occupation degree.

- It is impossible to make efficient consultations between The European Central Bank and 12 national governments. There is an institutional „deafness" which is not favorable for frequent and open consultations (these are made only within the formal system of the Eurogroup, between the ECB President and the President-in-office of the Council of Economy and Finance Ministers).
- Because there is the principle of bi-annual rotation for the European Council Presidency, it is obvious that a solid communication cannot be achieved within 6 months, between the representatives of the Government and those of the ECB. Moreover, article 108 in the Treaty clearly shows that ECB cannot develop informal consultations with any of the communitary institutions.

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Lecturer drd. Alina Solovăstru
„Dimitrie Cantemir" University of Tg. Mureş, Romania
Lecturer drd. Mircea Solovăstru
Medicine and Pharmacy University of Tg. Mureş, Romania

THE BANKING CONSOLIDATION DIRECTIVE

Abstract: This summary of the basic scope of the Banking Consolidation Directive ("BCD") highlights the following key features of the Directive under witch it is intended to create a single market for banking services in the EEA and on which this chapter focuses:
(a) the requirement for the business of credit institutions to be subject to authorization and a prohibition on carrying on the business of a credit institutions without authorization; and
(b) the concepts of mutual recognition, home country control and the single banking license (or " passport").

Introduction

Directive 2000/12/EC, retying to the taking up and pursuit of the business of credit institutions, is the principal Community instrument coordinating banking activities in the European Economic Area ("EEA"). The Directive is generally known as the Banking Consolidation Directive ("BCD"), combining as it does the next of no fewer than seven earlier banking and capital directives, although the Directive does not in fact use the word " consolidation" (or at least not in this context) but refers instead to codifying and combining the texts of the source directives[1].

The sixth recital to the BCD provides that the scope of the measures for the coordination of credit institutions should be as broad as possible, covering in principle all institutions whose business is to receive repayable founds from the public (whether in the form of deposits or in other forms such as the continuing issue of bonds and other comparable securities) and to grant credits for their own account[2].

However, the recitals also state that the BCD is without prejudice to the applications of nationals laws which provide for special supplementary authorizations permitting credit instructions to carry on specific activities or undertake specific kinds of operations (which might in the UK, for instance, include the grant of a consumer credit license). Furthermore, the BCD is a so-called " minimum harmonization directive" since its approach, stated in the seventh recital, is to achieve only the essential harmonization necessary and sufficient to secure the mutual recognition of authorization and of prudential supervision systems of credit institutions.

The BCD embodies a mutual recognition concept under which a credit institution has the ability in many instances to conduct business through-out the EEA without the need to secure prior authorization in each Member State[3]. Once authorized in its home state, a credit institution may obtain a passport to provide banking and investment services in other Member States – " host states"- or open branches in such states without the need for an additional authorization in either case.

Home-states authorities are responsible for the initial authorization. The BCD lays down minimum potential requirements which the home state must impose in order the protect depositors and investors. A credit institutions needs authorization in accordance with these minimum standards irrespective of whether it intends to take advantage of the passport to provide services into other Member States. In addition, home states are required to exercise continuing prudential supervision in accordance with these standards.

Directives consolidated into the BCD

The Directives consolidated in the BCD are as follows:

a) Banking Directive 73/83/EEC
b) First Banking Directive 77/780/EEC
c) Own Funds Directive 89/299/EEC
d) Second Banking Directive 89/646/EEC
e) Solvency Ratio Directive 89/647/EEC
f) Consolidated Supervision Directive 92/30/EEC
g) Large Exposures Directive 92/121/EEC

[1] The BCD is re-cast into Capital Requirements directive which is awaiting publication in the Official Journal
[2] To which must now be added issuers of electronic money
[3] Investment firms have a similar ability under the Investment Services Directive

Credit Institutions

As a preliminary matter, is it necessary to establish what institutions are subject to the BCD regime. The BCD regulates the activities of a credit institution[1], which is defined in Article 1 to mean:

a) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account; or
b) an electronic money institution within the meaning of Directive 2000/46/EC (not being a credit institution falling within (a)).

Electronic money issuers were brought within the scope of the BCD by the Electronic Money Directive (2000/46/EC; also known as the " E-money Directive") on the basis that it was felt appropriate to harmonies the supervision of those e-money issuers that would not otherwise have fallen within the Directive. While traditional credit institutions have always been able to issue e-money) on a Community-wide basis under point 5 of Annex I to the BCD), the activity of issuing e-money did not of itself require authorization under the BCD. However, institutions falling within limb (b) of the definition above are not subject to the whole of the BCD and in particular they are subject to a lighter prudential supervision regime.

Article 2 (1) of the Electronic Money Directive provides further that: " save where otherwise expressly provided for, only references to credit institutions in Directive 91/308/EEC (the Money Laundering Directive) and (the BCD except Title V, Chapter 2 (regulatory capital)) shall apply to electronic institutions".

The title of Article 2 is " Application of Banking Directives", although these Directives are not listed or defined and the scope of the provision is on clear. It is presumably intended to limit references to credit institutions, at least in " banking directives", to traditional credit institutions although Article 2 (3) is not in therms limited to " banking directives", which may leave open the question of whether general references to institutions in Community instruments include money institutions.

Authorization

Article 3 of the BCD requires Member States to impose a general prohibition on persons or undertakings that are not credit institutions to stop them carrying on the business of taking deposits or other repayable funds from the public[2]. There are certain exclusions from the general prohibition including deposit taking by central or local government or by public internationals bodies provided that these activities are subject to appropriate regulations and controls for the protection of depositors and inventors. In addition, the provisions of the Directive do not apply at all to a numer of bodies listed in Article 2 (3) including Member State Central Banks and certain specified institutions in the various Member States (e.g. the National Saving Bank in the UK).

Requirements for authorisation

The Directive then sets out (in Articles 4-17) the requirements for the taking up and pursuit of the business of EEA credit institutions including, under Article 4, the requirement that credit institutions are to obtain authoration before commencing their activities. The BCD lays down certain minimum prudential requirements which mast be met for initial authourisation to be granted. These minimum requirement are, in summary, as follows:

a) the credit institution must have adequate initial capital-generally at least 5 euro (Article5);
b) the direction of the credit institutions business must be in the hands of at least two persons, each of whom satisfies the "good repute and sufficient experience" test-this is commonly known as the " four eyes " test (Article 6 (1));
c) where credit institution has a registered office , this must be in the same EEA state as its head office, and where it does not have a registered office then its head office must be in the EEA state which issued its authorisation and in which it actually carries on its business (Article 6 (2));
d) the credit institution must provide to the relevant competent authority information about the identities and holdings of its larger shareholders (Article 7- considered further below); and
e) the credit institution must also provide a programme of operations covering the business proposed and the organization of the institution (Article 8).

The effect of Article 6 (2) is that BCD regime applies only to credit institutions which have their registered or head office (or both) in the EEA. When Article 6 (2) is read in conjunction with the ninth recital, it is clear that authorization must be granted by the Member State in which on institution has its

[1] Although certain financial subsidiaries of credit institutions are also given rights under the Directive and the consolidated supervision provisions apply to certain non-credit institution holding companies

[2] This provision was not, but should presumably have been, amended by the Electronic Money Directive to include a prohibition on the issue of electronic money other than by a credit institution

registered office (or head office if it has no registered office) Accordingly, the provisions of the BCD (and in particular the pass porting provisions described below) do not as a general matter apply to branches in the EEA of non – EEA institutions. However the Directive does address relations with third countries and this is considered below.

Under Article 7, " qualifying holdings " in a person applying for authorisation must be disclosed to the competent authority for authorisation (being the national authority of a Member States responsible for the supervision of credit institutions). A qualifying holding is a direct or indirect holding of 10 per cent or more of the capital or of the voting rights, or which makes it possible to exercise a significant influence over the management of the institution. Article 7 also reflects a further test introduced in the wake of the collapse of the Bank of Credit and Commerce International (" BCCI ")[1] . Competent authorities are required to with hold authorization where any " close links " which an institution has with any person, or the laws and procedures of any non-EEA state governing such a person, would prevent the effective supervision of the institution. Article 16 contains provisions relating to the ongoing supervision of a credit institutions controllers (i.e. those persons with qualifying holdings in it).

Where an institution applying for authorisation in a Member State (" A ") is, broadly speaking, in a group of undertakings which already contains credit institutions insurance undertakings and investment firms authorized in other Member State, then the competent authorities of state A are required to consult with the competent authorities of the other Member States involved (Article 12).

Home Member State competent authorities must also require that every credit institution has sound administrative and accounting procedures and adequate internal control mechanisms (Article 17).

Since as already noted, the BCD is a minimum harmonization directive, Member States are free to impose such additional authorisation requirements on those institutions of which they are the home Member State as they think appropriate. As a matter of general European law, how ever, any such additional requirements must not be discriminatory as against EEA Nationals.

With drawl of authorisation

Article 14 lists the circumstances in which competent authorities may withdraw the authorization issued to a credit institution. These circumstances include where the institution:

a) does not make use of the authorization within 12 months expressly renounces the authorization or has ceased to engage in business for more than six months
b) has obtain the autorisation through false statements or any other irregular means;
c) no longer fulfils the conditions under which authorization was granted;
d) no longer possesses sufficient own funds or can no longer be relied on to fulfill its obligations towards its creditors, and in particular no longer provides security for the assets entrusted to it; or
e) falls within one of the other categories where national law provides for withdrawal of autorisation.

Reasons must be given for any withdrawal of authorisation .

The single banking license

Title III of the BCD contains provisions dealing with the freedom of establishment and the freedom to provide services and which give effect to such rights under the Treaty (i.e. the BCD does not create those rights). Under Article 18 of the BCD, Members States are required to provide that the activities listed in Annex I to the Directive (the least is reproduced in 3.5.1.1 below) may be carried on within their territories either by the establishment of a branch or by way of the provision of services, by any credit institution authorized and supervised by the competent authorities of another Member State, provided that such activities are covered by the authorization.

These provisions are a reflections of the principle of mutual recognition under the BCD since day required host Member States to respect the authorizations granted by the home state and the ongoing supervision of the home-state authorities. They are reinforced by the seventeenth recital to the Directive which states that:

" Member States must ensure that there are no obstacles to carrying on activities receiving mutual recognition in the same manner as in the home Member State, as long as the latter do not conflict with legal provisions protecting the general good in the host Member State ".

Article 19 extends the scope of this so-called "single banking license" to a subsidiary of a credit institution in the subsidiary is subject to consolidated supervision with the parent and if certain stringent conditions are fulfilled (e.g. the parent must hold 90 per cent or more of the voting rights attaching to the shares in the capital of the subsidiary and the parent must guarantee the commitments entered into by subsidiary). This provision was included originally in the Secon Banking Directive to cover the situation

[1] By the Post – BCCI Directive (95/26/EC)

witch applied in some Member States where local laws required certain banking operations (e.g. leasing) to be carried out through separate companies. Since these companies would not themselves have come within the definition of a credit institution, there was a risk that banks authorized in these states would not be able to passport certain listed services (i.e. if these were carried on by non-credit institution subsidiaries).

A number of observations may be made about the scope of the single banking license. The first point, witch emerges from the consideration of Article 19 above, is that the scope of the license is not limited to the activities which define a credit institution. The license is instead available for any of the listed activities " provided that such activities are covered by an authorization" of the credit institution. It is clear therefore that if a bank is expressly authorized to carry on a listed activity in Member State. However, there does not appear to be any reason in principle why the license should not also be available where specific authorizations is not needed in a Member State for a particular listed services witch it is lawful it to carry on in the UK[1] and this coulee cover listed services witch do not themselves require authorization in the UK. (e.g. non-consumer lending).

Where in contrast a banks authorization excludes a listed activity for witch authorizations is required in the home state, then the bank could not carry out that activity in another Member State in reliance on the single license. For instance , if a UK banks permission under Part IV Financial Services and Markets Act 2000 does not include dealing in derivatives, then that bank could not passport activities under item 7 (c) of Annex I to BCD. The license would also of course not be available in respect of activities for witch a credit institution is authorized in its home state but witch are not listed in the BCD.

The remainder of Title III of BCD (Articles 20-22) deals with the procedures relating to obtaining the passport and the powers of the host state.

Activities listed in Annex I to the Banking Consolidation Directive[2]

1. Acceptance of deposits and other repayable funds from the public.
2. Lending, including, inter alia: consumer credit, mortgage credit, factoring (with or without recourse), and financing of commercial transactions (including forfeiting).
3. Financial leasing
4. Money transmission services
5. Issuing and administering means of payment (e.g. credit cards, travelers cheques and bankers drafts).
6. Guarantees and commitments.
7. Trading for own account or for account of customers in:
   (a) money market instruments (cheques, bills, certificates of deposit ("Cds"), etc);
   (b) foreign exchange;
   (c) financial futures and options;
   (d) exchange and interest rate instruments;
   (e) transferable securities.
8. Participation in share issues and the provision of services related to such issues.
9. Advice to undertakings on capital structure, industrial strategy and related questions and advice, and services relating to mergers and the purchase of undertakings.
10. Money broking
11. Portfolio management and advice
12. Safekeeping and administration of securities
13. Credit reference services
14. Safe-custody services

Exercise of Treaty rights

The fact that certain activities fall outside the list in the BCD does not necessarily mean that such activities cannot be provided in another Member State since, as noted, the basic freedoms of establishment and to provide services arise in the fourteenth recital to the BCD which states that:

" the carrying-on of activities not listed in the said Annex enjoys the right of establishment and the freedom to provide services under the general provisions of the Treaty."

The sixteenth recital goes on to state that a host Member State may require compliance with specific provisions of its own national laws or regulations:

[1] The Financial services and Markets act 2000 (EEA Passport Rights) Regulations 2001 (SI 2001/ 2511), regulation 19

[2] In addition, the services and activities provided for in Section A and B of Annex1 of the Markets in Financial Instruments Directive (2004/39/EC) when referring to the financial instruments provided for in Section C of Annex1 of Directive will de subject to mutual recognition according to the BCD

- by institutions not authorize as credit institutions in their home Member States, and
- for activities not listed in Anexa I, provided that :
  (a) such provisions are compatible with Community law and are intended to protect the general good; and
  (b) such institutions or such activities are not subject to equivalent rules under this legislation or regulations of their home Member States.

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conf. univ. dr., Elena Cerasela Spãtariu
"Ovidius" University of Constanta, Romania
Lecturer Phd Nicoleta Asaloş
"Ovidius" University of Constanta, Romania
Lecturer Phd. Cristina Mihaela Grozea
"Ovidius" University of Constanta, Romania

A SHOART ANALYSIS CONCERNING THE NATIONAL AND INTERNATIONAL ANTIFRAUD ACTIVITIES

Abstract. *Our country integration in the European Union's structures implies efforts both on economic and political plan for supporting the restructuring of the Romanian economy as well as the direct involvement in the European structure by means of its active presence in the Union's Institutions. Romania's access to the unredeemable funds has inevitably led to fraud on the fund access and administration meant for economic activity development. Both at the European Union and at national level there were created antifraud fighting structures. This paper aims a short analysis over the existent relations between the existing national structures (DLAF) and the European ones (OLAF) of the DLAF activity.*

Key words: *integration, fraud, institutions*

JEL Classification*: G28, M48, F15*

From an economical standpoint, Romania's integration in the European Union structures supposes the formation of a free trade zone, cooperation in the economic and financial fields for the support of Romanian economy invigoration.

In the economic area, the integration process implies the creation of an institutional frame required for the existence of a political dialogue between Romania and the European Union.

The European Union member statute allows our country the access to financing assigned by the European Commission from the structural and cohesion funds. For the absorption and the control of these funds, at the national level, there were elaborated a series of norm documents which strengthened the institutional and legal frame. Within the next period Romania will benefit from the irredeemable funds amounting to 5973 mi€, sum that is four times bigger than the one that was assigned in the adhering period.

As a consequence, for the use and the control of these funds there are required the information issued from the accumulated experience concerning the use of the financing programs from the precursory adhering and also from the experiences of the other countries which had already adhered at the European Union and had been already confronted with various problems related to the management and the implementation of the programs financed by structural and cohesion funds. In this context there inevitably appeared the fraud which concerns the access and the administration funds assigned to some economical activities development.

Fraud is considered as being any action or intended omission, consisting in:

- use or presentation of false, incorrect or incomplete declarations and documents;
- omission of information by means of the infringement of one or more specific obligations;
- using funds in other purposes than the assigned ones.

These criminal acts have as a result the allocation/obtaining, respectively the inconvenient or incorrect use of communal funds and/or the co-financing sums.

In this respect, it has appeared the necessity of developing some activities for reducing fraud addressed to the European Union funds, through an agreed action of all the competent national institutions to undertake actions in this direction.

The protection of the financial interests of the European Union constituted, over years, a priority domain both at the community and national level. In this respect, the 280th art. of the EC Agreement foresees both the competence of the Community and the member states of fighting fraud, as well as other activities which affect the financial interests of the European Union. Thus, each member state must ensure at a national level the implementation of the obligations assigned according to this Agreement.

The development of the activities in the Economic Community framework is financed by the tax payers' citizens and is considered to be the Community's Budget. This is adopted, at the Commission's

proposal, by the budget authority (European Parliament and the Council). On the basis of the European Union policies, there are financed projects of national interest and not complying with the duties which support the Community's budget or the incorrect use of funds has a negative effect over the European citizens.

Consequently, the European institutions have as a duty, as far as the citizens are concerned, the efficient use of funds, and especially the most efficient fight against fraud. Therefore, the protection of the financial interests of the Community came out as one of the major priorities of the European institutions that imply:

- activities regarding detecting and monitoring fraud in the custom field;
- actions of tracking activities for inadequate appropriating of subsidies and the tax evasion, as far as the Community's budget is possible affected by it;
- fighting against corruption and any other illegal activity to the detriment of the financial interests of the Community.

For that scope, by means of the EC/CECA Decision 1999/352 of 28th of April 1999, the communal institutions had found the European Anti-Fraud Office (known also as the French acronym of OLAF). The operation of this office implies investigation independence. The office got the responsibility of guiding the administrative antifraud investigations, and also, benefits from an independent social statute. The office has started its activity at 1st of June 1999, the entry into force of the Regulation (EC) No 1073/1999 of the European Parliament and of the Council of 25th of May 1999 concerning investigations conducted by OLAF. The office has followed the "Unit of Coordination of the Fight Anti-Fraud" (UCLAF), which has been part of the Secretariat-General of the Commission, created in 1988.

Today, OLAF's personnel consist of 400 employees; the OLAF investigation team is multidisciplinary, which allows a complete and inter-sectorial approach (in the police, judicial, financial, custom, agricultural domain etc.).

Romania's integration in the European Union implies, apart from the compliance with the obligations related to this process, the direct participation of the European structure, by the active presence as part of the Union's Institutions. As a result, by means of The Government Emergency Ordinance no. 49/2005 concerning the settlement of some reorganization measures in the public central administration frame there was created the Fight Against Fraud Department – DLAF.

The department, as a contact institution to OLAF, has as main competences:

- Obtaining, succeeding and using control funds acquired from EU assistance programs;
- Cooperation ensuring between the national institutions involved in the financial interests of the EU and between them and the European Anti-Fraud Office (OLAF)and the member EU's states;
- The initiation and authorization of the normative documents required for the legislation's harmonization in the protection area of the financial EU's interests;
- Gathering, analysing and processing the required information for carrying on some raising analysis;
- Elaborating and supervising the professional grounding and improvement programs in the fight against fraud.

For the efficient and complete control's execution, DLAF benefits from operational support from other public entities in their specific examination areas, based on the contracted collaboration proceedings, such as: State Building Inspectorate, Financial Guard, General Inspectorate of Romanian Police, Audit Authority. By virtue of these competences and with the specialists' support from the partners' national institutions, the DLAF investigators control:

- The applicants' eligibility for communal funds;
- Technical/financial capacity for development projects;
- Compliance with acquisition procedures;
- Reality and lawfulness of the patrimonial operations;
- Quality of the accomplished works;
- Projects' support subsequent to the implementation.

From the appearance and up to the present, DLAF had a sustained activity in the anti fraud domain and there was an intense collaboration from its level with OLAF. In 2007, as it follows from the annual activity report, DLAF has accomplished 103 controls on the methods of obtaining, succeeding and use of funds resulted from the financial irredeemable assistance programs of the European Union.

As compared to 2006, the total value of the controlled programs rose up with 38% and reached the €200 million value. The controlled PHARE project number (58 cases) has registered a growth of 20% as compared to the same year, and the SAPARD program concerned had registered a 100% growth.

From all controls, 84 cases were finalized and in 66,6% of them there were found fraud indicators, and in 16,6% of the there were found various disorders.

Between 2005-2007, DLAF assigned to the National Anticorruption Directorate 121 cases concerning the possible frauds in obtaining and using the communal funds. From this number, the Prosecutor's office has solved 53 cases; 30 controls have been confirmed by proceeding against the guilty persons, the prosecutors issuing 20 charges, and for other 4 cases there have been decided administrative penalties. 2 of the cases were finalized by suspension of trial procedure of the persons concerned and for 17 of the cases, the prosecutors have decided not to take legal actions. The non-settling percent for the 2005-2006 period was 23,2% and 37,5% for the year 2007.

The confirmation percent for DLAF notifications (64% of the solved cases) proves the high potential of capitalization findings and, therefore, the quality and efficiency of the control activity. At the same time, it can be observed a lack of celerity in settling files by the judicial authorities, pointed out by the large number of unsolved causes (about 56% from DLAF total notifications), a part of them lasting for more than 2 years since the notification date.

Since most old causes are still in the preliminary phase, (11 from the 17 cases for 2005-2006), there is the risk of prescribing the penal responsibility, which makes impossible the prejudice recovery during the legal proceedings and the punishment of the culpable persons.

The control activity took was based on a proactive approach in the verification process, in the context of the continuous improvement of analysis and data collection, aspect confirmed by the large number of self notifications (47% of the developed verifications).

Out of the 103 performed verifications, DLAF has self notified in 49 cases, 34 of the verifications being launched as a result to the judicial authority requests (DNA -31, IGPR – 2, others institutions-1).

As compared to 2006 it was recorded a 7 times growth of the controls performed at the solicitation of the National Anticorruption Directorate (31 cases in 2007 as compared to 4 cases in 2006).

In 2007, DLAF performed a number of 3 verifications related to the origin of funds from the European Bank of Investments, one of them being executed with the PLAF and BEI officials.

As value, based on the developed actions of DLAF there were recovered from the setting up and up to present about 2.420.000 euros, 700.000 euro in 2007.

In the criminal cases constituted on the basis of the DLAF controls, the judicial authorities decided to take measures amounting to about 2.420.000 euros, whence in 2007 about 1.000.000 euros. In 2007 there was entirely recovered the settled debts in 20 cases, and in other 11 cases the calculated debts were partially recovered.

At the DLAF's level there was an intensification of the collaboration with various institutions, as it follows:

- State Building Inspectorate (23 cases, 60% more than in 2006) determined to carry out some controls in the infrastructure project, with focus on the financial operation correctness, complying with the quality standards of the service agreements;
- Financial Guard (9 cases);
- General Inspectorate of Romanian Police (15 cases).
- First fraud possibilities identified on control were:
- The use of false, incorrect or incomplete justified documents (35 cases)
- The use of false or falsified declarations or certificates (16 cases)
- The performance of illegible expenditures (16 cases)
- Standard infringement concerning public acquisitions (5 cases).

The DLAF controls of 2007 have covered unanimously all the 8 development areas. The highest value of the controlled projects in the period concerned makes reference to the 2nd South-East Region (47.330.042 euros), and most of the controls performed were in the 3rd South Muntenia Region and in the 7th Centre Region (17 controls each).

The cooperation with the European Anti-Fraud Office has been consolidated by the growth of common controls. If in 2006 Romania was the first country to perform common controls with OLAF, in 2007, the number amounted to 7. Moreover, OLAF provided technical assistance to DLAF for the finalization of 8 complex cases which concerned economic operators with the headquarters in other member states. Out of the 103 controls developed by DLAF in 2007, 6 controls were triggered by the notifications sent by OLAF. What is more, there were sent to OLAF a number of 82 control memos which include fraud indicators, three times more than those sent in 2006.

As a coordination service of the anti-fraud fight, in 2007 DLAF centralized, analyzed and sent to OLAF 160 reports with new indicators on fraud. Among them, 34,3 % are related to the SAPARD programme, 42% to the ISPA programme and 23,7% to the PHARE programme.

Aspects concerning the activities related to fraud are to be found even at the level of the European Parliament; therefore, there were signalled situations when 785 euro-deputies were accused for fraud on the money paid by the European tax payers. The Parliament members were the subject of an internal inquiry which was triggered by many suspicions concerning the fraud of the money received from the communitarian budget for parliamentarian assistance, as pointed out by "Times" and "Euobserver." The Parliament members receive each year over 140 million euros and part of this sum went directly to the pockets of the members of the European Parliament which fictionally employed relatives who did not have the qualifications required.

In conclusion, Romania, by means of the activities developed, aims at complying with the obligations assigned as member state and at protecting in fact and equivalently the financial interests of the European Union in Romania.

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conf. univ. dr., Elena Cerasela Spãtariu
"Ovidius" University of Constanta, Romania
Lecturer Phd Nicoleta Asaloş
"Ovidius" University of Constanta, Romania
Lecturer Phd. Cristina Mihaela Grozea
"Ovidius" University of Constanta, Romania

COMUNITARY PREOCCUPATIONS CONCERNING THE INFORMATION NETWORKS SECURITY

Abstract: *Having into consideration that the volume of the dates and the information electronically administrated is more and more developed, their security represents a preoccupation for the private company, on a side, and for the public institutions, on the other side. The assurance of some services and products for the protection of computational systems has become a priority at global level. At European level, in 2004 was constituted the European Agency for the Computational Networks System (ENISA), whose main mission is to help the European Committee, member states and businesses community to treat, to answer and to prevent information and networks security problems. Romania accepted the whole acquis, adapting the legislation in the domain of information technology and telecommunications, and from January 1st 2007 has a representant in the Administration Council of ENISA, participating directly to the decisions that will be taken in the domain of dates' security at comunitary level. Romania in collaboration to ENISA will unroll mediating actions of the aspects that have to do with the networks security and the information security and will have in sight the creation of some expertise national centers and an answer to the security incidents.*

Key words: *security, networks, information, threatenings*

JEL Classification: *D83, F15, F52*

The development of computers' network conduced to the raising of the importance of the aspects concerning the security in the computers' networks. The operation of confidential information conduces to the growth of the advantages of separation and communication brought by the computers' network to be sustained by facilities of substantial security. This aspect is essential in conditions when computers' networks became to be used inclusively for the realization of bancary operations, purchases or taxes payment. Only through the implementing of security mechanisms in a computer network, the information could not be accessed or listened by not authorized persons (curious or even with bad intentions) and will hinder the transmitted information falsification or their clandestine utilization of some services destinated to specific categories of networks users.

Because the assurance of computational system security became a priority at global level, conduce to the apparition of more organisms and agencies with preoccupations in this sense. ENISA was constituted in order to help the European Committee, the member states and business community "to treat, answer and foresee security problems of the networks".

ENISA was borne at the beginning of the year 2004, constituted by the European Parliament and Europe Council, having as objective the support offer of European Committee and member states on the part of date security and networks and organizes guides in order to raise the informing level on diverse themes created for the information security. ENISA contributes to the modernization of Europe and assures the good functioning of digital economy and informational society.

From January 1st 2007, once with the adhering of Romania to the European Union, has the right of directly participation to the activities and decisions of ENISA and a member in its administration council. Because Romania has passed over the childhood faze concerning the manifestations in digital European economy, the belonging to such organization is necessary.

ENISA establishes contacts also with some other international organisms from the security information domain from Japan, Coreea and USA.

The debts of ENISA will concentrate on:

- the collecting and analyzing of the dates reffering to the disfunctionalities in the network security and potential risks;
- the cooperation between the involved parts, in special through the agreement of a public/private partnership with the present actors in European Union industry or to global level;

- the consciousness and promoting of evaluating methods and the best practices for the inter-operational solutions of the risk;
- the following of standards evolution for products and services that function for Network and Information Society;

The ENISA mission is to assist the community in the maximum security of the networks and information. The agency will contribute to the development of a culture in the domain of networks and information security in the benefit of citizens, consumers, enterprisings and organizations form public sector from European Union, contributing through this to a good function of intern market.

ENISA put forward the most recent document with the theme of "pirate-networks". This document identifies the roles and organizatoric criminal structures that controls "pirate-network", which means those utilized networks of delinquents for the fraudulent activities on the Internet. These networks involve programs that installs immediately at the downloading of some documents form the internet and than can be used for any type of fraudulent online activities.

As an active part of ENISA, Romania will be able to participate to the decisions that will be taken in the information security domain and will receive Know-how to support he developing iniatives in this domain. Romania is represented, also, in the International Union Council of Telecomunications which collaborates in the anti-spam fight, anti-pirate, and also to raise the consciousness in the administrative environment in what concerns the security needing of information and networks.

Those who encroach on the networks security can be part of diverse categories, committing infractions more or less serious: students that have a great time trying to steel the electronic mail of the others, "hackers" that test the security systems or follow to obtain fraudulent certain information, employees that pretend to have larger attributions than in reality, accessing services that in normal are forbidden, or ex-employees that follow to destroy information as a way o revenge, business people that try to discover the enemies strategy, persons that realize financiary frauds, (the steel of identification numbers from the credit cards, illegal bancary transfers, etc), military or industrially spies that try to discover the secrets/strategies of the enemies, or even terrorists that steel strategic secrets.

Because a network "breaking" interests are many, it is obvious the resources hard and soft planner must take serious protection measures against of some bad intentioned tentatives. Protection methods that can stop the accidental "enemies" can be proved in vain or with a reduced impact over the redutable adversaries – dedicated and with considerable material possibilities.

Thanks to the continuous evolution of the viruses, spy-ware and ad-ware systems, apparition of new vulnerabilities, your network security and connected systems to it must beneficiate of continuous attention. The security solutions of the networks classify like this:

- security solutions concerning in passive systems (firewall, DMZ);
- security solutions concerning in active systems (IDS).

A first step in the networks' security is represented by the vulnerabilities analyze, that means a security audit. After the finish of the audit, it will be redacted a detailed report that will explain in accessible terms all the identified problems, with their remediate modalities. The vulnerabilities are classified in function of category and security. A special attention must be accorded to the wireless networks, thanks to the specific problems that could appear. The security of such networks is more laborious, being able to suppose the partial of total remaking of network configurations or infrastructure.

The threatening of networks security comes most often from the next persons or programs: kacker, cracker, persons form the interior of the organization, unauthorized, that search information in the system, trojan horse – a program hidden in the system or in software applications that realize the systematic destroy of viruses and dates.

The network security is an entire process, not a product. The elimination of several problems of security can be realized through the periodical verification and refreshing of firewall's and preventing system of intrusion.

The next step is constituted by the creating of security politics at the level of each organization that must include a few basic rules that specify the users from the realization mode of resources access to the assurance plan of business continuity or dates recovering. The organizations must adhere to one or more security politics, politic that may be null or to have an extinguished rule set.

Security politics is essential in any company and there exist a few free models or very cheap one to be used: COBIT model, oriented model to the retail from PCI Security Standards Council (PCI Security Standards Council) of the international model ISO 27001/17799.

After the establishing of a security politic, there must be implemented security mechanisms specific, starting from the physical level (physical protection of transmitting lines), continuing with blocking

procedures of the access to the level of the network (firewall) till the application of some codification techniques of the dates (crypting), specific method for the protection of communication between the processes of type application which rolls on diverse computers from the network. The security mechanisms must be able to solve the next aspects:

- bombarding with spasm;
- rolling of the viruses;
- the accessing through the network of a computer of a certain user and the "attack" over this person;
- intercepting of the transit dates and eventual their modification.

It can be used one of the next security mechanisms:

- the coding, for the assurance of the dates' confidentiality;
- digital signature;
- the access control through the using of the identity for the establishing of access rights;
- the traffic protection with the aim of the traffic analyse.

Periodically must be tested the recovering mechanisms of the dates in the case in which could intervene a spoiling of a router, the stopping of an important server, the corrupting of the dates from a hard-disk, the blocking of an application or in case of infecting with a spyware.

In the analyze of the risk in a network, are had into consideration the next activities:

- are determined the objects that must be protected;
- are identified to risk sources;
- are established the risk probability;
- are evaluated the costs in the eventuality of a breaking.

The implementing of the security services is realized through the security protocols on different levels in the computers' networks and can be grouped thus:

- protocols of identification and authentication;
- protocols for the protection of dates' transfer;
- protocols for the administration of coding keys;
- protocols for the verification of the actuality of the message.

The most used protocols are: S-HTTP, SSL, PCT, IPSec, VPN.

Secure Hypertext Transfer Protocol is a protocol that delivers confidentiality, authenticity, integrity and non-repuration. The protocol gives the possibility of the negotiating of involved parts for each transaction and uses cryptografic algorithms operating at application level.

Secure Socket Layer permits the authentication of the messages and crypting using many different keys.

The IPSec protocol is the most used at the level of network and permits the securized communication at IP level.

Virtual Private Network is the network of a company that uses the Internet infrastructure and not a network property of the company.

American Express, Discover Financial Services, JCB, MasterCard Worldwide and Visa International formed in common a Council destinated for the administrating of the evolution of Dates Security Standard from the industry of Market Cards, that points the improval of dates' security in time of payment transactions. The PCI Security Standards Council forming marks an important moment of the payment industry efforts for the assurance of payment count dates' security in a coherent manner at global level. The principal consequence of this action will be that over 1 billion payment cards possessors benefit of a high level of security against the eventual frauds of dates' steeling.

IBM Security & Privacy Services considers that, "cybernetic criminality represents a real threatening for the companies, and the IT departments directors take it into serious"… "It is a continuous fight, and their protection technologies, such as antivirus programs and firewalls are not enough. Will be necessary that these take into consideration the human factor and the threatenings came from the interior and, in the same time, to watch the security as a process, not as a product". A study realized by IBM in 17 countries from the entire world, inclusively 8 states from Europe came to the conclusion that more than a half from the companies in the entire world consider that the cybernetic attacks suppose expenditures bigger than physical attacks.

Conforming to the representants' declarations of these organizations, the expenditures that involve the cybernetic criminality determinates, first of all, the diminution of the incomes, the loosing of the actual or potential clients and the diminution of employees productivity. The IBM study indicates also that 84% form the IT departments directors consider that, in what concerns the cybernetic criminality, organized crime

organizations – that have at hand sophisticated techniques – replace step by step the hackers that action individual.

The preoccupation for the security of cybernetic space is a mondial one. The Germany companies consider in a percentage of 63% that the cybernetic attacks represent a bigger threatening to their address than physical attacks. In Grand Britain, 76% from the organizations consider that the cybernetic criminality is the most dangerous threatening to the address of their securities, and in Russia, only 39% form the companies consider that are enough protected against the organized cybernetic criminality.

Romania manifests also preoccupations in what concerns the network security, which means that in collaboration to ENISA will roll mediating actions of the aspects that have to do with network security and information security, will create expertise and answer national centre to the security incidents CERT-RO (Computer Emergency Response Teams), and also the participation of Romanian experts to the work groups of ENISA.

I consider that the electronic commerce market developed through the internet is not at the beginning anymore, but its potential is much higher. The proof is the big number of virtual shops that develop activities through the intermedium of electronic commerce. Gecad informs that the total value of electronic transactions with on-line payment raised in 2007 with 263%, confronted by the year 2006, arriving to a total value of 34,8 millions EUR. The biggest number of payments effectuated in electronic payment system in Romania is made for the payment of mobile phones bills, but also in tourism, reservations, transport, quartering, acquisition of electronics and multimedia products. A number of five banks from Romania were certified in the electronic payment system 3D Secure, system that suppose that at each transaction is made the verification of the plan and commerciant. The five banks are: BCR, BRD Group Societe General, Raiffaisen Bank Romania, Transilvania Bank, UniCredit Tiriac Bank.

Conforming to some estimations realized by the company eMAG, online commerce market from Romania will double in 2008, till 250 millions EUR, confronted by the estimations made in the past year when raised at almost 115 millions EUR, because the migration from the classic retail to the online retail.

In conclusion, the dates' importance and transmitted information through the computers network raised continuously. That is why, the organization efforts, software efforts scientific and specialists forums are going straight to the projection and implementation of some techniques and security methods that to conduce to the security of this space, cyberspace.

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Prep. univ. drd. Renate Tănase
"Lucian Blaga" University of Sibiu, Romania

EVALUATION AND CREDIT RISK QUANTIFYING BY ROMANIAN CREDIT INSTITUTIONS IN ACCORDANCE WITH THE BASEL II REGULATIONS

***Abstract**: The banking activities internationalization, an ever tougher competition between credit lending institutions as well as the diversification of products offered are factors that expose these institutions to various specific risks. Risk protection has become a main preoccupation of credit lending institutions worldwide by means of strategies and management methods of effective risks. The present paper sets out to introduce the concept of credit risk as well as its current evaluation, quantifying and monitoring techniques set by the Basel Committee through Basel Agreement I (1998) and in particular through Basel Agreement II (2004). The credit lending institutions in Romania were compelled to adopt the Basel II provisions, with a view to determining the minimum capital requirements for covering risks (credit, market and operational risks) ever since January 2008. As regards quantifying credit risk most of the credit lending institutions in Romania will use the standard procedure and only one of them will use the internal rating model approach. The query is if the Romanian banks are actually prepared or not to meet the Basel II requirements.*

***Key words**: credit lending institutions, risk management, banking risks, credit risk, exposure*

***JEL Classifications:** G21, G24*

Introduction

The Basel Committee on Banking Supervision, initially called The Committee for Banking Practices Regulation and Supervision, was established at the end of 1974 as a result of serious crises of the main international currencies as well as of the financial crises of great banking institutions and the bankruptcy of the West Germany Herstatt Bank, of the Franklin National Bank in the U.S. and of the British Israel Bank branch in London, banks whose crises affected other banking institutions they were working with due to the banking activities internationalization phenomenon.

Recommendations in matters of banking supervision established by the Basel Committee are based on two fundamental principles: each foreign banking institution should be included in the banking supervision area and should adopt adequate supervision practices (setting the minimum capital requirements, monitoring banking risks, etc.).

In accordance with the second principle guiding the activities and decisions of the Basel Committee in 1988 *The Basel Agreement* of the same year also known as The Basel I Agreement (Basel I) was published (*International Convergence of Capital Measurement*).

The main objective of Basel I is to promote the safety and soundness of the banking system and to increase equal competitive banking opportunities, objective accounted for also by the fact that in their desire to increase their benefits the banks got involved in ever riskier activities, both nationally and internationally, activities that were not in concordance with the levels of constituted funds.

The Basel I Agreement comprises a definition of the regulating capital, of risk exposure measures and rules that specify the level of capital to be maintained in correlation with these risks. The agreement introduces a capital adequacy standard de facto, based on a balanced issuance of the bank's assets function of risk and with a view to protecting solvability. Therefore, a correlation between risks taken by the banks and their own funds available has been established, in the shape of a capital adequacy indicator that cannot be lower than 8%.

However, the provisions adopted by Basel I had certain limitations, in the sense that they did not take into consideration all types of risks banks are exposed to and the weight of each risk category analyzed was too rigid and not relevant with some of the subjects within the same group of counterparties.

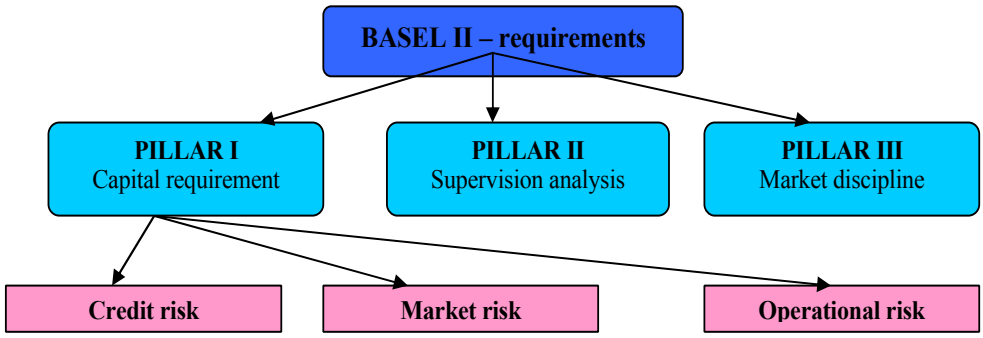
As a result of content transformation and of the covered area of the world financial sector, of the volatility of the financial markets in the last decade, of the degree of the financial innovation development as well as of the economic turbulences that generated financial crises (as in Asia-1997, Eastern Europe-1998) of ever complex risks that banks today are faced with, the Basel Agreement of 1998 was not considered to offer an effective means of ensuring that capital requirements corresponded to the actual risk profile of a bank. In other words, it was no longer sensitive enough to banking risks.

As a result of criticism on the Basel Agreement of 1988, the Committee put forth the adoption of a new capital adequacy scheme, in June 2004 through Basel II (official denomination: *International Convergence of Capital Measurement and Capital Standards, a revised framework).* The content of the New Agreement is based on three pillars that have the same degree of importance, that is:

- *P 1*: capital adequacy requirement;
- *P2*: an analysis and supervision process;
- *P3*: requirement regarding market discipline.

Thus, quantifying and ways of preventing the most important types of risks these institutions are faced with, that is the credit, market and operational risks, were put forth for international banks' consideration and not only.

Fig. 1. Synopsis of Recommendations Stipulated in the Basel II Agreement, 2004



The New Agreement sets out to recommend and apply a more complex and accurate approach in order to evaluate banking risks (credit, market and operational risks) with a view to fulfilling the same main objective of the Basel Agreement in 1988—promoting the safety and soundness of the banking system and increasing equal competitive banking opportunities.

Risk Credit Evaluation In Keeping with the Basel I and II Agreements

Within the profile regulations issued by he Basel Committee, the credit risk as a specific risk in the banking risk evaluation and monitoring activity was the basic component of the banking activity.

Quantifying a bank's credit risk profile—in accordance with Basel I—meant attributing different risk shares to calculation bases specific to this type of risk. The components of the calculation base for the credit risk are made of: fixed asset related balance sheet account balance, off-balance sheet commitments, equity derivatives that have to be covered by the level 1 and 2 types of capital.[1].

By devising and adopting the Basel Agreement II in 2004 the perspective regarding risk evaluation and quantifying, the banking activity supervision context and content has considerably changed. The novelty as against the provisions of the Basel Agreement I is obvious. In fact, a shift and an evolution from "to control", "to impose" the banking risk quantifying process to practicing an effective risk management both individually and in groups, has been achieved. The reason for this is due to, on the one hand, meeting the minimum capital requirements imposed by Basel II and on the other hand to protection against possible "blockages" and/or financial crises generated or not by the banking market at aggregate level or under the economic circumstances as such under which the credit lending institution operates. The approach to banking risk management has to include the credit risk (1988), the market risk (1996) and the operational risk (2004).

The banking risks evaluation, quantifying and monitoring methods and techniques are structured on different approaches function of the possibilities and risk profile of each credit lending institution.

All types of approaches suggested for evaluating the three types of banking risks have different degrees of complexity when put in application and also have different results in evaluating banking risks. The standard approach is the one that has the lowest degree of complexity and a low level of risk sensitivity; therefore it stimulates risk management very little. At the opposite end is the advanced approach based on the internal rating model approach (IRB) which is a sophisticated risk approach method with a high level of risk sensitivity and which refers to increased rights and responsibilities for the credit lending institutions (this approach stimulates risk management).

[1] The elements of the level 1 type of capital are: shares, retained earnings, and the non-bootable and non-cumulative shares; the level 2 type of capital is made of: share revaluation reserves; general provisions and general loss reserves, hybrid capital instruments (preferential cumulative retrievable share); subordinate term liabilities

Table no. 1. *Pillar I –capital adequacy requirement, banking risk approach*

Type of risk	Type of risk approach	
Credit risk	Standard approach	
	Internal rating approaches (IRB)	Fundamental approach
		Advanced approach
Market risk	Standard approach	Global approach
	Internal model approach	VAR, etc
Operational risk	Basic indicators approach	An indicator: gross income
	Standard approach	An indicator for different lines of activity
	Advanced evaluation approach	Internal evaluation approach
		Loss distribution approach
		Scorecard approach

The Basel II Agreement stipulates that the credit risk should be evaluated by means of two approaches: the standard approach and two forms of approaches based on internal rating models (the fundamental and the advanced approaches).

Applying to the banking practice the approach based on internal rating models refers to doing operations regarding exposure classifications according to the type of exposure (governmental, corporate, retail) and analysis of these exposure classifications from the standpoint of banking supervision regulations, that is complying with the minimal set regulations and observing certain specific criteria on the part of the bank so that it could apply the IRB method for risk credit evaluation.

Using approaches based on internal rating models means an initial draw-up on the part of the credit lending institution of a *Risk Administration Strategy* as a practiced risk management component. Drawing up this strategy has to consider on the one hand the shareholders' interests, and on the other hand it should comply with the regulations in force. Therefore, the bank's strategic objectives and the means of drawing them up will be set. The point of departure in reaching these objectives is based on the relation ***return-risk***, that is creating a balanced assets portfolio that should generate an expected return (profit rate) correlated with the risk profile (low, moderate, medium or high) set by the credit lending institution function of the estimated loss and of the minimum capital requirement for covering risks that generate this loss.

The means of achieving these set objectives take into consideration the process of devising the main principles regarding risk administration, creating an organizational structure specialized in risk management (Risk Committees or Departments for Risk Evaluation at the level of Credit Lending Institutions) as well as devising procedures and specific risk quantifying and monitoring techniques.

The risk administration strategy is devised based on specific risk components such as the credit risk administration strategy, the market risk administration strategy, the liquidity risk administration strategy, the reputation risk strategy s well as the operational risk administration strategy.

The credit risk administration strategy refers to monitoring all activities that generate exposures specific to the credit risk, classified function of different criteria:

- Exposure based on types of customers: central institutions, public institutions, legal or natural persons;
- Exposure based on resident or non-resident individuals;
- Exposure based on types of banking products;
- Exposure classified as performance categories;
- Exposure based on the fields of activity of the national economy;
- Exposure based on national or foreign currency;
- Exposure based on geographic areas or locations;
- Exposure based on banking units of the financial group they are part of: subsidiaries, branches, mother companies, etc.

All these exposures are attributed percentage quotas function of the approved banking risk profile (highest, average, moderate or low). If an exposure segment generates losses over the bank's set limit then a decrease of their share in the overall assets portfolio is performed so that the portfolio rate required by investors should not diminish.

One can state that devising such a strategy is based on the financial administration principle of a financial assets portfolio (similar to those made of securities placed on the stock market) within which the expected return is considered to be a "mirror of the past" correlated with the investor's reluctance or non-reluctance, function of which the risk portfolio corresponding to the chosen portfolio is set.

Therefore, the New Agreement provisions are related to adapting risk management function of each credit lending institution's particularities, that is function of the set objectives, the activity volume, the placement portfolio quality, etc.

Applying the Basel Committee's Provisions to the Romanian Banking Regulations

The banking system stability depends on the central bank's ability to coordinate and monitor the banking activity macro-economically through its objectives, strategies and its role, and through the Romanian credit lending institution's capacity to comply with the regulations issued by the central bank, to carry out its activity based on principles of effectiveness and in accordance with the laws governing a competitive market economy.

In Romania the Basel Committee's provisions were progressively applied to the legislative banking framework issued by The National Bank of Romania once the Romanian banking reform system started from the early to the late '90s (Law 3/1991 concerning the banking system, Law 34/1991 concerning the NBR Statute, Law 58 of March 5, 1998 concerning the banking activity which was continuously changed by various emergency ordinances and laws, with a view to improving and perfecting the legislative framework with regard to regulating the banking activity, Law 101 concerning the NBR Statute of May 26, 1998, changed by Law 156/1999 and various Government Emergency Ordinances).

In 2006, the banking legislative framework taken up by the monetary authority was again modified by its adoption of the latest European directives in the field. Directive 48/2006 and Directive 49/2006 which regulate new minimum requirements of access and of activity carried out by credit lending institutions, the status of credit lending institutions in other member-states and third party-states, operational requirements, covering risks requirements, objectives and content of credit lending institutions supervision, etc. These directives actually regulated the Basel Committee's recommendations of 2004, that is the New Capital Agreement norms.

NBR applied the requirements of these directives within the provisions of an emergency ordinance—GEO 99/2006 concerning credit lending institutions and capital adequacy *i*[1]--published in the Romanian Official Gazette no. 1027/27.12.2006, which besides the basic principles of the two European directives mentioned above, also stipulates specific dispositions for different categories of credit lending institutions (banks, cooperatist credit organizations, savings and credit lending banks in the housing sector, mortgage credit banks, institutions issuing electronic currency). In 2007 the monetary authority issued instructions, regulations and norms with a view to properly applying by the Romanian credit lending institutions of the GEO requirements no.99/2006, that is, the practical application methodology of the Basel II recommendations starting January 1, 2008.

Mention must be made of the fact that the Basel II provisions were disseminated and explained by the supervision authority—The Romanian National Bank—ever since their official publication, in 2004, in various articles and meetings in order to make the credit lending institutions familiar with what was to become later a compulsory aspect for these institutions.

The Romanian credit lending institutions can use, in order to determine, the minimum capital requirements the typical three types of risk—credit, market and operational risk—each of the approaches being allowed by the New Agreement credit lending institutions' own possibilities and their risk profile. Therefore, the capital risk requirements for the credit risk can be determined by choosing the standard approach or, if approved by The Romanian National Bank, the approach based on internal rating models[2] as well as a mix between the two types of approaches.

Table no. 2. *Pillar I – minimum capital requirements. Credit risk components*

Expected loss value=	Non-imbursement probability (NIP) x	Loss generated by non-imbursement (LGNI) x	Exposure to non-imbursement risk (ENIR)
Standard approach	External rating (specialized agencies	Stipulated by regulations, according to Basel II	Stipulated by regulations, according to Basel II
IRB basic approach	Internal rating (internal scoring	Stipulated by regulations	Stipulated by regulations
IRB advanced approach	Internal rating	LGD according to the internal model	EAD according to the internal model

Source: NBR

[1] Ordinance approved and modified by Law 227 of July 4, 2007, published in the Romanian Official Gazette, Part I no. 480 of July 18, 2007.

[2] GEO no. 99/2006 concerning credit-lending institutions and capital adequacy, www .bnr .ro

The methodology for determining the risk weighted values of exposures by using the standard approach is regulated by NBR and CNVM through Regulation no. 14/19 of December 4, 2006—concerning credit risk treatment for investment companies and institutions, according to the standard approach.

The NBR-CNVM regulation no. 14/19/2006 is applied, on an individual or consolidated level, to all credit-lending institutions, Romanian legal entities and to the subsidiaries of third party states of credit-lending institutions, for all risk exposures, except for the credit-lending institutions that opted for an IRB type of approach. The minimum level of capital requirements for the credit risk is set at 8% of the overall weighted risk values of exposures. [1]

The weighted risk value is set function of the nature of the assets it is determined for. Thus, in case of an asset, the exposed risk value is equal to its balance sheet value. For elements outside the balance sheet, the exposed value is determined function of the risk category that element is part of (high, average, or low risk). Therefore, the weighted risk value of an element that is outside the balance sheet is equal to 100% of the high risk element value, 50% of the average risk element value, 20% if the element is an average risk bearer, 0% of the low risk element bearer value. According to legislative stipulations issued by NBR, risk weights are also determined function of the category or type of exposure typical of activities carried out by credit-lending institutions that asset is part of.

Credit-lending institutions can use, in order to determine the weight risk applicable to an exposure, external ratings set by institutions specialized in credit evaluation. In order to be eligible, external institutions for credit evaluation have to be acknowledged by the Romanian National Bank or by the competent authority of another member-state. In practice, credit-lending institutions have to use ratings solicited by debtors or, by permission of NBR, unsolicited ratings carried out by one or more external eligible institutions for credit evaluation.

Table 3. Standard approach to an external evaluation of credit risk

Debts		Evaluation					
		AAA la AA-	A+ la A-	BBB+ la BBB-	BB+ la B-	sub B-	Unquoted
Central authorities and banks		0%	20%	50%	100%	150%	100%
Banks	Option 1 – standard	20%	50%	50% (20% initially)	100%	150%	50%
	Option 2 – short-term exposure	20%	20%	20% (20% initially)	50%	150%	20%
Corporations		20%	50%	100% (100% initially)	150%	150%	100%
Retail		75% (100% initially)					
Mortgages on residences		35% (50% initially) – by complying with certain terms					
Mortgages on commercial locations		100% (100% initially), a share of 50% can be used, and the weight of only 50%, only by permission of the central bank and observance of some conditions.					

Source: NBR

Regulating the credit risk according to the standard approach is based on internal rating models, materialized in issuing the GEO no 99/2006 of the NBR-CNVM regulation no. 15/20 of December 14, 2006 concerning the risk credit treatment for credit lending institutions and investment companies based on internal ratings models of approach.

In order to be able to use the internal rating model of approach, the credit-lending institutions, the Romanian legal persons and the subsidiaries of credit-lending institutions of third-party states have to ask for this approach from the Romanian National Bank. The positive response on the part of NBR comes only if:

- The credit institution solicited has rating and administration systems for exposures to fiable credit risks that should allow a pertinent evaluation of the debtor's features and of the transaction, a pertinent differentiation and an accurate quantifying, a credit risk consistency and coherence based on relevant data.
- The soliciting credit-lending institution has administration and rating systems for exposures to fiable credit risks that should allow a pertinent evaluation of the debtor's features and of the transaction, a

[1] The NBR – CNVM nr.13/18 regulation of December 14, 2006 concerning determination of minimum capital requirements for credit-lending institutions and investment companies, art. 2, letter a, www .bnr. ro

pertinent differentiation and an accurate quantifying, a credit risk consistency and coherence based on relevant data.

- The credit-lending institution has a control unit for credit risk, autonomous and reliable, for its rating systems.
- The credit-lending instituion has used its own rating system for three consecutive years prior to the moment it asks for approval from NBR.
- The credit-lending institution proves that it has used its own estimations regarding losses in case of non-imbursement and/or conversion factors in a way that complies, in principle, with the minimum requests regarding the use of own estimations of these parameters over a period of three consecutive years prior to the moment when approval was asked from NBR.

Implementing the evaluation method based on internal rating models of approach is done gradually for the different types of exposures within the same operational unit or for different operational units within the same group. NBR sets ,by agreement with the credit-lending institution, the implementation period and the strict terms under which implementation should occur, and, if the credit-lending institution opted for implementing this method, the decision becomes permanent and reversible only in case of a well-grounded reason and only with approval from NBR.

The weighted risk values of exposures for credit risks and for the diminution risk of the debt value are calculated based on the relevant risk parameters associated to the respective previous exposures.

Te entry risk parameters—the non-imbursement probability (NIP), loss in case of non-imbursement (LNI), date due (DD)—used in determining the weighted risk values of exposures and of expected loss values are estimated by the credit-lending institutions individually for each category of exposure, in accordance with the regulations in force.

The calculation of the weighted risk exposures for credit risks are determined in accordance with the formulas stipulated in Regulation no. 15/20 of December 14, 2006 ,for each exposure category taken separately (exposures to companies, institutions, central administrations and banks, for retail types of exposure, for capital bond exposure, for exposure of assets, other than credit debts) and the credit risk diminution techniques (many categories of collaterals and eligible warranties, balance sheet compensation elements, credit derivatives, setting up provisions regulated by NBR specific norms and IFS standards, provisions specific for Basel II requirements, permanent monitoring of the credit portfolio, etc.) are presented and regulated in accordance with the NBR-CNVM Regulation no. 19/24 of December 14, 2006.

The internal rating models approach to assessing credit risk falls under two categories: the basic approach and the advanced approach.

The basic approach implies division of the bank's credit portfolio into at least seven different "classes", based on the PD values (calculated by the bank), LGD (required by the bank supervision unit) and EAD (required by the bank supervision unit).The total probable loss and the capital expenditure per "classes" of credit are calculated, based on a risk weight previously attributed to each of the seven classes.

The advanced approach is applied according to the same principles as those for the basic approach to IRB, except that the indicators-PD,LGD and EAD-are determined by the bank based on own data and historical experience. The advanced approach is rarely used, it is only part of the practice of sophisticated banks, as it takes into account the statistical method of correlation, an aspect not yet stipulated in capital adequacy agreements and is not accepted by the bank supervision units.

The legislative framework regulating credit risk assessment, issued in application of the GEO provisions no.99/2006, also includes provisions concerning credit risk assessment of the counter-party, in the case of derived financial instruments, of the redemption transactions, of operations of lending/borrowing/ of titles/merchandise, of long-term account settling transactions and of margin crediting transactions,5,and provisions concerning the treatment of credit risk specific to safeguarded exposures and to safeguarding positions, as well as regulations concerning accepting and evaluating the credit risk external assessment institutions.

The methodology stipulated by Basel II for determining capital requirements for credit risk implies that the credit institutions of Romania should diversify the classes of exposition and the corresponding risk weights supplied by external institutions of credit assessment and adopt a wider range of eligible credit risk diminution techniques.

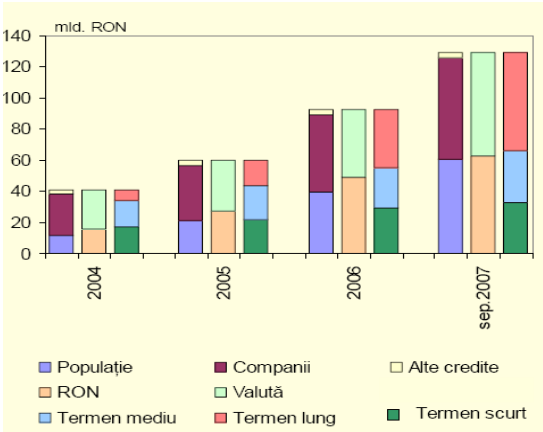
Prerequisites for credit risk assessment in the Romanian banking system

At the end of 2006, the net balance sheet assets of the Romanian banking system totaled 172297.1 million lei, which reflects an obvious development of the crediting activity. Crediting is specifically the segment along which there is the toughest competition, competition determined by the permanent effort of credit institutions in Romania for setting up and developing the client portfolio, rendering clients faithful,

territorial extension (number of units number of employees, etc), permanent renewal of banking products and services that should be as compatible as possible with the debtors' financing needs, etc. According to the data supplied by The National Bank, non-governmental credit has continued its rapid growth, especially along the segment of the population that borrows ever more heavily for consumption goods acquisition. Structurally, a higher growth can be noticed of credits denominated in foreign currency (predominantly in euros, dollars and Swiss francs), credits whose terms of maturity are ever longer.

Fig.2 Structural evolution of non-governmental credit in Romania

As regards companies, they resort little enough to banks for financing their activities, namely 14% (June 2007) of the companies resorted to bank credits, most of them finding financing abroad (about half of the internal credit).



The structural evolution of non-governmental credit reveals growing risks for the Romanian bank sector and, implicitly, of the efforts they have to make for carrying out efficient and permanent activities of risk management (credit, foreign currency, liquidity, operational).

Population Companies Other credits
RON Foreign currency
Medium term Long term Short term

Efficient assessment of credit risk by crediting institutions also implies quantifying and reduction of causes generating it. The Reports drawn up by the Supervision Direction of the RNB present the general and specific causes of credit risk crediting institutions have been faced with in Romania. The general causes have materialized in an ever stronger competition among banks, fact that has determined each crediting institution to set up strategies for consolidation and/or development of their market share, by rendering faithful old clients and gaining new ones. Starting from this, banks monitored more efficiently their credit portfolios as to their structure, terms to maturity and size of credits, quality of debtors, with a view to preventing and/or reducing losses in the crediting activity. The specific causes have been characterized by 6:deficiencies in the legal constitution of warranties for each category of credit, compulsory insurance of assts under warranty, and leasing of insurance policies to banks; non-observance of the conditions to be met by clients for getting credits and absence of documents necessary for approving them, or the submission of false documents which cannot be authenticated by bank personnel: non-registration or delayed registration of legally constituted warranties in the extra-balance sheet records; increase in the volume of credits taken in addition to the balance sheet and their slow retrieval rate; the high weight ,in the structure of warranties from clients ,of those having a high retrieval risk; erroneous determination and reporting of the level of loans representing high exposure, and exceeding the admitted limit for them; high degree of concentration of credits on a small number of clients.

Removal or reduction to the minimum of causes determining the manifestation of credit risk, and determination of the minimum capital requirements for covering the losses generated by credit risk by banks in Romania implies, as we have specified the use of one of the approaches stipulated by Basel II. Thus, according to a study carried out by the RNB, at the end of 2007, 31 crediting institutions operating in the banking market in Romania, opted for the standard approach, and one for a combined standard-internal rating models approach(in case of exposure for the public sector it applies the standard approach, while in case of exposure to sovereign entities and banks, it applies the internal rating models approach).

For crediting institutions, the implementation of Basel II implies financial efforts to cover the costs of the implementation of its provisions, costs generated by the activity of including the new requirements in the internal strategies and policies, the development of corporate governance practices, reshaping of objectives concerning clients and banking products, setting up and documenting of statistical data bases and of econometric methods for the documenting of internal assessment models for own banking risks and, implicitly, adaptation of computerized systems that should meet the needs for measuring, monitoring and reporting banking risks.

An important factor in the efficient application of one of the approaches presented is the adaptation of the information systems to the new requirements imposed by the provisions of Basel II, systems which should be characterized by accuracy of he data, that is, an efficient management of information as regards the

recording, processing, reporting and archiving of available information. According to the study Basel II implementation, carried out by the RNB half of the crediting institutions in the banking market in Romania have IT monitoring and reporting systems for risk exposure, policies, control and risk diminution procedures and processes and a for retrieval of data in case of disaster, adapted to the new requirements. To have an appropriate and efficient IT system, Romanian crediting institutions opted for one of the following variants: adoption of the IT systems supplied by the financial group to which they belong, extension of the functionality of the available systems with the financial assistance of the firms which supplied the basic software, purchase of a new software solution of the development of "in-house" solutions.

Another objective to be fulfilled, for the crediting institutions, concerns the training and updating of the personnel directly involved in adequating minimal requirements for capital and of those coming within the relation of reporting between the crediting institution and the RNB, as regards the crediting institution's options and risk control and the information and training of the bank's personnel activating along all segments of activity of the bank. The risk management system in crediting institutions must be based on the quality and flexibility of the modernizing strategy for risk management, on the functioning of an adequate internal control system and of a transparent and efficient managerial reporting system. For achieving these goals, crediting institutions must set up specialized risk management committees.

Conclusions

The new Agreement adopted in 2004 pursues the recommendation and application of a more complex and precise approach for assessing bank risks (credit, market and operational), for the attainment of the same main objective of the 1988 Basel Agreement-promotion of the safety and solidity of the banking system and the increase in the competitive equality of banks.

All types of approaches proposed for assessing the three types of bank risk have various degrees of complexity in their application and, obviously, different results in assessing bank risks. The standardized approach is the one that has the lowest degree of complexity and has a low level of sensitivity to risk, and it very little stimulates risk management. At the other end stands the advanced approach based on internal rating models(advanced IRB),which is a sophisticated method of risk approach, with a high level of risk sensitivity and which implies higher rights and responsibilities for crediting institutions(stimulates risk management).

Consequently, the provisions of the new Agreement pursues adapting risk management function of the characteristic features of each crediting institution, that is, function of the objectives set, volume of activity, quality of the placement portfolio, etc.

The methodology provided for in Basel II for determining the capital needs for credit risk implies that the crediting institutions in Romania should diversify the exposure classes and the corresponding risk weights supplied by external credit assessment institutions and adopt a wider range of eligible credit risk diminution techniques.

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Lect. univ. dr. Adrian Țăran Moroşan
„Lucian Blaga" University of Sibiu, Romania

THE ACCOUNTANCY OF COMMERCIAL REDUCTION IN RETAIL TRADE - PARTICULARITIES AND FISCAL IMPLICATIONS

Abstract: *The problem of reflecting in accountancy the price reductions has been treated in many specialized studies with a great success. One of these, remarkable not only from the documentation and precise information point of view but also from the systematization and communication point of view , has appeared some years ago in a accountancy magazine[1]. The author of the article proves, besides the capacity of analyse, synthesize and reflect the main opinions formulated along time by the international organisations from this field, also the ability of weighting and understanding the presented concepts, of making recommendations towards the application of recording ways and the avoidance of others. Because this study- as others publicized in a magazine – is small in size, it has no capacity of presenting in detail the studied problem, but it represents an essential and important start for the future researches. Through our article we will try to bring into discussion some adding to the author's ideas, without thinking that this is all that can be said about this subject.*

Key words: *price reductions, commercial reductions, financial reductions*

JEL Classification: *M41*

The price reductions presented by the accountancy literature[2] are, as the presented study mentions, separated in two categories:

1. Commercial reductions :

- Rebates, generally given for quality flaws of the delivered goods, but also for the deficient quality of the services regarding their delivery (delays towards the settling day mentioned in the contracts).
- Commissions, practised towards the costumers for which the enterprise shows a great consideration, either for their important orders(big value), either for their the position and the social influential of the customer;
- Restores, given to some costumers at the end of the financial administration period as a consequence of a great volume of profit obtained by the enterprise from its relationship with them.

2. Financial reductions (noun as discounts), resulted as a consequence of performing financial operations (discounts are connected to the debts payment before the setting day)

The price reductions mentioned before can be given either at the moment of invoice or at a subsequent date[3]. If the first two types of commercial reductions appear on the initial sale invoice, restore is practiced at the end of a financial administration period for all the operations that take place in the relation with a costumer. In order to follow the accountancy registering that is generated by the given commercial reductions to the retail sale units subsequent to the invoice, we will study three examples.

Example 1

One retail shop receives goods in value of 10.000 lei + VAT 19% and practices a commercial addition of 20%. Later it receives an invoice from a supplier on which is written a restore of 1.000 lei + VAT 19% (10% from the initial value of the invoice). The acquisition of goods is still in the shop financial administration at the moment of the obtained reduction. The acquisition price of the goods for the wholesale supplier was of 7.000 lei.

In the supplier's accountancy:

[1] Greceanu Dana, *Soluții şi alternative privind contabilizarea facturilor cu reduceri de preț. Consecințe fiscale*, Gestiunea şi contabilitatea firmei, nr. 10, 2003, pag. 16 - 23
[2] Pântea Iacob Petru, *Contabilitatea financiară a agenților economici din România*, Editura Intelcredo, Deva, 1999, pag. 224
[3] Greceanu Dana, ibidem

- The goods sale:

4111	=	%	11.900
		701	10.000
		4427	1.900

- The financial administration unloads of the sold goods:

607	=	371	7.000

- The registering of reduction given at the subsequent invoice:

4111	=	%	1.190
		701	1.000
		4427	190

In the shop's accountancy:

- The goods acceptance and their registering at a retail sale price :

%	=	401	11.900
371			10.000
4426			1.900

371	=	%	4.280
		378	2.000
		4428	2.280

- The registering of the subsequent received reduction (it is rectified 10% from the previous recorded sums):

%	=	401	1.190
371			1.000
4426			190

371	=	%	428
		378	200
		4428	228

Comment: Taking into consideration that the goods are on supply, the supplier can modify their retail sale price, so that the percentage of practiced addition stays the same.

There are situations in which either the acquired goods have been sold, either the merchant refuses to change the retail sale prise wanting to increase his benefits with the value of the received reductions. We propose to follow the accountancy registering that the retail shop will perform in these situations:

Example 2

The statement is the same as for the first example. The acquired goods are not in the shops financial administration at the moment of the received reduction.

In the supplier's accountancy:

Are performed the same accountancy registering as presented before.

In the shop's accountancy:

- The goods acceptance and their registering at a retail sale price:

%	=	401	11.900
371			10.000
4426			1.900
371	=	%	4.280
		378	2.000
		4428	2.280

- The registering of the subsequent received reduction after the goods sale:

%	=	401	1.190
607			1.000
4426			190
371	=	378	1.000
378	=	371	1.000

Comment: In contrast to the accountancy registering practiced by the wholesale shops, those with retail sale, besides the registration of commercial reductions of the goods sold on expenses, must be adjust their practiced added value. The sale price remains the same, the expense with the sold goods decreases, so the addition on each sold unit increases.

For a much more clear presentation of the analysed aspects and for highlighting the implications of some wrong or incomplete accountancy registering, we propose the following statement:

Example 3

A retail sale shop receives goods from a supplier in value of 10.000. The received goods are, being known that the enterprise practices a commercial addition of 10%. Subsequently, it is received a commercial reduction from the supplier of 1.000 + VAT 19%. The stated operations are registered in the retail merchant's accountancy.

- The goods acceptance and their registering at a retail sale price:

%	=	401	11.900
371			10.000
4426			1.900
371	=	%	3.090
		378	1.000
		4428	2.090

- The sale of goods:

5311	=	%	13.090
		707	11.000
		4427	2.090

- The sold goods removal from the financial administration:

%	=	371	13.090
607			10.000
378			1.000
4428			2.090

- The registering of the received reduction after selling the goods:

%	=	401	1.190
607			1.000
4426			190

Comment: If the enterprise performs only this registering in order to emphasize the received reductions, we observe that the sum noted in the account's credit 371 of 13.900 lei, representing the retail sale price, is not found in the accounts that reflect the components of the retail sale price (the acquisition price – 607, the commercial addition – 378, and VAT - 4428). If we sum up the registered values in these accounts we obtain only 12.900 lei. On the other hand, the difference between the registered sums from the income accounts and those reflected in the expenses accounts should represent and does represent the commercial addition practiced by the enterprise (11.000 – 9.000 =2.000). In 378 accounts however, both on debit and credit, instead of the sum of 2.000 we have only 1.000. In consequence, in order to reflect the economic reality, according with the accountancy formula above, we have to do other two registrations:

371	=	378	1.000
378	=	371	1.000

The solved problem has deep fiscal implications in economic practice. Because the commercial addition emphasized in the 378 accounts before the last two registering performances is lower than the one practised in reality by the enterprise, the coefficient used for calculating the addition due to the sold goods – in case stocked goods remain – it will be lower (K378). Taking into consideration that in practise, the due sold goods expense registered in 607 account, is determined as a difference between the sum written when unloading financial administration on 371 account and those reflected in the 378 and 4428 accounts' debits, this will be over increased in the conditions in which the debtor hauling time of the addition account is determined by using a financial administration unloading coefficient that is lower than the real one. It results that, in case the retail shops do not perform the latest two recordings mentioned before, they are eluded from a part of the tax payment on the profit.

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Andrei Toma
National Agency of Fiscal Administration, Romania

TAX AVOIDANCE AND TAX EVASION WITHIN ROMANIAN INTEGRATION INTO THE EUROPEAN UNION

Abstract: *Globalization and European Union extension represent for any economic entity the premises of financial performance maximization. Under the commercial boundaries abolishment, the diversity and complexity of the performed transactions lead to increased tax avoidance and tax evasion.*
By means of this research we try to explain the concepts of tax avoidance and tax evasion, identify the indictable elements, analyse the ways of fighting nationally and internationally against them, identify the shortcomings of the present national fiscal practices and we propose alternatives to answer the real eradication of these phenomena.
The steps of this study take into account a synthesis of the materials published by national and international standards, by professional bodies, papers on this theme proposed for debates, as well materials of the economic entities.
This study structures the issues of preventing and fighting tax avoidance and tax evasion in Romania within the framework of ascension of intracommunitar and the international transactions.

Key words*: fraud/tax evasion, tax avoidance, strategy.*

JEL Classification: *H26*

Tax evasion (tax elusion) and **tax avoidance** (tax dodging) are terms currently used both in the economic literature and legislative practice of several countries, showing a clear-cut distinction between these two concepts. This clear definition of these two non-payment of taxes practices is outmost important and appropriate because underlines different identification and control policies, adapted to the specificity of each phenomenon.

Tax avoidance refers to play taxation down by use of acceptable, real, legally debatable alternatives.

Tax evasion or fraudulent tax avoidance, on the other hand, is determined by contributors clearly interested in not complying with the fiscal law in force; it represents a clear law contravention.

Next to tax avoidance, which exploits the gaps and contradictions of fiscal regulations, there is a type of evasion which grows up on the basis of deficiencies brought in by exonerations or derogations for certain categories of contributors. Within the European Union states, all these exonerations are called *fiscal expenses* in order not to lead to discussions and interpretations, keeping in mind the fact that they are not different from the subsidies awarded by state to the people who benefit from such assistance.

If the avoidance to meet the budgetary obligations is carried out by interpreting the fiscal laws in favour of the contributor, then we stand within area of legal tax avoidance, not punished by law and not called crime. This is true, for example, when a certain part of the incomes of some persons or social categories are tax evaded because of the manner in which fiscal legislation sets the taxable object: this is a so-called "legal" tax avoidance because the income is established according to certain criteria or norms, the result being a taxable income, inferior to the real one. The tax dodger will exploit the gaps and contradictions of fiscal regulations, taking advantage of whatever law, deliberately or not, permits to contributors or only to certain categories.

To this last regard, Pierre Pestieau[1] admits that sometimes, in a certain conjuncture, the strongest professional bodies (unions) have a powerful influence on Parliament, obtaining thus different exonerations or derogations for their members. This situation is included also into the category of tax avoidance, keeping in mind the final effect – defrauding the state, respectively the budget of its rightful revenues.

The concept of **tax evasion** is the sum of illegal practices permitting partially or totally the elusion of the compulsory tax. These practices are penalised by administrative punishments (in case of simple fraud), in more serious cases, the ones of "professional" fraud are penal punishments. In most cases, tax evasion is a crime against law and is different from **tax avoidance**, which is a clever use of the possibilities offered by law, lying on the edge of legality in most of the situations.

According to Pierre Pestieau, in quoted work, **tax avoidance is at least as efficient as tax evasion, having though, the significant advantage of being legal.**

[1] :Pierre Pestieau. L'•conomie souterraine, Ed. Hachette, 1989

There is no breach beween tax avoidance and tax evasion, being related and continuous.This situation is similar to the one describing the "grey area", sometimes difficult to define and include into one area or another between the clearly legal behaviours and the ones which are without ambiguity illegal. Besides the legal aspect, and implicitly, the different ways of preventing and fighting against them (tax evasion – by punishments, tax avoidance – by sanctions and corrections and completions to the legislation under debate), between the two phenomena there are no distinctions.

The effect on the state revenues being the same, the two phenomena lead to diminution of fiscal profits and inequalities among the contributors. The consequences are known:

- decrease of budgetary revenues, with major implications on economy and society, generally speaking, and
- inequality before law – some people pay taxes, others do not – leads to unfair competition, an unhealthy business environment.

Limitation of the state's freedom to decision by limitation of budgetary policy further to short revenues has negative effects both at economic level (the state is the only one to interfere in correcting macro-economic unbalances) and at social level: social protection, health, education.

Of course, the public opinion is less severe towards tax evasion, as compared to tax evasion and rejection of any illegal practices. According to each country and time, the social tolerance before tax evasion varies, and at the same time, the frequency and harshness of controls vary, too.

In countries like France or Belgium tax evasion is condemned while tax avoidance is percieved by population as accepted: a sort of a "second national sport, after football".

Tax evasion has an importance place within underground (submerged) economy, its share varying according to factors which can be considered objective, respectively less dependent or even independent of economic policy decisions:

- fiscal pressure, which cannot suffer significant alterations on short time without the risk of producing high economic distortions, and, moreover, high distortions within the national fiscal system.
- country's economic status – a rich country, with quite a high level of living, is less exposed to fiscal, social and even moral law infringements.
- position of economy within the economic cycle. During economic crisis, the underground (submerged) economy and its main component – fraud of taxation meet an accelerate development. The two economic cycles – official and unofficial – are opposite: the development of one of them leads to the repression of the other.

There are also several subjective factors, such as: harsh punishments, population's tolerance, traditions, culture, ethnic structure.

According to many specialists, researchers of this phenomenon, tax evasion holds between half and three quarters of total amount of the unofficial economy; this, reported to gross internal product, represents huge amounts for many countries.

In western countries, tax avoidance is more frequent than tax evasion; they both appear as submerged phenomena. In less developed countries there appear black labour (which is, in the last analysis, a type of fraud) and the activities related to corruption, prostitution, drugs, interloping.

Though there is a provision of the European Union into the *Convention on the protection of the EU financial interests* dated 26 July 1995 concerning tax evasion definition into the European countries, the definitions vary even though the principle taken into account stays the same.

The Convention on the protection of the EU financial interests dated 26 July 1995 provides:

- tax evasion definition;
- Member States obligation to punish the crime, establish competence on territory basis, co-operate, centralize the accusations and smooth extradition;
- Member States obligation to make the managing boards respond penally for their involvement into tax evasion.

An important step into this field is the "FIP"[1] Convention coming into effect in October 2002, further to Member States' ratification and to the protocol existing since 1996 regarding the Court of Justice competence. According to this convention provisions, the Member States are obliged to integrate the penal definition of fraud and corruption (active and passive) that brings prejudices to the Community financial interests within their national law and to stipulate the penal responsibility for these crimes.

[1] FIP – Financial Interests Protection

At European Union level there is not a united regulation concerning tax evasion sanction, each country having its own legislation. Euro forgery is an exception to this rule. The European Comission investigates the way in which Member States have complied with their obligations on tax evasion and corruption punishment (as well as with the punishment of money wash). There have been issued provisions to allow fiscal authorities to mutually award administrative and legal assistance in order to establish and collect taxes.

The information exchange is officialized by fiscal conventions and co-operation between international financial information agencies and international fiscal authorities, in attempting to considerably reduce the temptation for natural persons and multinational companies' tax avoidance.

For example, Austria and France treaty fully authorizes the information exchange between the two countries, related to tax collection – except the ones which can endanger the law and order into both countries. There are also implementated, at European Union level, means of administrative co-operation and exchange of information between the fiscal authorities in order to prevent and fight off VAT and excises duty evasion.

An examination of the tax evasion and tax avoidance definitions, of the way these are considered and treated more or less distinctively, allows the legislator to understand this phenomenon in different countries.

In **Holand**[1], **tax evasion** is defined as deliberately writing an inaccurate declaration, presenting false documents or not complying with the legal regulations on providing to the administration certain information requested to establish or control taxes.

According to the Luxembourg law, **tax evasion** takes two forms that are differently punished:

Simple tax evasion, which is involuntary and is committed "by anyone, as a contributor, a mandatory or as a caretaker of a contributor's affairs and who, by negligence, makes possible the decrease of tax collection or assignment or unjustified holding of fiscal advantages". This infringement is sanctioned only by fine, whose value varies according to gravity, but cannot exceed one million Francs.

Within Luxembourg law, there is the definition of **breach of fiscal order**, called "*blakettgesetz*". This concept covers any infringement of fiscal legislation. This breach is committed by anyone, as a contributor or as a caretaker of a contributor's affairs, who comes in conflict deliberately or by negligence with both fiscal law and a decission made within the proceeding of taxation which underlines that its non-compliance is punished".

In **Ireland**, **tax evasion** is defined as any fiscal infringement committed deliberately to evade taxes. The Irish law punishes more harshly special fiscal crimes that are not proper for a certain tax category but they are common to all taxes and duties levied by fiscal administration. This is the case of serious law-breakings and therefore punishable by severe sanctions. Among the 15 categories ranged by the finance law from 1988, there are:

- an inaccurate statement submission or inaccurate documents communication;
- opposition to fiscal control;
- refusal to keep or submit documents prescribed by law, etc.

In **Germany**, the **tax evasion** is defined as the conscious refusal to submit to administration the fiscal elements that condition the tax establishment or communication of inaccurate or incomplete documents, situation when these actions tend to decrease taxation or procure unjustified fiscal advantages to their author or to a tertiary party:

- Contributor's willingness to get rich by fraud;
- Size of evaded taxes;
- Get the best out of appurtenance to a public function or appeal to a clerk's complicity.

Therefore, the fiscal legislation in **Germany** provides three concepts to define tax evasion. The first element is avoidance of tax payment, which is perfectly legal and permissible; the second one is tax avoidance which is not allowed but once discovered can be corrected without sanctions; the last one is tax evasion which is considered an abuse to be punished according to the law.

Where the fiscal inspector has suspicions about tax evasion, he/she first informs the certified fiscal authority whose duty is to integrate fraud into the type of fiscal legislation related to the relevant field.

Spain is one of the European Union states with a high tax evasion. Taking into account the complex situation from sociologic point of view and the specificity of the complicated fiscal system, Spain has high tolerance for "simple" offences.

[1]according to – Nicolae Hoanta, Tax Avoidance "Tribuna Economica" Publishing House, Bucharest, 1997.

Finland's penal code carries a detailed definition of fraud. Here are the three key words of the definition:

- "premeditation": the tax dodger is conscious of the possible consequences of his actions by which he/she intends to evade tax payment.
- "inaccurate information": this refers to the information that is relevant for the tax size, submitted orally, in writing or in other ways.
- "consequences": the consequence of the contributor's behaviour is the one that the paid taxes amount is situated at a low level or the tax is totally evaded from payment.

The Romanian law defines "tax avoidance" within the *Fiscal Procedure Code* as:

"Tax avoidance refers to the wrong determination of the taxation basis and of the payable amount representing duties and taxes, by hiding data and circumstances relevant for taxation and by conscious behaviour of wrongful declaration of data in order to decrease the fiscal burden. Double invoicing, as well as the use of transfer by prices, aiming to diminution of taxes and duties, in opposition with the rules that establish the ways of determining the taxes and their basis will be considered tax avoidance."

In terms of penal law, tax avoidance is not mentioned as a convicted act, though financial evasion as a concept, is broadly described. The concept of financial evasion does not include only activities that involve Treasury but also underlines those acts which evade both public and civil institutions and natural and legal persons. Thus, tax avoidance is nothing but a type of the "financial evasion" category.

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Elena Toma
„Alexandru Ioan Cuza" University of Iaşi, Romania

CORPORATE TAX - A NEW APPROACH

***Abstract**: The Common Consolidated Corporate Tax Base, abridged „CCCTB", represents a new concept in the fiscal theory, which in the nearby future, will become a reality of fiscal practice of each EU's member state. The year 2007 represented a significant step in shaping the principles which will gouvern the CCCTB, as a result of the great meetings at the level of European Comittee on the matter. The author wants to analyze the impact of such a legislative inittiative and at once to describe, technically speaking, its containt.*

***Key words**: Common consolidated corporate tax base, fiscal competition, fiscal policy*

***JEL Classification**: H25*

The problem of harmonising the Common Consolidated Corporate Tax Base, abridged „CCCTB", has been discussed within the framework of the European Committee, even since 2004. Though a better approach of this problem, when the stakes which concern the primar aspects to be harmonised in this area, occured in september 2007. Harmonising the common consolidated tax base remains a priority on the list of the Europeen Commission. Its foundation consists of the following motivations, at least.

First of all, achieving a common consolidated corporate tax base represents a reaction of adapting the common legislation to the evolution of the globalization process. Extended in all the areas of the economic life, this process has no physical boundaries to stand in the way of the world wide expansion and development of the grand companies, and has marked the economy in the whole wide world.

As a second answer to the „Why the common consolidated corporate tax base?" question we find the basic idea of the European Union's construction through which they wished to find a unique economic frame, including common fiscal legislation. They also wish to create an attractive european economic space in order to place the foreign investments (where a harmonised legislation may constitute an advantage of localization).

In the third place a common consolidated corporate tax base would remove the world wide's groups trouble: the cost for managing the tax will remarkably diminish if we take into consideration the fact that now, a multinational group, which activates in all the member states, needs to work with 27 different systems of the profit tax.

By comparison, in this case, the steps started early, even since 1977, when through the 77/388/CEE Directive, which concerns harmonising the indirect taxes such as VAT and of the excises duties at the European Union level, they proceeded to harmonise the VAT's tax base available for all the member states. The process of harmonising the VAT started to improve since 1 January 1993 along with the new created Unique Market.

The stated process has as foundation the fact that this tax represents, in the first place, the most important fiscal sourse as weight in GDP, in which the commom budget is being also formed. This process has also aimed to one of the four fundamental liberties such as the free circulation of merchendise and services, knowing that the VAT represents a fundamental element of this prices.

The things stand differently regarding the profit taxes of the economic agents which, now, stand on quite mobile and different principles. Until now, the fiscal politics in the domain have been orientated and limited to defining Corporate Tax Base and in adding rules regarding avoiding the double constraint. In conclusion we talk about 27 different techniques of the profit's constraint: each member state having its own system of taxing the economic agent's profit.

From the money politic's point of view, the member states sort of lost their sovereignty because they mostly took over this privilege from the European Central Bank. Concerning the fiscal political side, we can say that each Govern can establish its own objectives and fiscal strategies; this way, the fiscal politicy and especially the one in the direct taxes domain, became an operating device in creating teritorial attractivities for the potential investors, starting with 2004.

Througout the 10 new commers in 2004, the tendency manifests also in Romania's and Bulgary's case. Their governs juggled with the level of the part tax or with some fiscal facilities which aim the investments or the reinvestments of the profit, concerning the profit tax. The other member states were forced themselves to reduce the level of the corporate tax in order to keep the important investors already

localised on their own teritory or the potential new investors. In this way, they reached a sort of fiscal competition between the states with unwanted effects (the example of the Nokia Company being the most relevant in this case).

We can conclude by analizing all this, that the European Commission's legislative proposition of harmonising the common consolidated corporation tax base has as motivation this phenomenon of „fiscal competition" along with the other three motifs mentioned before. There is no doubt that this legislative measure was considered important imediatly after the member states have diminished their corporate tax rates, in 2005 and 2006.

This fiscal competition, sometimes camouflaged, in the sense of lowering the tax rates, is not to blame because the new commers must fit into the catching-up process of the member states with high performance at the level of macroeconomic meter, such as: rythm of economic development, unemployment rate, general price meter, etc (this process was initially used by the new commers and after that by the other member states). This phenomenon of diminishing the interstates ecarte, reporting on the level of economic development, comes as a purpose itself for the creation of the European Union. This new created space aims to be an international economic power in competition with the other economic forces of the world.

Starting with 2005, we witness a general process of reducing the corporate rate tax.We can notice in the following table that a number of 16 countries have reduced their tax rates as it follows:

Table no. 1 : Corporate Tax Rates in Europeen Union 27

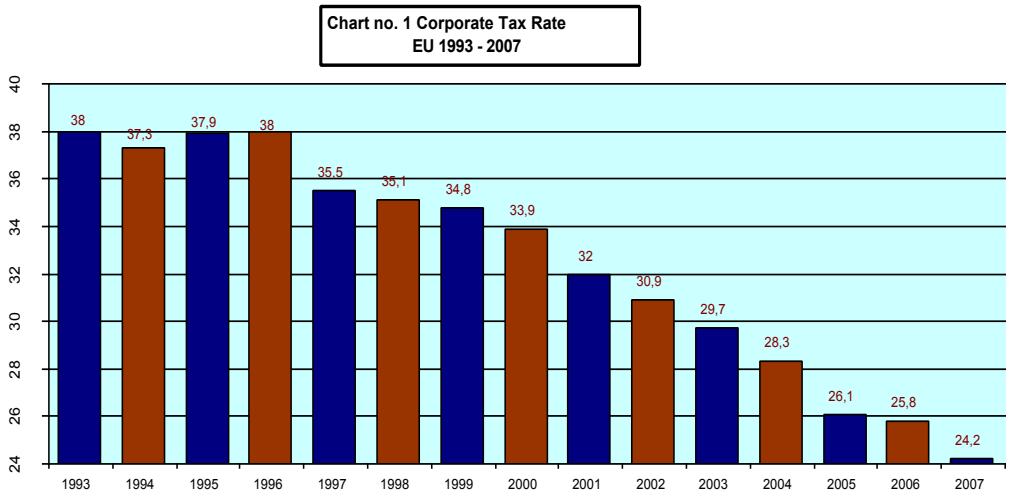
Country	2004(%)	2005(%)
Austria	34	25
Belgium	34	34
Danmark	30	28
Finland	29	26
France	34.3	35.43
Germany	27.9	25
Greece	35	32
Ireland	12.5	12.5
Italy	34	33
Luxembourg	30.38	30
Netherlans	34.5	31.5
Portugal	30	27.5
Spain	35	35
Sweden	28	28
United Kingdom	30	30
Ciprus	15	15
Czech Republic	28	26
Malta	35	35
Estonia	0% for profit reinvestment	0% for profit reinvestment
Hungary	18	16
Latvia	19	15
Lithuania	19	15
Poland	27	19
Slovenia	25	25
Bulgaria	15	12.5
Romania	25	16

Source: modified by „ KPMG's Corporate and Indirect Tax Rate Survey 2007", p. 5 -11, http://www.kpmg.com/Services/Tax/Business/IntCorp/CTr

In 2007, the average of the corporate rate taxes, which concerns the Union, was 24.2 %, lower with 3,6 % than the registered average at OECD, with 3.8 % than the registered average at Latin America and with 5, 9 % lower than Asia-Pacific, according to a study of KPMG.

From chart number 1 we can observe a descendent trend regarding of the average corporate tax rates, but in 2005 we can notice a more sudden drop then in the other years, as a result of legislative measures taken by the 16 member states of the union to reduce the corporate tax rate. The descendent trent has maintained in 2006 and 2007 as a consequence of the lowering of the corporate tax rates in the following

states :Portugal has modified,starting with 2007 , to 25 % the corporate tax rate, Spain has lowered to 32.5%,Czech Republic to 24%, Cyprus to 10%, Bulgaria to 10%, and Slovenia to 23%.



Source : http://www.kpmg.com/Services/Tax/Business/IntCorp/CTR

It was enforced a new way of thinking the profit constraint system because of all these many reasons, in elaborating a Common Consolidated Corporate Tax Base "CCCTB", materialized in a working document which is to be found on the priority list of the European Commission, in the moment of speaking.

The history of this legislative first step begins in july 2004, when the European Commission elaborated the draft-document on the edge of this problem. This document was analyzed later on, within the framework of ECOFIN, in september 2004. Elaborating a unique fiscal tax base, in taxing the profit of the companies, joined a common timetable of development in the area of the competition between the enterprises of the European Union. The efforts of the European Union in what concerns the common consolidated tax base shaped in a new document named „The common consolidated corporate tax base: the draft of the technique background".

Throughout this document they accomplished to trace the corporate tax bas as a sequel to the arguments of the European Commission's experts with the collegiate and business environment.

Between the formative elements of the fiscal tax base of the corporate tax, the taxpayer draws our attention. Moreover, the companies which carry on their activities on the Union's teritory will have the possibility to choose the common consolidated corporate tax system, wether if they are resident in a member state or if they have a permanent etablishment. Only the fiscal consolidated companies have the compulsoriness to use this new system, starting up 2010.[1] Talking about the fiscal consolidated companies, we have to underline the fact that the document defines them as a group in which over 75% of the suffrage are owned by the parend company. In the other cases in which the group is not being fiscaly consolidated, the option for common consolidated corporate tax base is being used by all the companies which are members of the group or by neither of them.

The option remains valid for at least five year. It also quietly renews itself for another three years if the tax payer hasn't manifested his denial in writing. In order to make possible a continuity in applying the system corporate tax in case that the tax payer who already uses the stipulations of the tax base is being taken over by a company which hasn't chosen this system, will continue to calculate the owed tax until the end of the 5 or 3 years period, respecting the stipulations of the common consolidated corporate tax base.

The document elaborated by the Commission stipulates the general rule of calculating the taxable profit and also gives a list of the main taxable or exempt income, deductible and non-deductible expenses. In detail, the taxable income represent all the acquired income of the society from all the sources: monetary or non-monetary, of exploitation, financial or exceptional. That leaves us with the exempt income and the investment income which diminishes the acquisition or the production price of the assets like dividends. The deductible expenses represent all the expenses made by the society in order to accomplish the activity object. On the list of non-deductible expenses we fiind the following: corporate tax expenses, penalties, expenses for

[1] www.ec.europa.eu.int, in GROUPE DE TRAVAIL SUR L'ASSIETTE COMMUNE CONSOLIDÉE POUR L'IMPÔT SUR LES SOCIÉTÉS(GT ACCIS), p.28

the shareholders or/and the personnel, liquidating the fixed assets from the luxury goods category, entertainment and representation costs (only 50% of them being recognized).

Concerning the fiscal depreciation, are being considered fixed assets those which have a usage period bigger than a year and have an entrance value bigger than 1000 EUR. What looks different than the usual fiscal practice is the Commission's wish to calculate the fiscal depreciation variously in categories of fixed assets (named pools) in case that all these are utilized on medium or short term, or individual fixed assets if they are utilized on long term. In case of the long term fixed assets we need to bookkeep them separatly in order to combine all the following rules: entrance value of minimum 5.000.000 EUR and usage period of minimum 25 years. The buildings will be depreciated with a rate of 2.5% per year, while the other long term fixed assets will be depreciated with a rate of 4%. We consider this change a favourable one, especially when it comes to the price of managing the corporate tax which will be reduced allong with the physical time affected by the depreciation's calculation.

The income and the expenses' will be registered after the bookkeeping of engagement principle and the bad debts provisions are totally educible by respecting some certain conditions. On the other hand, the fiscal losses will be recovered from the upcomming profits, in an unlimited time period, while the former profit recuperation is forbidden. The common consolidated corporate tax base would result from the sum of the individual profits obtained by each group's daughter-company with no concern for the member state which gave it (mentioning that it will be allot and taxed with the legal rate from that state).

It's also important to mention that the European Commission's legislative proposal aims to create a new fiscal tax base but not a unique rate tax; it also has been harmonised the base of VAT's of application without a unique rate but qith a minimum threshold.

At the september 2007 debates they drew the most important rules of profit's apportionment. Moreover, the apportionment will took place by taking into consideration the next five key-elements: salaries, fixed values, sales level, incorporation criterion and the possible sector formula. It also came to an intermediate form of the profit's apportionment. This profit makes possible the three following key-elements: work factor (with two elements: salaries and number of employes), asset factor and sales factor.

The tax base of each taxable entity will be calculated with the following formula:

$$CCCTB_A = \left(\frac{1}{3} \left(\frac{1}{2} \frac{PayRoll_A}{PayRoll_{Grup}} + \frac{1}{2} \frac{NoEMP_A}{NoEMP_{Grup}} \right) + \frac{1}{3} \frac{Assets_A}{Assets_{Grup}} + \frac{1}{3} \frac{SalesT_A}{SalesT_{Grup}} \right) \times CCCTB_{GRUP}$$

Where: NoEMP = number of employees;

The impact of introducing the system will be major, especially when it comes to reducing the red tape (this one being an obstacle in the way of placing the foreign investments, though it creates an attarctive european economic space for the potential investors from out of Europe) which works with one specific law and remarkably reduces the administration tax price.

The idea of a unique common consolidated tax base that facilitates the calculation of the corporate tax has the support of 78% of Union's experts (according to a 2006 boring made by the European Comittee); the most fanatic advocates were the ones from Cehia, Denmark and Spain with a maximum percent of 100; in Italy the proposition was sustained by 96% of the questioned ones, while in Greece, Louxemburg, Polland, Slovenia and Sweden only 90% agreed. The least bit enthusiastic were those from Great Britain with only 62% in favour of changing the system, while in Ireland and Slovakia 50% opposed to the initiative of the European Comittee.

In Romania the project was sustained by 90% of those questioned; the people noticed the positive impact over the red tape's reduction, a steel present disaster of the administrative romanian system[1].

An obstacle in the way of functionality of the common consolidated profit tax base consists of the inconsistently bookkeeper's system at the level of the member states, pointed out by the European Commission. At the moment, there are 27 accounting systems either of anglo-saxonic origins or french continental origins. The differences between the accounting systems of the member countries are related to the degree of independency between bookkeeping and fiscality. If in Great Britain the fiscal legislation does not „contaminate" the accountancy (which offers the investor a real information on the patrimony), in the other member states, the fiscality leaves it's mark on the accountancy, in different proportiones, it's purpose being to supply the information for the fiscal devices. Another alternative would be eliminating from the accountancy area the way of calculating the owed corporate tax . Anyhow, the European Commission has left the problem opened to discution, so that the member states can make propositions on the matter.

[1] "Tibuna Economica" Review, no. 42/2007, p. 60

We add to this the eventual government's reticence to introduce in the national fiscal legislations the common foresight by subjective or objective motifs.

The making of an unique framework of profit tax does not represent the solution in order to attract foreign investments, but only one of the factors which can contribute to the creation of the location advantages, along with the other factors such as: the existence of a well done infrastructure, fiscal and monetary stability, the lack of red tape. All these factors contribute to transform the state into an attractive teritory for the investors.

In Romania, such a legislativ project would be usefull taking into consideration the ascending rythm of developing the foreign investments, but it will incounter obstacles in the stated process, like in most of the states.

On the course of harmonising the fiscal legislation with the common legislation in the area, Romania has already made progress, now being in full process of introducing the IFRS. This way, the Fiscal Code has been elaborated taking into account the preadhasion's conditions which are to be found in „Assessment", chapter 10, also partially adopting a series of international standards. Partial encounters of the International Accounting Standards were included into the Finance Minister's Order No. 94/2001 and No. 306/2001. These regulations belong to the romanian accountancy system and are mantained nowadays in the new Finance Minister's Order No.1752/2005 which canceled the regulations mentioned before.

The new order No. 1752/2005 has been written according to the european orders; all the judicial persons who develop their activity in Romania are obliged to submit this regulation. Moreover, starting with 2006, through the Finance Minister's Order No. 907/2005, the credit institutions are obliged to make „a distinctive set of financial situations coresponding to the IFRS for their own necessities of informing the users, other than the state institution", meanwhile the public interest entities can chose the preparation of financial situations according to IFRS.

Starting with 2007 the companies listed are also obliged to draw up financial situations according to the IFRS. It's imposed to mention that through International Standards of Financial Reference we understand „International Standards of Financial Reference" (IFRS), International Accounting Standards (IAS) and afferent Interpretations (Interpretations SIC-IFRIC), the amendments that follow those standards and the relevant interpretations, the standards and the future afferent interpretations, just as they are approved by the European Union, translated and published in romanian."[1]

In conclusion the legislative initiative of the European Commission , once adopted and added to the national level represents another step closer in the direction of unrolling the unifying process which aims also the fiscal legislation area.

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[1] Finance Minister's Order No. 907/2005

Phd. Student Luiza Denisa Truică
Relationship Manager UniCredit Tiriac Bank, Romania

ASSESSMENT OF BUSINESS PERFORMANCE FROM LENDERS' POINT OF VIEW

Abstract: *We wish to assess the performance of a business more from lenders' point of view, therefore we will look for ways to measure the financial and economic consequences of past management decisions that shaped investments, operations, and financing over time. The important questions to be answered are whether all resources were used effectively, whether the profitability of the business met or even exceeded expectations, and whether financing choices were made prudently. As we'll present, there is a wide range of choices among many individual ratios and measures, some purely financial and some economic which can indicate problems of repayment capacity. No one ratio or measure can be considered predominant. We will base present analysis of business performance on published financial statements. Our focus will be on key relationships and indicators that allow the analyst to assess past performance and also to project assumed future results. We'll point out their meaning as well as the limitations inherent in them. Past performance and future expectations have to be viewed at some point in terms of cash flow generation, investment returns, and operational effectiveness. Many performance measures are related to each other in various ways, and credit analysis requires a thorough understanding of these linkages. Performance analysis is best performed as a dynamic process, using financial models where possible, to assess combinations of data and measures over time.*

Key words: business performance, ratio analysis, manager, lender

JEL Classification: G32; G39.

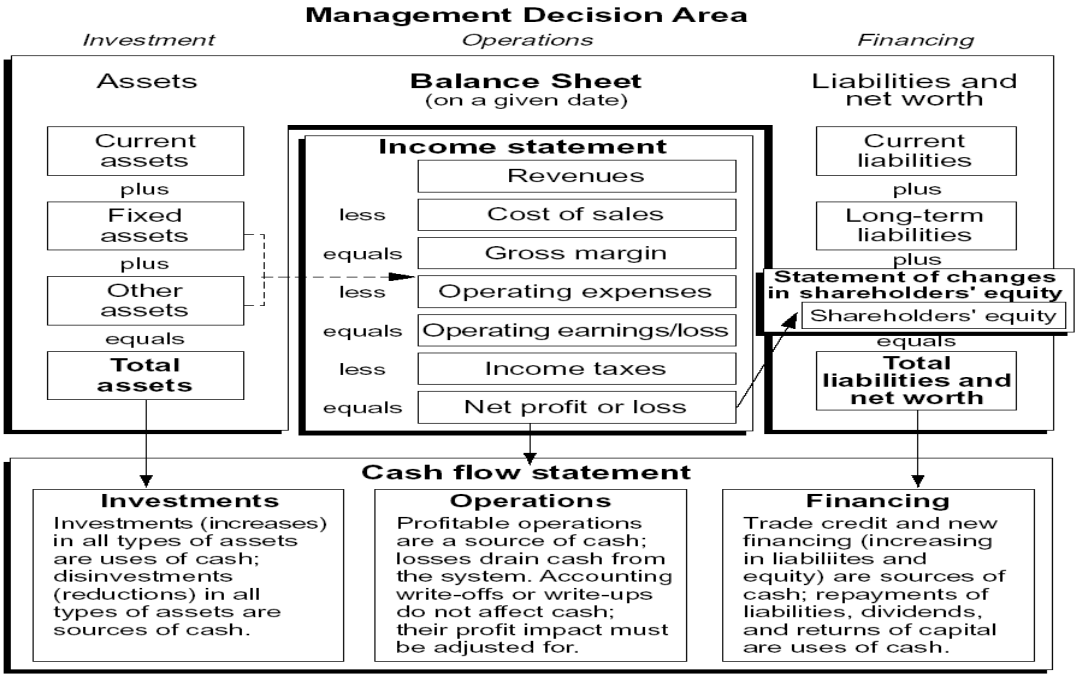
The Context of Financial Analysis

Managing a business successfully requires an understanding of the systematic relationships among the key elements in the areas of investment, operations, and financing, and the impact of decisions on these relationships. Total systems thinking is a critical requirement both in setting strategies and in their execution. While published financial statements are the most widely available source for financial analysis, the limitations inherent in their preparation (based on generally accepted accounting principles) require a basic understanding on the part of the user of how analytical results in the areas of performance and valuation can be distorted and what adjustments might be necessary. Cash flow is the ultimate driver of business performance and value, but its use in internal and external analysis generally requires considerable care in selecting data, constructing proper analytical frameworks, and interpreting the results. Expectations by shareholders about future cash flows are the basis for deriving shareholder value. The value of a business relative to its peers and the stock market as a whole will change with these expectations. This requires a future orientation in analyzing business performance. Creating shareholder value is a key responsibility of business management, the success of which depends on consistent use of sound economic trade-offs in all decisions made by the management team. This requires an understanding of the cash flow implications of decisions, and an organizational climate and incentives that will foster such consistency in strategies, policies, and in making and implementing management decisions. The context of any analytical effort is critical to successfully addressing the issue or problem to be resolved by the analysis. Much of the thought process underlying an analysis should be directed to ensuring consistency between the objectives and the data sources and processes employed.

Managers or analysts performing various kinds of financial/economic analysis normally do so with a context for specific purpose in mind. During the process of analysis, financial statements, special analyses, databases, and other information sources are used to derive reasonable judgments about past, current, and prospective conditions of a business and the effectiveness of its management.

We must recognize that not only does the person performing the analysis and interpretation have a purpose and viewpoint, but so do the preparers and providers of the various types of data and information on which the analysis is based.

Generalized Overview of Financial Statements



Please see a descriptive overview for the key objectives of three major financial/economic processes as an understanding the differences in data generation and analytical orientation involved in each:

The Different Objectives of Financial/Economic Analysis Processes

Financial Accounting	*Investor Analysis*	*Managerial Economics*
Profit Determination	**Financial Information**	**Activity Economics**
• Revenue recognition	• Adjustment process	• Task analysis
• Expense recognition	• Trend analysis	• Economic allocation
• Cost allocation	• Profit projection	• Contribution analysis
• Profit definition	• Cash flow projection	• Trade-off determination
Value Determination	**Comparative Data**	**Resource Effectiveness**
• Historical costs	• Industry analysis	• Investment base
• Conservatism	• Competitor analysis	• Capital investments
• Equity as residual value	• Economic conditions	• Capital divestments
• Contingency recognition	• Adjustment areas	• Human resources
Tax Determination	**Market Analysis**	**Shareholder Value Creation**
• Legal data requirements	• Share price patterns	• Cash flow patterns
• Income/expense timing	• Market trends	• Cost of capital
• Tax management issues	• Value drivers	• Investor expectations
• Statement adjustments	• Market models	• Ongoing business value

Ratio Analysis and Performance

By definition, a ratio can relate any magnitude to any other—the choices are limited only by the imagination. To be useful, both the meaning and the limitations of the ratio chosen have to be understood. Before beginning any task, therefore, the credit analyst must define the following elements:

- The viewpoint taken.
- The objectives of the analysis.
- The potential standards of comparison.

Any particular ratio or measure is useful only in relation to the viewpoint taken and the specific objectives of the analysis. When there is such a match, the measure can become a standard for comparison. Moreover, ratios are not absolute criteria: They serve best when used in selected combinations to point out changes in financial conditions or operating performance over several periods and as compared to similar businesses. Ratios help illustrate the trends and patterns of such changes, which, in turn, might indicate to the credit analyst the risks and opportunities for the business under review.

A further caution: Performance assessment via financial statement analysis is based on past data and conditions from which it might be difficult to extrapolate future expectations. Yet, any decisions to be made as a result of such performance assessment can affect only the future.

To provide a coherent structure for the many ratios and measures involved, the discussion will be built around one major viewpoints of financial performance analysis - ***lenders***. While there are many different individuals and groups interested in the success or failure of a given business, the most important are:

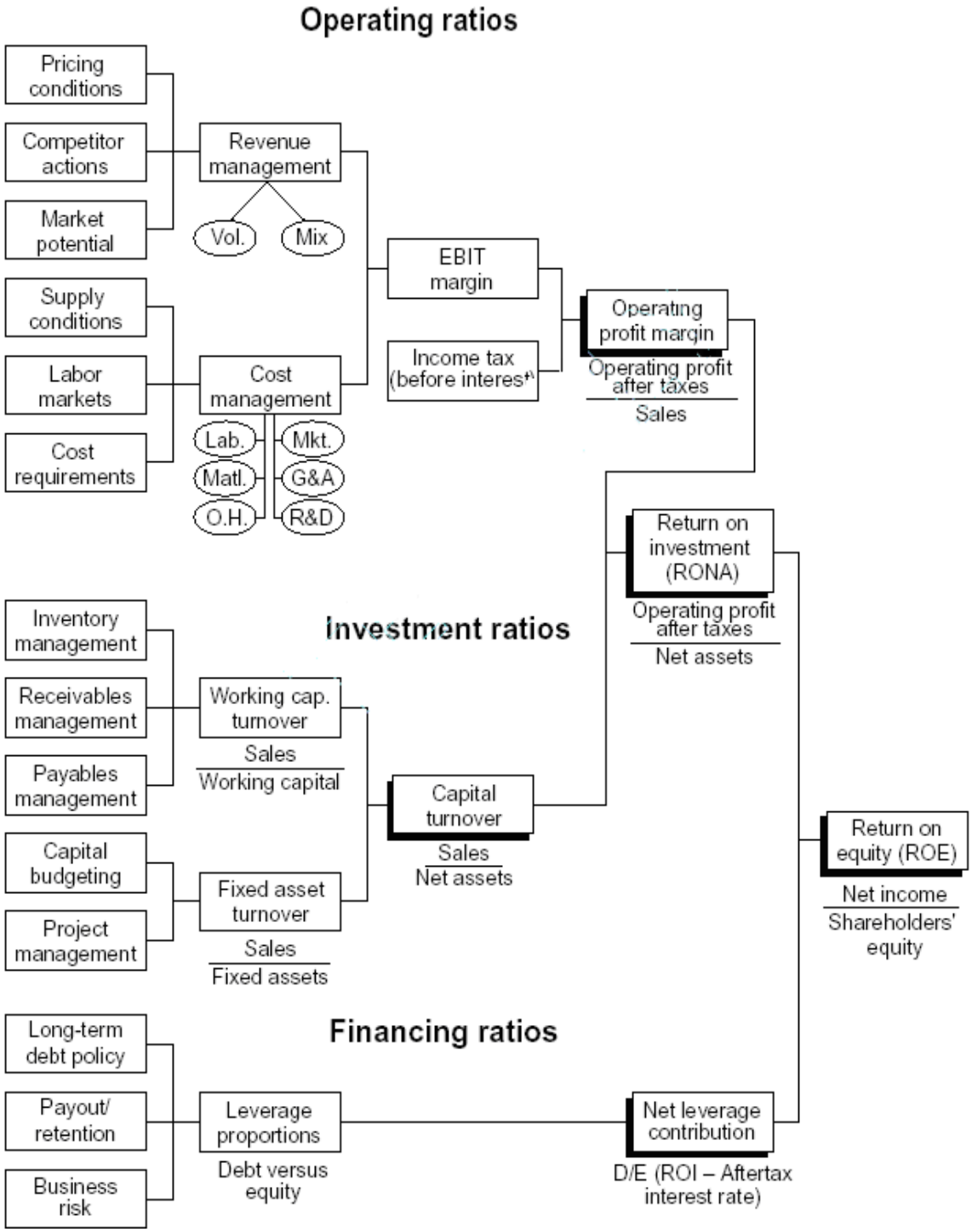
- Managers.
- Owners (investors).
- **Lenders and creditors.**

Performance Measures by Area and Viewpoint

Management	***Owners***	***Lenders***
Operational Analysis	**Investment Return**	**Liquidity**
Gross margin	Return on total net worth	Current ratio
Profit margin	Return on common equity	Acid test
EBIT; EBITDA	Earnings per share	Quick sale value
NOPAT	Cash flow per share	
Operating expense analysis	Share price appreciation	
Contribution analysis	Total shareholder return	
Operating leverage		
Comparative analysis		
Resource Management	**Disposition of Earnings**	**Financial Leverage**
Asset turnover	Dividends per share	Debt to assets
Working capital management	Dividend yield	Debt to capitalization
• Inventory turnover	Payout/retention of earnings	Debt to equity
• Accounts receivable patterns	Dividend coverage	
• Accounts payable patterns	Dividends to assets	
Human resource effectiveness		
Profitability	**Market Performance**	**Debt Service**
Return on assets (after taxes)	Price/earnings ratio	Interest coverage
Return before interest and taxes	Cash flow multiples	Burden coverage
Return on current value basis	Market to book value	Fixed changes coverage
EVA and economic profit	Relative price movements	Cash flow analysis
Cash flow return on investment	Value drivers	
Free cash flow	Value of the firm	

Ratios as a System- View of Key Ratios and Their Elements
Operating, Investment and Financing Ratios

The ratios presented have many elements in common, as they are derived from key components of the same financial statements. In fact, they're often interrelated and can be viewed as a system.



The credit analyst can turn a series of ratios into a dynamic display highlighting the elements that are the most important levers used in order to approve financing requested.

Lenders' Point of View

While the main orientation of management and owners is toward the business as a going concern, the lender—of necessity—has to be of two minds. Lenders are interested in funding the needs of a successful business that will perform as expected. At the same time, they must consider the possible negative consequences of default and liquidation. Sharing none of the rewards of success other than receiving regular payments of interest and principal, the lender must carefully assess the risk involved in recovering the original funds extended—particularly if they have been provided for a long period of time. Part of this assessment must be the ultimate value of the lender's claim in case of serious difficulty.

The claims of a general creditor rank behind federal tax obligations, accrued wages, and the claims of secured creditors, who lend against a specific asset, such as a building or equipment. Thus, caution often dictates that lenders look for a margin of safety in the assets held by the company, a cushion against default. Several ratios are used to assess this protection by testing the liquidity of the business. Another set of ratios tests the relative debt exposure, or leverage of the business, in order to weigh the position of lenders versus owners. Finally, there are so-called coverage ratios relating to the company's ability to provide debt service from funds generated by ongoing operations.

Liquidity

One way to test the degree of protection afforded lenders focuses on the short term credit extended to a business for funding its operations. It involves the liquid assets of a business, that is, those current assets that can readily be converted into cash, on the assumption that they form a cushion against default.

Current Ratio = Current Assets / Current Liabilities

The ratio most commonly used to appraise the debt exposure represented on the balance sheet is the current ratio. This relationship of current assets to current liabilities is an attempt to show the safety of current debt holders' claims in case of default. Presumably, the larger this ratio, the better the position of the debt holders. From the lender's point of view, a higher ratio would certainly appear to provide a cushion against drastic losses of value in case of business failure. A large excess of current assets over current liabilities seems to help protect claims, should inventories have to be liquidated at a forced sale and should accounts receivable involve sizable collection problems. Seen from another angle, however, an excessively high current ratio might signal slack management practices. It could indicate idle cash balances, inventory levels that have become excessive when compared to current needs, and poor credit management that results in overextended accounts receivable. At the same time, the business might not be making full use of its current borrowing power. A very common rule of thumb suggests that a current ratio of 2 : 1 is about right for most businesses, because this proportion appears to permit a shrinkage of up to 50 percent in the value of current assets, while still providing enough cushion to cover all current liabilities. The problem with this concept is that the current ratio measures an essentially static condition and assesses a business as if it were on the brink of liquidation. The ratio does not reflect the dynamics of a going concern, which should be the top priority of management. A lender or creditor looking for future business with a successful client should bear this in mind, and will likely turn to the type of cash flow analysis to judge the viability of the business as a client.

Acid Test =(Cash + Marketable securities + Receivables)/ Current Liabilities

An even more stringent test, although again on a static basis, is the acid test or quick ratio, which is calculated using only a portion of current assets—cash, marketable securities, and accounts receivable—which are then related to current liabilities. The key concept here is to test the collectibility of current liabilities in the case of a real crisis, on the assumption that inventories would have no value at all. As drastic tests of the ability to pay in the face of disaster, both the current ratio and acid test are helpful. From an operational standpoint, however, it is better to analyze a business in terms of the expected total future cash flow pattern, which projects inflows and outflows over the period for which credit is extended. The proportion of current assets to current liabilities normally covers only a small part of this picture.

Quick Sale Value

Another stringent test that can be applied to the business as a whole is to determine, through a series of assumptions, what cash value the various assets of the company would bring in a hurried sale, and relating this total to the liabilities of the business. Again, this is a liquidation point of view that does not allow for recognizing the ongoing cash flow patterns.

Financial Leverage

Successful use of debt enhances earnings for the owners of the business, because the returns earned on these funds—over and above the interest paid—belong to the owners, and thus will increase the return on owners' equity. From the lender's viewpoint, however, when earnings do not exceed or even fall short of the interest cost, fixed interest and principal commitments must still be met. The owners must fulfill these claims, which might severely affect the value of owners' equity. The positive and negative effects of leverage increase with the proportion of debt in a business. With higher leverage, the risk exposure of the providers of debt grows, as does the risk exposure of the owners. From the lender's point of view, a variety of ratios that deal with total debt, or long-term debt only, in relation to various parts of the balance sheet, are more inclusive measures of risk than leverage alone. These ratios measure the risk exposure of the lenders in relation to the available asset values against which all claims are held.

Debt to Assets=Total Debit/Total Assets

This ratio describes the proportion of "other people's money" to the total claims against the assets of the business. The higher the ratio, the greater the risk for the lender. This is not necessarily a true test of the ability of the business to cover its debts, however. As we've already observed, the asset amounts recorded on the balance sheet are generally not indicative of current economic values, or even liquidation values. Nor does the ratio give any clues as to likely earnings and cash flow fluctuations that might affect current interest and principal payments.

Debt to Capitalization = Long Term debt* / Capitalization (net assets)

A more refined version of the debt proportion analysis involves the ratio of long term debt to capitalization (total invested capital). The latter is again defined as the sum of the long-term claims against the business, both debt and owners' equity, but doesn't include short-term (current) liabilities. This total also corresponds to net assets, unless some adjustments were made, such as ignoring deferred taxes. The ratio is one of the elements that rating companies such as Moody's take into account when classifying the relative safety of debt. Another definition of debt is sometimes used, which includes (1) short-term debt (other than trade credit), (2) the current portion of long-term debt, and (3) all long-term debt in the form of contractual obligations. In this case, long-term liabilities like set-asides representing potential employee benefit claims and deferred taxes are not counted as part of the capitalization of the company, which is (1) the sum of debt as defined above, plus (2) minority interests, and (3) shareholders' investment (equity).

A great deal of emphasis is placed on the ratio of debt to capitalization, carefully defined for any particular company, because many lending agreements of both publicly held and private corporations contain covenants regulating maximum debt exposure expressed in terms of debt to capitalization proportions.

Debt to Equity = Total Debt/Shareholders' investment (equity)*

* Includes minority interests.

A third version of the analysis of debt proportions involves the ratio of total debt, frequently defined as the sum of current liabilities and all types of long-term debt, to total owners' equity, or shareholders' investment. The debt to equity ratio is an attempt to show, in another format, the relative proportions of all lender's claims to ownership claims, and it is used as a measure of debt exposure. The measure is expressed as either a percentage or as a proportion.

In preparing this ratio, as in some earlier instances, the question of deferred income taxes and other estimated long-term liabilities is often sidestepped by leaving these potential long-term claims out of the debt and capitalization figures altogether. We have included all of these elements here. One specific refinement of this formula uses only long-term debt, as related to shareholders' investment, ignoring long-term obligations and deferred taxes.

Debt to equity (alternate)=Long term debit*/Shareholders' investment (equity)*

* Includes current portion of long-term debt.

** Includes minority interests.

The various formats of these relationships imply the care with which the ground rules must be defined for any particular analysis, and for the covenants governing specific lending agreements. They only hint at the risk/reward trade-off implicit in the use of debt.

Debt Service

Regardless of the specific choice from among the several ratios just discussed, debt proportion analysis is in essence static, and does not take into account the operating dynamics and economic values of the business. The analysis is totally derived from the balance sheet, which in itself is a static snapshot of the financial condition of the business at a single point in time. Nonetheless, the relative ease with which these ratios are calculated probably accounts for their popularity. Such ratios are useful as indicators of trends when they are applied over a period of time. However, they still don't get at the heart of an analysis of creditworthiness, which involves a company's ability to pay both interest and principal on schedule as contractually agreed upon, that is, to service its debt over time.

Interest Coverage= Net profit before interest and taxes (EBIT)/ Interest

One very frequently encountered ratio reflecting a company's debt service uses the relationship of net profit (earnings) before interest and taxes (EBIT) to the amount of the interest payments for the period. This ratio is developed with the expectation that annual operating earnings can be considered the basic source of funds for debt service, and that any significant change in this relationship might signal difficulties. Major earnings fluctuations are one type of risk considered. No hard and fast standards for the ratio itself exist; rather, the prospective debt holders often require covenants in the loan agreement spelling out the number of times the business is expected to cover its debt service obligations. The specifics are based on judgment, often involving a detailed analysis of a company's past, current, and prospective conditions.

Burden Coverage=Net Profit before interest and taxes (EBIT)/ {Interest + [Principal Repayments/(1-tax rate)]}

A somewhat more refined analysis of debt coverage relates the net profit of the business, before interest and taxes, to the sum of current interest and principal repayments, in an attempt to indicate the company's ability to service the burden of its debt in all aspects. A problem arises with this particular analysis, because interest payments are tax deductible, while principal repayments are not. Thus, we must be on guard to think about these figures on a comparable basis. One correction often used involves converting the principal repayments into an equivalent pretax amount. This is done by dividing the principal repayment by the factor "one minus the effective tax rate."

An alternate format uses operating cash flow (net profit after taxes plus write-offs), to which after-tax interest has been added back.

Burden Coverage=[Operating cash flow + Interest(1-tax rate)]/[Interest(1-tax rate)+Principal repayments]

Fixed Charges Coverage

Amore inclusive concept is the combination of interest and rental expenses into a fixed charges amount, which is then compared to pretax earnings to which these fixed charges are added back.

Cash Flow Analysis

Determining a company's ability to meet its debt obligations is most meaningful when a review of past profit and cash flow patterns is made over a long enough period of time to indicate the major operational and cyclical fluctuations that are normal for the company and its industry. This might involve financial statements covering several years or several seasonal swings, as appropriate, in an attempt to identify characteristic high and low points in earnings and funds needs. The pattern of past conditions must then be projected into the future to see what margin of safety remains to cover interest, principal repayments, and other fixed payments, such as major lease obligations. If a business is subject to sizable fluctuations in after-tax cash flow, lenders might be reluctant to extend credit when the debt service cannot be covered several times at the low point in the operational pattern. In contrast, a very stable business would encounter less-stringent coverage demands. The type of dynamic analysis involved is a form of financial modeling that can be greatly enhanced both in scope and in the number of possible alternative conditions explored by using spreadsheets or full-fledged corporate planning models.

Integration of Financial Performance Analysis

We've presented the great variety of financial ratios and measures available to analyst wishing to analyze the performance of a company and its various units, or of an individual business. We've also grouped the measures by points of view and shown their many interrelationships as well as the key management drivers that impact them. At this point, it'll be helpful to provide a few practical guidelines for structuring the process of using the measures. We'll briefly address the following key points:

- Careful definition of the issue being analyzed and the viewpoint to be taken.
- Identifying a combination of primary and secondary measures and tools.
- Identifying key value drivers that affect performance.
- Trending performance data over time, both historical and prospective.
- Finding comparative indicators and supplementary information.
- Using past performance as a clue to future expectations.
- Recognizing systems issues and obstacles to optimal performance.

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Prof.univ.dr. Mihai Aristotel Ungureanu

CONSIDERATIONS ON THE ACTUAL AND FUTURE FISCAL POLICY

Abstract: *Funding the fiscal policy should come in support of economic growth , as Romania is entering the functional market economy stage and should take into account certain criteria related to the Romania's integration within the EU, such as revenue collect ad equation, effectiveness and neutrality, that suppose the non existence of differences between economical activities, simpleness of the tax system, stability and predictability of the Fiscal Code and the Fiscal Procedure Code. The fiscal system is a product created during the times by the man, by the history of humane civilization, in order to respond to financial, economical and social needs. It allowed public authority to intervene into the national economy and finance all public utilities : administration, defense, political representation etc.*

Guy Gest and Gilbert Tixier consider that the fiscal system is normally the expression of political will of an organized community, established on a well determined territory and having enough autonomy to be able to establish throughout the organs that represent it, a series of legals and especially fiscal regulations. However, we consider that an efficient and effective fiscal code should fulfill three conditions : adequate legislation to the European context, modern organization, with direct reference to the Ministry of Public Finance, professional formation of employees in the area of operative control of Financial Guard, fiscal inspection and fiscal administration.

Key words: *fiscal policy, tax system*

JEL Classification: *H21*

Fiscal policy and tax system after 1990

In the context of finance reform initiated after 1990, the fiscal and budgetary policy was oriented towards creating a healthy economical environment, that would ensure a decent financing of the public sector, the specialists efforts in this area having the following main objectives : even distribution of the fiscal burden, effective collecting system and rational distribution of budgetary expenses, having in mind especially projects and restructuring programs, regional development projects, re-conversion of some industry sectors, development and rehabilitation of infrastructure etc.

In a first stage, within the Romanian fiscal system occurred modifications such as equal treatment of economical actors, private or public, proportional participation to he revenues to the budget, tax facilities in accordance to the object of activity, introduction of VAT that replaced the old system of taxing the merchandise circulation, modifications of some other taxes, fiscal and non-fiscal.

The beginning of tax transition, although its scope was to ensure, within the transition towards the market economy, the necessary budgetary revenues, evenly and with little repercussions over prices, did not have a clear strategy in a long term change in revenue administration. All governments after 1989 considered that the temporary adjustment of some fiscal instruments would contribute to macro-economical stabilization. For this purpose we can speak about the drafting and approving of the public finance law, reform on the tax on the merchandise circulation system and preliminary use as base for VAT introduction in 1993, tax on profit, tax over salaries by using revenue quotas; tax over dividends and sale of actives; adoption of a new law on local taxes; adoption of a custom tax system that lead to drafting, approval and entering into force of a Custom Code Law in 1997 and its Application Regulation; adoption of the new accountancy law; creation of the State Treasury; decentralization of tax competence between different organs of central and local administration (Modification of Law 69/1991 and adoption of Law 189/1998). At the same time, were annulled some tax obligations from the salaries funds and other compulsory contributions, independent of the fact hat companies were on losses or on profit. Some other public funds were created that make pressure over companies, managed by other ministries, while the Ministry of Public Finances, that should manage them, supports all consequences, even this is contrary to the principles on which stand the elaboration and execution of the budget – unity and universality,

National legislation was harmonized with the European one, in accordance to dispositions contained in the Romania's Accession to the EU Partnership and the National Program elaborated and adopted in this respect in areas such as: public acquisitions, accountancy, budgetary structures alignment to principles of budgetary statistics used in the EU and international financial organisms, VAT, custom taxes. So, all chapters of negotiation with the EU were closed, as well as chapter 1o on Taxation, but starting with 2005 a reform was needed, in order to ensure finding all common points until accession date on 01.01.2007.

One must also remember the restructuring of the ministries, in a new shape that envisages the effectiveness and decentralization of the activity in some of them, amongst which the Ministry of Public Finance. However, this was not finished and the excessive centralization was not abolished, as the hard mode of work characteristic of the territorial branches, repetition and superposition of controls. This things should have been done by spring 2005, but things started to get better in the period April-May 2006, expecting that starting with 2008-2009 period things will be perfected, throughout a reorganization process of the Ministry of Economy and Finance and its decentralized structures in the territory, for full decentralization of control and State revenues management activity.

One can appreciate that, in Romania, due to the difficulties to which all governments were confronted after 1989 and also to the fiscal policies that were adopted, the reform took place at a slow pace, especially in what regards the rethinking of the tax notion and the structural modification of tax categories. Many of the fiscal objectives of the governments that lead the country were not met or were realized with long delays. Thus, despite the fact that the introduction of the income tax was due for 1996, it was introduced only in 2001 and then in a transitory format. The Government Ordinance 73/1999 on taxation of individuals revenues, with all modifications made afterwards (mainly between 2000 - 2001), did not solve the basic principle of globalizing all revenues and their taxation based on a grille to stimulate the salaried work and fight illegal employment, having in mind at the same time all social aspects related to deductions meant to encourage declaration of all revenues and fight and prevent tax evasion. Although there were several versions of this legislation more adapted to modern taxation requirements in market economy environments with a tradition in this area, such as Germany, this transitory version was preferred. For example, we can look at the 1997 version of the global income tax law, elaborated in the autumn of 1997 by a team of experts from the Ministry of Finance of Romania, together with specialists of the Bruhl Finance Academy. During the period October 1997 – January 1998, was drafted, debated and adopted a modern version of global income tax law within the seminary organized by the German Finance Federal Academy next to the German Federal Ministry of Finance, in the project "Assistance offered to the Romanian Ministry of Finances for fiscal system reform", organized throughout Deutsche Gesellschaft für Technsche Zusammenarbeit (GTZ) GmbH, at the request of the German Federal Ministry for Cooperation and Economical Development. However, this version of the law had no echo, as the "original" version was still preferred.

The introduction of a 16% flat tax solves a series of problems regarding costs related to tax evidence in the previous system, encourages salaried work in relation to the illegal employment and contributes to diminishing tax evasion, bringing a plus of income for the State budget in comparison with the previous taxation system. At the same time, reducing contributions calculated on the revenues realized from a salaried work represent an important element for the functional market economy starting with 01.01.2005.

The commercial tax was reduced from 25% to 16%. Such a reduced rate, corroborated to the simplification of the applicable rulings, leads to an increase of the taxation base throughout the development of the existing businesses, increase of the foreign investments and the decrease of the GDP ratio of the black economy.

Even if acts were adopted in order to rule the activity in almost all areas, including the fiscal and financial one, those acts were not always conceived in correlation with future possible effects, have proven to be incomplete, confuse, instable, incoherent, reasons for which they had to be frequently modified and completed, making more difficult the activity of both fiscal organs and economic actors.

Not even Law 572/2003 on the Fiscal Code managed to solve this legislation stability problem, its dispositions being in many cases modified in 2004 and 2005, whereas in 2006 were laid the bases of a new Fiscal Code that would ensure the stability needed in Romania's European integration context.

Criteria and principles that supporting the actual fiscal policy

Fiscal policy should be thought and looked at as a sub-system of the economy, next to budgetary policy and monetary policy.

Funding a fiscal policy that would come in support of economic growth, should take into account some basic criteria that could orientate taxation on a medium term base and would, for the future, determine the creation and maintaining of a reasonable tax level. Those criteria have the following objectives :

- ad equation for revenue collecting – criteria that supposes that the marginal level of taxes is sufficiently low to ensure encouragement of the economical activity and the number of taxes is the lowest possible in order to prevent significant budgetary fluctuations;
- neutrality and effectiveness – it supposes that all economic activities are treated in the same way;
- simpleness – it requests that the tax system is easy to understand both by tax personnel and tax payers;

- stability and predictability – criteria that, once respected, allow investors to elaborate real and feasible business plans, as well as development plans that would finally lead to an increase of the taxation base.
- Actual fiscal policy is designed and implemented based on the following principles :
- fiscal neutrality – the fiscal norm should not produce different reactions at economical level;
- fiscal effectiveness – the fiscal norm should have an impact on the envisaged fiscal behavior;
- equal fiscal treatment – the economic actors that realize similar economical activities in a similar time framework, should be treated identically from a fiscal point of view, independent of their other differentiation criteria;
- sustainability of the fiscal norm – taxation should be designed in such a way that the tax itself would stimulate the payment, under aspects of extension, stability and transparency of the tax base.
- A reasonable system requires, however, in order to create the conditions to fulfill the above-mentioned criteria.

Smaranda Vancea
" Dimitrie Cantemir" University of Tg.Mures, Romania

THE OPTIONS TRADING VOLUMES IN ROMANIAN CAPITAL MARKET ANALYZE

Abstract: *The realization of some viable appreciations about the development perspectives of the Options Market in Romania can't be fulfiled without an analytic overview ot the past performances .*
It is being build up as an argument of the trading volumes indicators analyze within the options on futures contracts market from BMFMS.
I made the data's analize on a chronological serie of dates included in the 1998-2006 interval , for options contracts , meaning , precisely from the moment when the first instruments of this type were transactionated in the Sibiu market .

Key words: *capital market*

JEL Classification*: G12*

The assessment of an activity within an option market is based on the trading volumes indicator , meaning on the number of closed deals and on the number of opend positions on the market , at a given time

The value of the options transactions is not a relevant indicator for the option market , because , the transactions value is related to the value of the bonuses negociated at the market , and they only represent the prices of some contracts , not the prices of the actuals to which the option contracts report to.

What informations are the trading volumes whithin an option market offering us ?

Certainly , it must contain significances , otherwise the data about the number of option contracts which are being traded within a market wouldn't be published .

This type of informations are useful to evaluate the market's "sentiment".

A series of investors are using theese informations to take trading decisions .

In the situation when an increase of the trading volumes is being estimated, a speculative fervor is sugested .

If this volume is based on PUT contracts , the tendency of the actual's quotation evolution is bearish .

If this volume is based on CALL contracts , it signifies a bulish tendency of the actuals market

In the estimation of such a situation , we can consider the closing data within the option market from BMFMS on the 7th of Dec 2007 , presented in Table nr 1 .

The informations from the table are bringing to light some aspects :

1. Just a small number of CALL or PUT options on futures contracts are being traded in the market
2. The largest number of CALL and PUT positions are on DESIF5 , which holds a 90% percentage from the CALL market and an 80% percentage from the PUT market .

In the spirit of the statement about the market's sentiment , which can also be evaluated by the number of opend positions in the market : it can be concluded :

- at the end of the year 2007 in the BMFMS option market a speculative fervor exists with the derived DESIF5 .
- the larger number of DESIF5 CALL contracts than the DESIF5 PUT indicates a bullish tendency of the DESIF5 contract , traded in the futures market
- on the options on futures contracts market two actuals are being transactionated in principle , DESIF5 and DESIF2 , the other contracts are having an inessential trading volume .

Table nr 1 . The trading volumes in the option market at the end of the year 2007

CALL				PUT			
Nr.	**Actual**	**Quoted dates of payment**	**Opend positions**	**Nr.**	**Actual**	**Quoted dates of payment**	**Opend positions**
1	**DEBRK**	**Dec the 7th**	**2**				
2	**DERRC**	**Dec the 7th , June the 8th**	**6**				
3	**DESIF2**	**Dec the 7th,March the 8th, June the 8th**	**1716**	**1**	**DESIF2**	**Dec the 7th,March the 8th, June the 8th,Sept the 8th**	**482**
4	**DESIF5**	**Dec the 7th,March the 8th, June the 8th**	**16852**	**2**	**DESIF5**	**Dec the 7th,March the 8th, June the 8th**	**2770**
5	**DESNP**	**Dec the 7th,June the 8th**	**20**				
6	**DETLV**	**Dec the 7th,March the 8th**	**14**	**3**	**DETLV**	**Dec the 7th,March the 8th**	**104**
7	**DE RON/EUR**	**Dec the 7th**	**8**				
8	**SIBGOLD**	**Dec the 7th**	**14**				
Total			**18632**				**3356**

Source:BMFMS , market reports on the 7th of Dec 2007

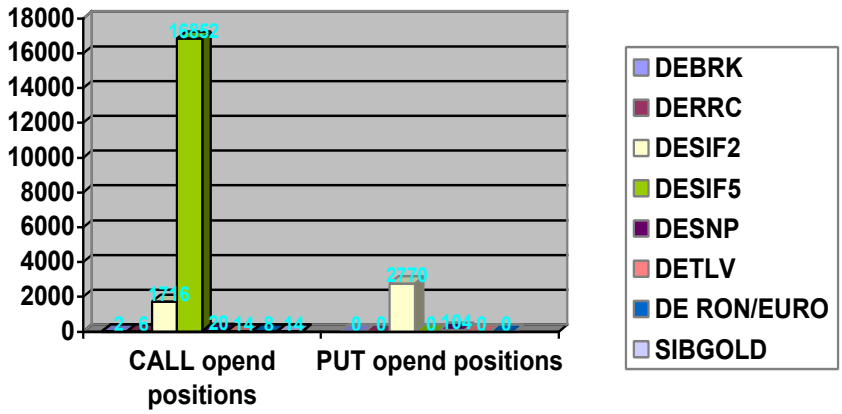

Fig. nr. 1. Opend positions in CALL and PUT options market at BMFMS , 7th Dec 2007

1. The establishment of the traded options contracts number evolution tendency within BMFMS

The method of the analyze of the traded option contracts number evolution trend between 1998 and 2006 within BMFMS , is based on the following :

3. every influence factor of the traded contracts volumes are known and are containd by the method
4. theese factors will manifest influences in the future time
5. the random factors that can appear in the future can't be estimated

The graphic presentation of the number of option contracts traded within BMFMS between 1998 and 2006 , is not suggestiveto determine the tendency manifested within the parket , which imposes multiple variants testing .

The informations that will be processed are taken aut of the public reports of BMFMS about the trading volumes .

Testing the parabolic trend variant

The methodology of calculation used is based on the analytical determination of the adjusting function's variable principles that offer the smallest departure formthe real evolution of the investigated phenomenon .

Table nr 2 The mathematical calculations for the parabolic TREND variant

Years	Y_t	t	t^2	t^4	t*Y	t^2*Y	$\hat{Y}_t$	$(Y_t-\hat{Y}_t)^2$
1997	10	-9	81	6.561	-90	810	353.080	353.070^2
1998	133	-7	49	2.401	-931	6.517	368.582	368.449^2
1999	15.215	-5	25	625	-76.075	380.375	380.628	356.413^2
2000	46.752	-3	9	81	-140.256	420.768	389.218	342.466^2
2001	53.731	-1	1	1	-53.731	53.731	394.352	340.621^2
2002	67.300	1	1	1	67.300	67.300	396.030	328.730^2
2003	19.369	3	9	81	58.107	17.321	394.252	374.883^2
2004	2.273	5	25	625	11.365	56.825	389.018	386.745^2
2005	11.629	7	49	2.401	81.403	569.821	380.328	368.699^2
2006	36.651	9	81	6.561	329.859	2.968.731	368.182	331.531^2
Total	253.063	0	330	19.338	276.951	4.699.199		

The adusting function for a parabolic trend has the following mathematical form :

$\hat{Y}$= a+b*t+c* t^2 with the a,b,c real parameters which are determined by imposing the conditions that $(Y_t-\hat{Y}_t)^2$ is minimum and the time has no influence ($\sum t = 0$) . That means that a ,b ,c will be the sistem's solutions :

$$\begin{cases} n*a + c*\sum t^2 = \sum y \\ b*\sum t^2 = \sum t*Y_t \\ a*\sum t^2 + c*\sum t^4 = \sum t^2*Y_t \end{cases} \Leftrightarrow \begin{cases} 10a + 330c = 253.063 \\ 330b = 276.951 \\ 330a + 19.338c = 4.899.199 \end{cases} \Rightarrow a = 395.623, b = 839, c = -432$$

The adjusting function will be :

$\hat{Y}_t$=395.623+839*t-432* t^2

The adjusted values :

$\hat{Y}_1$=353.080	**$\hat{Y}_6$=396.030**
$\hat{Y}_2$=368.582	**$\hat{Y}_7$=384.252**
$\hat{Y}_3$ =380.628	**$\hat{Y}_8$=389.018**
$\hat{Y}_4$=389.218	**$\hat{Y}_9$=380.328**
$\hat{Y}_5$=394.352	**$\hat{Y}_{10}$=368.182**

The large adjusting values resulted from the calculation are imposing the testing of new evolution variants of the option contracts number .

1.2 Testing the exponential trend variant

Even though the graphic presentation of the number of option contracts doesn't suggest such an evolution only on the 1998-2006 interval ,for austerity testing this evolution variant is imposant .

Table nr.3 The mathematical calculations for the exponential TREND variant

Years	Indicators				
	lg Y_t	t* lg Y_t	$\overline{Y_t}$	$(Y_t - \overline{Y_t})^2$	The percentage %
1997	**1,00000**	**-9,00000**	**473**	**463** ^{2}	**0,07**
1998	**2,12385**	**-14,86695**	**833**	**700** ^{2}	**8,69**
1999	**4,18241**	**-20,91205**	**1.467**	**13.748** ^{2}	**22,77**
2000	**4,66978**	**-14,00934**	**2.583**	**44.169** ^{2}	**28,43**
2001	**4,73022**	**-4,73022**	**4.549**	**49.182** ^{2}	**23,02**
2002	**4,82802**	**4,82802**	**8.010**	**59.290** ^{2}	**10,31**
2003	**4,28713**	**12,86139**	**12.106**	**5.263** ^{2}	**3,02**
2004	**3,35660**	**16,78300**	**24.838**	**22.565** ^{2}	**1,64**
2005	**4,06558**	**28,45906**	**43.743**	**32.114** ^{2}	**0,86**
2006	**4,56407**	**41,07663**	**77.019**	**40.368** ^{2}	**0,01**
Total	**37,80766**	**40,48954**			

The exponential adjusting function has the following form $\overline{Y}$ **=a*b**^{t} with a,b real parameters which determine the condition that $\sum(Y_t - \overline{Y})^2$ is minimum and the time has no influence ($\sum t = 0$) **.** The conditions imposed lead to the system's solutions :

$$\begin{cases} n * \lg a = \sum \lg Y_t \\ \sum t^2 * \lg b = \sum t * \lg Y_t \end{cases} \Leftrightarrow \begin{cases} 10 \lg a = 37{,}80766 \\ 330 \lg b = 40{,}48954 \end{cases} \Rightarrow \textbf{a=6.036 si b= 1.327}$$

$\overline{Y_t}$ **=6.036*1.327**^{t}

The adjusted values will be :

$\overline{Y_1}$ **=473**	$\overline{Y_6}$ **=8.010**
$\overline{Y_2}$ **=833**	$\overline{Y_7}$ **=14.106**
$\overline{Y_3}$ **=1.467**	$\overline{Y_8}$ **=24.838**
$\overline{Y_4}$ **=2.583**	$\overline{Y_9}$ **=43.743**
$\overline{Y_5}$ **=4.549**	$\overline{Y_{10}}$ **=77.019**

The high adjusting values resulted , do not lead , for now , to the conclusion that the exponential trend variant of the option contracts number evolution is the most designated for the realization of stipulations related to future possible evolutions .

1.3 Testing the linear trend variant

The linearity in the evolution of the number of traded option contracts signifies a relative constant evolution .

Table nr 4 The calculations for the linear TREND variant

Years	Y_t	$\tilde{Y}_t$	$(Y_t - \tilde{Y}_t)^2$
1997	10	17.759	17.749^2
1998	133	19.433	19.300^2
1999	15.215	21.107	5.892^2
2000	46.752	22.789	23.963^2
2001	53.731	24.467	29.264^2
2002	67.300	26.145	41.155^2
2003	19.369	27.823	8.454^2
2004	2.273	29.505	27.232^2
2005	11.629	31.179	19.550^2
2006	36.651	32.857	3.794^2

The linear adjusting function is :

$\tilde{Y}$=a+b*t , where a and b are real parameters which can be determined from conditions like: $\sum (Y_t - \tilde{Y}_t)^2$ must be minimum and $\sum t = 0$. It results that a and b are the system's solutions :

$$\begin{cases} n * a = \sum Y_t \\ b * \sum t^2 = \sum t * Y_t \end{cases} \Leftrightarrow \begin{cases} 10a = 253.063 \\ 330b = 276.951 \end{cases} \Rightarrow \text{a = 25.306,3 and b=839}$$

b>0 means an incerasing tendency . As follows , the adjusting function is **$\tilde{Y}$=25306+839*t** .
The adjusting values will be :

$\tilde{Y}_1$=17.759	**$\tilde{Y}_6$=26.145**
$\tilde{Y}_2$=19.433	**$\tilde{Y}_7$=27.823**
$\tilde{Y}_3$=21.107	**$\tilde{Y}_8$=29.505**
$\tilde{Y}_4$=22.789	**$\tilde{Y}_9$=31.179**
$\tilde{Y}_5$=24.467	**$\tilde{Y}_{10}$=32.857**

In conclusion : $\sum (Y_t - \hat{Y}_t)^2 > \sum (Y_t - \overline{Y_t})^2$ and $\sum (Y_t - \hat{Y}_t)^2 > \sum (Y_t - \tilde{Y}_t)^2$ which suggests that the parabolic trend is not proper to aproximate the option trading's evolution at BMFMS .

The results with the smallest adjustments correspond the best to the linear trend . Such a solution determines us to be pesimists relating the evolution of the number of option contracts that will be traded within BMFMS .

An explanation related to the slow growth of the number of option contracts in comparison with the one of the futures contracts could be the low notoriousness of the product between the effective investors from the market , and probably the low tolerance relating the acceptance of the trading risks of a sofisticated market product .

2. The option tranding volumes within BMFMS in the present

The evolutions during the year 2006 were considered the first signals of an investors come back on the options market , thus the first semester in 2007 marked this direction . The option volumes have considerably increased related to the same time interval from the past year . In total , in the first semester of 2007 , 19.326 of this type of contracts were closed , a volume higher by over 124% of the same period in 2006 . The best month for trading options was March when the number of contracts was higher than the same month in 2006 by 6664 contracts , over 607 % .

Table nr 5. The situation of the number of option contracts traded in the first semester of 2007 vs 2006

VOLUME	OPTIONS January – June 2007	OPTIONS January – June 2006	Growth %
TOTAL	21.449	9573	124,06

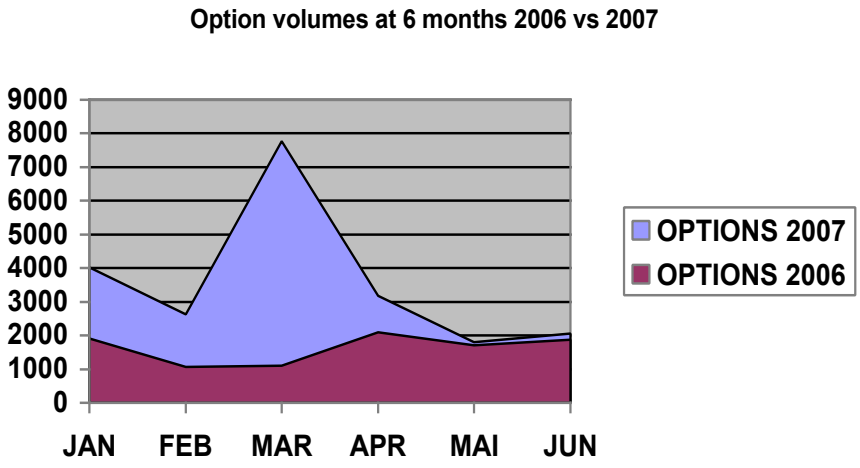

Fig. Nr. 2

Source : market report BMFMS , first semester

In the first month of the year over 4000 contracts were closed , the increase unto the January 2006 being by 110% .

In February , 2623 option contracts were closed , by 2,4 times above the same month in 2006 .

The March sessions were , looking to the total of 7761 closed contracts during this period , the most favorable for the option trading . Unto the month of March 2006 a surplusage of 6664 contracts meaning over 6075 , informations contained also in Table nr 6 .

Table nr 6

Month	OPTIONS 2007	OPTIONS 2006	Growth %
January	4.024	1.909	110,79
February	2.623	1.074	114,23
March	7.761	1.097	607,47
Total 1st Trim	14.408	4.080	253,14

Source : CRC report 1st trim

The informations from the table can be graphicaly represented , which offers us a suggestive image on the noticeable leap of the realizations from 2007 unto the same period of the year 2006 .

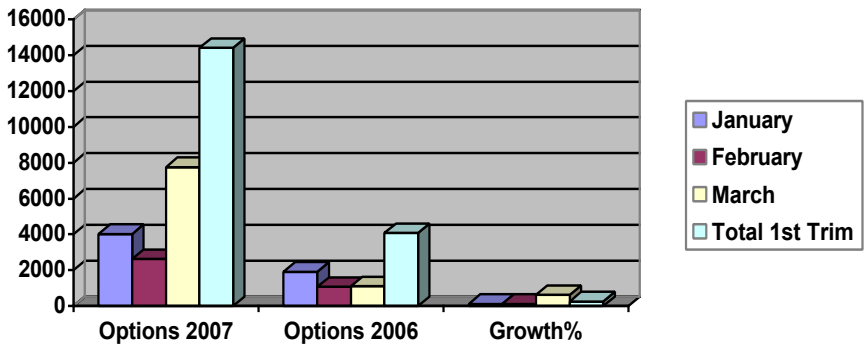

Fig. nr 3 Option trading volumes in 2007 in comparison with 2006

Until the end of the 1st semester , year 2007 , the results within the option market , are satisfying , if we relate to the past year's accomplishments . Good for notice , however the same tendency of evolution of the contracts number , with a minimum of transactioning in the months of April and a maximum in the months of March , which coincides with the day of payment for the contracts from the market .

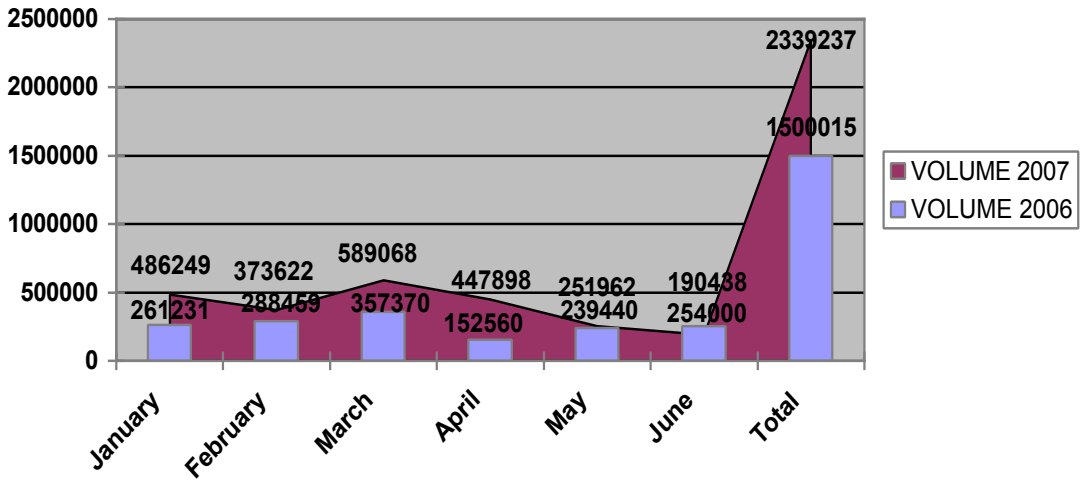

Fig nr 4 Representing the option traded volume in 2007 and 2006 in the 1st sem .

Having as bench-mark the informstions presented analytical in this subchapter , is noticeable the fact that , the evolution tendency anticipated is the linear one , in the conditions in which , the linear trend presented the smallest adjustment calues . However , the achievments of the year 2007 , being close to its end , already give us an apoximate image of the closing level of the option trading volumes indicator. The data confirm the fact that , the linear forecast itself is optimistic , the level recorded until October 2007 is at 50% from the forecasted level . This , is not still a relevant information , because the months of November , December , according to the past years experience , were the months with the most traded contracts .

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Lecturer drd. Gavrilă Mircea Vasloban
˝Dimitrie Cantemir" University of Târgu Mureş, Romania

FUNDAMENTAL ANALYSIS IS THE PRACTICE OF EVALUATING A COMPANY'S STOCK PRICE

Abstract: Fundamental analysis is the practice of evaluating a company's stock price by comparing base elements in the company's balance sheets as well as general market factors. It does not include chart analysis, which is the domain of technical analysis.

The main principle of fundamental analysis is to find profitable companies to invest in by comparing revenues, sales, management, etc. There are two types of drivers to look at in fundamental analysis: internal drivers and external drivers. Internal drivers are company specific (e.g. revenue, net income, assets, debts, etc.). External drivers are things that can affect the company's profitability but is not company specific (e.g. the economy, industry averages, etc.).

The analysis of internal drivers can be broken down into two components: balance sheet numbers/valuations (you can calculate); and, news/management/analyst ratings/economic outlook (you cannot calculate). The items you cannot apply numbers to like news, management style, etc., are subjective so discussion of these factors with others will help.

With balance sheet numbers and valuation techniques you can get a general appraisal of whether the company is overvalued or undervalued. This can be done in many different ways. The most common is in the form of a P/E ratio.

The analysis of external drivers is more subjective, as it requires a broad knowledge and, discussion of future industry growth, politics, economy, etc. These influences are important but cannot be easily calculated.

Key words: Book value; Accounts receivable turnover; Forecasted Market Price; Profit margin on sales

JEL Classification: G120

1. Internal drivers

Internal drivers are company factors that are directly related to the actual business in question. For example, liabilities, assets, revenue, income, products, management, etc. It is these characteristics in a company that you will be comparing to other companies in the same industry. This allows the trader to get a general understanding of where this company "sits" in relation to other companies with similar businesses. A trader can also use these internal numbers to calculate many different ratios that will help determine if the company is currently undervalued or overvalued.

Management - Who are they? What have they done in the past? What is the quality and diversity of the management team? All these questions can lead to a lengthy discussion about the particulars of each individual in management. Traders should use analysts reports, news, internet, and other sources to help make an informed decisions about the management team.

Products - product cycles and competition. What is the company's product and/or service? How does it compare to other competitive products? What's unique? Why is it better? If you would not be willing to buy the company's product why would you invest in that company? Companies with inferior products, weak development/product cycles, poor quality companies tend not to last very long (I'm sure there are some exceptions to that rule, but it can be considered bad policy to invest in companies with bad products).

Production is very important when it comes to companies that produce oil/gas, wood, power, metals etc. Their value depends highly on their production output as well as the current value of the product. The more a company produces, the more it can earn. As well, these specific commodities vary in cost, the higher the value of the product, the higher the potential for profit. Oil is a perfect example of this relationship. As global oil prices rise so does the value of oil companies.

Profit margins are important, or for that matte, profit in general is important. Profit can be considered the keystone to fundamental analysis - the more profitable the company, the higher the potential for dividends as well as price growth. Most valuation techniques compare profit in some form or another to that of similar companies.

Companies that have not yet attained net profit are still in the early stages of development. While these companies generally have a larger growth potential, they also have more risk. Companies that are producing net income can generally be considered established in the market place. There is less risk, and

typically, the price of the stock will reflect that. The axiom here is that the more the company makes, the more the company is worth.

Is there an institutional presence? The level of institutional presence is determined by the amount of shares outstanding that are owned by institutional investors (mutual funds, pension funds, investment houses, etc). As small companies mature, there is a point where they will be recognized by institutional investors. When these institutions begin investing in a company, the stock price will reflect that recognition (also when they sell out, it will be noticed in the stock price as well). Larger and more established companies typically have larger percentile institutional presence than smaller companies (micro-caps tend to have little to none).

2. External drivers

External drivers are factors which are outside the company's influence that can affect profitability. For example, the economy, inflation, interest rates, politics, bond market, etc. External drivers can be interpreted differently by different individuals (there is no magic formula).

To explain some of the external factors we will begin with Inflation. Inflation is the rate at which the general level of prices for goods and services are rising.

Inflation has a direct influence on the stock market. While looking at inflation can be still subjective to the trader, a little history can explain what the effect inflation has had in the stock market's past.

Between 1970-1980 there was high inflationary trend. During this period, as inflation was rising and "not in control," the trend was for businesses and individuals to increase debt load. The rationale was to borrow today with more valuable dollars and pay off the debt in the future with less valuable dollars. While this concept is sound in a situation with up-trending inflation, the problem comes in when the inflation trend is stemmed and reversed.

As businesses and individuals continue to borrow and inflation continues to rise, the Federal Reserve (which will be discussed in further detail later) tends to step in to correct the problem. As these controls are activated, the inflationary trend changes direction. As history shows, there will always be a group of individuals and businesses that do not realize the trend has ended. As interest rates climb, they are caught with an excessive debt load which they can no longer service. By 1986 the excessive debt load was being noticed and by the early 1990s a record number of business and individual bankruptcies were declared and resulted in a high unemployment rate (1990-91). There has been a slow economic recovery since this recession and the inflation rate (consumer price index) has been trending downwards since then.

Part of the formula of a strong bull market is when inflation is perceived as being in control. During some of the best bull markets all you needed was a dart board. While the dart board is NOT recommended, these bull markets all had something in common - inflation was in control. This effect can be observed in the following super bull markets: 1920-29; 1949-66; and, in the current bull market.

Inflation also has a direct effect on interest rates. As the inflation rate climbed from the 1970s until the late 1980s, the demand for debt financing was high. Like anything, if the demand is high, so is the price, so interest rates were equally high. In 1990, the recession and the huge number of bankruptcies dramatically reduced the general debt demand. By 1993, interest rates fell about 4%. This drop in interest rates also made CDs and money markets less attractive to investors and led to a significant shift in assets to stocks and bonds (which was the beginning of the new bull market).

Interest rates

The first two types of rates are short term and long term. In general terms, if there is strong economic growth, short term rates will rise. Long term rates are related to the inflationary trend as well as rate differences between foreign countries.

There is also the discount rate and federal rate. These are the rates that are controlled by the Federal Reserve. These rates are also used to control the inflationary trend as well as the interest rate trend, and have a significant impact on investors. The discount rate is the interest rate that member banks use to borrow money from the Federal Reserve. The federal rate is one that banks use to borrow from each other. If the economy is growing too fast, the Federal Reserve will raise the federal rate to hold back the inflationary trend.

Finally, there is also the "real" interest rate. The real interest rate is the average Federal Funds rate minus the inflation rate. Most economists use the real interest rate for analysis to determine the general future direction of interest rates and the overall market.

The National Bank of Romania primary function is to keep the economic system in balance. The National Bank of Romania has three economic controls to influence imbalances like high inflation rates.

The National Bank of Romania can: alter the amount of reserve that member banks are required to maintain; control the discount rate.

During a recession or slow economic growth period, the National Bank of Romania will lower interest rates to encourage investors to move assets into stocks and bonds (which will obviously help the stock market). When economic growth is too fast and inflationary pressures begin to build, the National Bank of Romaniawill raise interest rates to encourage investors to move assets into money markets. This is the National Bank of Romania preferred method of economic control.
Note: A reasonable method for forecasting interest rates is to look at the BET Utility index. If the index in trending upwards it indicates that interest rates are trending down, if the index is trending down, it indicates that interest rates are on the rise. Utility stocks are considered sensitive to interest rates and therefore make a good leading indicator towards the interest rate trend as well as the overall market trend. (Some might argue that other indexes work just as well, however this depends on the investor's strategy. *Generally speaking* the utility index works well for interest rates and for overall market trend).

3. Balance Sheet items

Assets are resources which are controlled by a company which have future economic benefits. Such as patents, land, equipment, etc.

Assets are very important when analyzing a company. The most obvious point being that the more assets a company has the more the company is worth. Also a company with a larger asset base should in theory have a higher potential for future earnings. Assets are also a key element when an industry takes a down turn as companies with larger asset bases can consolidate easier and weather the bad times better.

Assets are also a key component to determining the book value of a company. Using book value an investor can get an idea of whether a companies share is overvalued or undervalued as well.

Book value is the calculated dollar per share value of a company. To calculate book value, subtract liabilities from assets, then divide by total number of outstanding shares.

Book value has several important limitations that investors need to understand, the following is a brief description of these limitations.

When using book value, companies should only be compared to others in the same industry. The ratio is influenced by the following factors which cause this limitation. First, certain businesses have different asset bases from which they run their business (e.g. a car manufacturer versus Google). Secondly, the size of the company changes the ratio since larger companies have more outstanding shares than do smaller ones.

Book values can also be inaccurate or misleading because they do not reflect changes in market valuations, inflation, appreciation/depreciation (only recognized when sold), total costs of repayment of liabilities, different accounting practices or methods or others.

Even with these limitations, in general, there has been a long term correlation between book values and stock prices.

When analyzing a companies assets it is also important to take into considerations any liabilities against those assets. If a companies liabilities outweigh their assets this is a sign that the company is performing poorly or is still in its growth stage.

4. **Beta Signals**

Beta is derived from a formula that measures the volatility of a stock compared to the volatility of the market in general (as measured by a market index such as the S&P 500, DJIA, etc). Beta's companion measure for volatility is alpha.

The Beta for a stock may vary in up-versus down-markets.

Monthly data is preferred.

Beta provides a good idea of a stock's inherent risk or sensitivity to general market fluctuations.

High beta stocks react strongly to variations in the market, and low beta stocks are less affected by market variations.

- If Beta is 1, then an issue has the same volatility as the general market. It is either growing at the same rate or declining at the same rate.
- If Beta is greater than 1, then an issue is more volatile. At 1.25 it will probably move 25% more than the market. If the market is in an up trend, then the security will gain 25% more than the general market.
- If Beta is less than 1, then an issue is less volatile. At 0.5 it probably will move only 50% or a half of the market. If the market is In a downtrend, it will only lose 50% of what the general market loses.
- If beta is less than 0, then the stock is moving in a reverse pattern to the index. When the index moves up the stock declines and vice versa.

To calculate the 200-day Beta for a stock (in comparison to the S&P index), you would compute the 200 one-day percentage changes in S&P and the 200 one-day percentage changes in the stock. These calculations produce 200 ordered pairs that are then charted as a scatter graph, and the slope of the least-squares-fit line is the value for beta. (Alpha is the y-intercept of the least-squares-fit line.)

Filtering Beta

- Filter Beta = 1, results return companies that are either growing at the same rate or declining at the same rate.
- If Beta is greater than 1, results return at 1.25 it will probably move 25% more than the market. If the market is in an up trend, then the security will gain 25% more than the general market.
- If Beta is less than 1, results return at 0.5 it probably will move only 50% or a half of the market. If the market is In a downtrend, it will only lose 50% of what the general market loses.
- If beta is less than 0, result return stocks that are moving in a reverse pattern to the index. When the index moves up the stock declines and vice versa.

5. Fundamental valuation methods

5.1. Efficiency Ratios

In any business the ability to convert accounts receivables (or credit sales) into cash is an important measurement of management's efficiency. These two ratio's give investors a decent appraisal of a company's ability to collect on credit.

To calculate accounts receivable turnover & age of accounts receivable:

Accounts receivable turnover = (net credit sales / average net accounts receivable)

Age of accounts receivable = 365 days / accounts receivable turnover

The values of each ratio will vary from industry to industry and research should be done also into a companies credit terms to give an idea of whether the management is effective or not. For example if a company has a 60 day credit term it would be unreasonable to expect an age of accounts receivable value which is significantly less than 60 days.

Some computational side notes:

- It is important to only use credit sales when calculating accounts receivable turnover and age of accounts receivable.
- The investor should use the average monthly receivables rather than the ending balance of accounts receivable. This will remove any seasonal fluctuations. To calculated the average monthly receivables add the 13 monthly balances (Jan1, Jan31-Dec31) and divide by 13. If the investor cannot get the monthly balances the average of the beginning of year and end of year balance should be used.

A company that generates more revenue from less assets is better than one that requires huge assets to generate little revenue. While this concept seems pretty straight forward, the asset efficiency values change dramatically depending on the industry.

To calculate:

N= per dollar of assets Asset Efficiency = (Revenues / Total Assets) x N

The asset turnover ratio is an expansion on the idea of efficient use of capital. It expands this principle to include all assets. There are several important limitations to this ratio as it is influenced by depreciating assets and when used as a management performance indicator can be misrepresented by the use of older assets. Because of this significant limitation, asset turnover ratio should be used only with similar related measurements.

To calculate asset turnover ratio:

Asset turnover = Net sales revenue / average total assets

The earnings retention ratio (ability to keep profits and pay to shareholders) is a way to calculate what the percentage of earnings are returned to shareholders.

To calculate

earnings retention ratio = ((earnings per share - dividend per share) / earnings per share)* 100

By charting historical earnings retention ratios, the trend will show you what the general direction the company is taking in regards to dividends. If the trend is declining, it is paying more shareholders. If the trend is growing, it is using more of the earnings for company expansion/expenses. A value of 100% means the company is not paying any dividends while a value of 0% (which is impossible) would mean the company is paying every cent earned to the shareholders. Smaller companies (or growth stocks) will generate high percentage retention (even 100%), while larger companies (or income stocks) will pay some form of dividend.

To determine what a reasonable ratio is for a company, you should compare companies that are of the same business type and size as the one you are evaluating

The inventory turnover ratio is a ratio between the cost of goods sold and the average inventory balance. To create a more meaningful ratio it is advised to create the ratio based on inventory type. Also this ratio represents an average of all inventories and does not reflect the turnover rate for individual items. The value of this ratio will significantly change based on the industry so only comparisons by like companies will have any meaning.

To calculate inventory turnover:

Inventory turnover = cost of goods sold / average inventory

Some computational side notes:

- This ratio can be influenced based on the inventory costing method used by the company. This will influence the comparison even to like type companies if the companies being compared are using different inventory costing methods.

Net cash flow to current liabilities is a measurement of a company's ability to cover current liabilities. A value of 1 would indicate the company can cover its current liabilities with cash flow and as a "rule of thumb" a value of over 1 is desired.

To calculate net cash flow to current liabilities

Net cash flow to current liabilities = net cash flow from operations / current liabilities

This ratio is quite straight-forward. How much revenue does a company need to take in to produce how much net earnings? While this ratio will differ between business models, it is a good comparison to show how one company sits compared to its competitor.

To calculate:

N= per dollars of revenue Revenue Efficiency = (Net earnings / Revenue) x N

Charting this ratio historically will also give you an idea of future prospects. Ultimately an investor would like this number to be as high as possible.

The working capital turnover ratio is a ratio between sales revenue to working capital. This is a measurement of managements ability to use working capital to generate revenue.

To calculate working capital turnover:

Working capital turnover = Net sales revenue / average working capital

It is also important to note that accounts receivable turnover and inventory turnover are components of working capital turnover.

5.2. Equity position and coverage

Book value per share is a ratio that is calculated by subtracting all liabilities from all assets, then dividing it by the total number of outstanding shares (or equivalents). The idea behind book value per share is that if a company's calculated book value per share is higher than the current stock price, the company is undervalued. It can also be used in the reverse where if a stock price is substantially higher than the book value per share that it is overvalued and prone to corrections. *It is important to note that investors using book value per share that they need to understand book value and its limitations. Limitations in book value also directly apply to book value per share.*

To calculated book value per preferred share:

(Share capital of preferred and common stock + contributed surplus + retained earnings) / number of preferred shares outstanding

General value guidelines are as follows:

- Utilities & industrials: Minimum equity value per preferred share in each of the last 5 fiscal years should be about 2 times the dollar value of assets that each preferred share is entitled to in the event of liquidation
- Other industries: These numbers vary greatly and should be compared to companies that are about the same size and qualities (compare against the primary competitors)
- Book value per preferred share should also show a stable or increasing value over the last 5 year period.

To calculate book value per common share:

(share capital of common stock + contributed surplus + retained earnings) / number of common shares outstanding

General value guidelines are as follows:

- There is <u>no generally accepted values for this ratio</u> and in practice most fundamentalists will find there is generally no substantial relationship between the equity value per common share and the

market value. Some companies (depending on industry) will trade high above the equity value while others are far below the equity value. The difference between the equity value per common share and the market price is usually accounted for by the actual/future earning power of the company. Companies that have a higher actual/future earning power will generally have a higher market value then equity value (example: technology companies).

Based on these guidelines, book value per common share is not regarded as an effective fundamental ratio to analyze market value.

The two most basic sources of funds for a company are debt and equity. Debt and equity both have unique characteristics and the relationship between these two sources is widely used to evaluate the financial strength of a business.

Debt requires maintenance in form of interest payments and on maturity are payable whether a company has earned or lost income. The only benefit is that interest payments are tax deductable unlike dividend payments which are not. Also equity does not require fixed interval payments and dividends are only paid on earned income.

The debt to equity ratio is the most widely used ratio for debt to equity analysis. There are however some notable warnings on this ratio. First is that book value of debt is typically much closer to market value than shareholder equity. Second is the definition of what is debt. Are deferred taxes or minority interests included in debt? It is quite common for these two items to be left out since it does not involve a firm obligation. Depending on what is considered debt the ratio can have quite different results.

To calculate debt to equity ratio

Debt to equity = Total liabilities / Owner's equity

To calculate price to book ratio, take the book value per share and divide by the last reported close.

For example: If a company's close price was $10 and the book value per share was $2, then the price to book ratio would be 5 (10/2=5). A price to book ratio is similar to P/E in the respect that it can also be calculated using individual stocks or market indexes like the S&P.

It is important that investors using price to book value ratio understand book value and its limitations. Limitations in book value also directly apply to price to book ratio.

Price-to-cash-flow ratio is a less-used fundamental valuation indicator. This valuation focuses on the amount of cash a company can pay to its shareholders in the form of a dividend.

To calculate price-to-cash-flow ratio, take the stock price and divide by the last reported yearly cash flow.

Price-to-cash-flow ratio is similar to that of P/E, and when using price-to-cash- flow ratio as a valuation tool, it is advisable to compare it only with companies in the same industry.

rice-to-dividend ratio is a type of fundamental valuation indicator. A price to dividend ratio is the reciprocal of dividend yield.

To calculate price to dividend ratio:

Dividend ratio = current market price per share / dividend

The reciprocal to price-to-dividend ratio is the dividend yield which would be 10% (or 2/20).

Price to dividend ratio is typically used as a general guide to determine whether an issue is overvalued or undervalued. Price to dividend ratio should not be used to pick bottoms or tops.

P/E is one of the more important fundamental valuation tools. P/E is a ratio of the stocks price and the stocks earnings per share. To calculate a P/E, take the price of the stock and divide it by it's earning per share.

Types of P/E, Individual and Collective - P/E can be calculated for an individual stock as well as for the overall market. To calculate P/E for the overall market, investors typically use DJIA and the S&P 500. To calculate the market P/E in the DJIA, the investor must use the value of the DJIA divided by the earnings of its 30 components.

Trailing P/E is when historical values are used. This does not give an indication of future performance, but does give the investor an idea of the stocks historical value which can then be compared to it's current P/E or projected P/E's. Trailing P/E ratio's are commonly used in newspapers.

Projected P/E uses the current stock price divided by the stocks projected earnings per share. Projected earnings are generally provided in company research reports. Projected P/E should be used with care, since it is based on estimated earnings.

The relative P/E ratio is a ratio between the current P/E and historical P/E's. A relative P/E has a numerical range of between 0-100%, representing the all time low (0%) to the all time high (100%) P/E.

For example: if a stock has historically traded with a P/E range of 10-20, and the current P/E is 20, than the relative P/E would be 100%. If the stock's P/E is 15, the relative P/E would be 75% (15 / 20 = 0.75 or 75%).

Some investors believe that trading in the high range of a stock's relative P/E is not considered safe since it could be considered overvalued.

Historical P/E's are not always accurate since they do not account for large events, like in 1992, which followed a large recession, when a large portion of companies wrote off assets and went into restructuring.

Company growth is reflected in the stock's P/E. The higher the company growth rate, the more expensive the stock, as measured by P/E. Growth stocks tend to have high P/E ratios, in the range of 25 to 50 times the annual earnings per share.

Investors tend to invest when they believe the company growth will accelerate, thereby increasing the price and the P/E. If the company is seen by the public to have a decreasing growth, the price tends to fall as well as the P/E.

With growth stocks, it is important to compare the earnings growth rate with the stocks P/E. Depending on the investors risk, one may consider a company with a growth rate of 20% and a P/E of 20 to be reasonably valued. A P/E which is as high as 25% above the growth rate may considered reasonable in industries like high-tech. Conservative approach would only consider stocks with a 20% growth rate if the P/E was less than 75% of the growth rate. (20 x 0.75 = 15, therefore the stock must have a P/E less than 15)

Analyzing P/E's and projected growth rates can help give the investor an indication of valuation. For example a P/E of 50 may be considered quite high, yet if the company's growth rate is estimated at 50%, then this stock would be at a discount in comparison to it's future earnings. On the other hand a stock with a P/E of 10 and a growth rate of 5% is considered overvalued.

If the company has a high P/E, the reasoning would be that it would have high growth expectations. If these expectations are not met, the higher the P/E, the higher the potential price fall. However stocks with low P/E's should not be so quickly considered based on the P/E alone. A low P/E may be a results of competition, low growth, earnings expectations and more.

Company's with low P/E's are generally considered more attractive because of two main reasons, 1) the stock will rise in price if the P/E rises to that of the industry, and 2) it can only go up. It is important when using a low P/E to always consider the companies potential growth in earnings.

Forecasting with P/E - P/E by itself is not always a good predictor of future price movements, however it is quite commonly used by investors to forecast future price level of stocks and the market.

Forecasted price = Current P/E * project annual earnings per share.

Forecasted market price is calculated in the same way as forecasted price.

Forecasted Market Price = Current market P/E* total projected annual earnings per share of the market.

It should be understood by investors that forecasted prices are calculated from assumptions made on company growth, and that they are not immune to favorable/unfavorable news, competition, panic selling, business outlook and business cycles, etc.

Tips:

- Current P/E has little meaning on forecasted price.
- Positive P/E conditions are that the company P/E is higher than the market P/E at the beginning of an up-trend.
- P/E's should be compared to similar companies in the same market as well as historical P/E values.
- If institutional ownership is low, P/E tends to be low.
- Companies with low P/E tend to be safer.
- Do Not buy low P/E stocks just because they are low, Do Not buy stocks just because the P/E is at a historical low and Do Not use P/E's as the only mean of analysis.

Price to sales ratio is a less-used type of fundamental valuation indicator. This valuation focuses on total revenue.

To calculate this ratio, take the stock price and divide by the last 12 months revenue/share (12 month revenue per share is calculated by the last 12 month revenue combined divided by total number of shares outstanding). Price to sales ratio is generally only used for evaluating companies with volatile earnings.

Studies have shown that there is a correlation of low price to sales ratio's and good returns on those stocks.

These P/S numbers are categorized as follows;

- under 0.4 is considered undervalued;
- 0.4 to 0.8 is average;
- and, a ratio greater than 0.8 is considered overvalued.

Growth companies typically have high P/S numbers, therefore, it is advisable that the scale reflects each particular industry. This can be done by comparing P/S numbers for companies in the same industry group and will help determine how the scale should be altered.

To calculate Times interest earned:

Times interest earned = (Income before taxes + interest) / Interest charges

Times interest earned is a ratio which measures the amount of times interest payments can be covered by income before taxes. Interest payments are paid before taxes which is why income before taxes is used in this ratio.

5.3. Profitability Ratios

Earning per share or EPS is considered one of the primary driving forces behind share market price. To fully understand EPS we should make mention of some of EPS's key contributors which are earnings and common shares.

Past performance or the last reported earnings are generally considered a good indicator of future performance. The issuance of shares (common or preferred) is typically the primary source of capital for corporations. This capital can then be used by the corporation to further generate wealth. Profit arising from the business can either be reinvested in the corporation or paid out to investors in the form of dividends. EPS is a ratio of the companies past performance per common share. The relationship of EPS to current market price is known as PE (or P/E ratio).

It is important to compare EPS to like type companies. Depending on the industry acceptable EPS ranges will vary. EPS is most effective when comparing the historical trend of EPS as well as comparing to companies within the same industry and approximate size.

There are of course certain factors which need to be taken into account when using EPS as a fundamental valuation. A company's asset structure has the potential to change through operations, acquisitions, issuance of additional common shares, stock options, warrants and other financial methods. This makes the historical trend of the EPS or current EPS value difficult to compare. Secondly, a company may actively influence their EPS figures to achieve forecasted EPS values. This can be done through a variety of methods like sale of assets to boost revenues, buy-back or dilution of shares to prevent takeovers, issuance of unbundled stock units, etc.

Calculating Earning per Share (EPS)

Earnings per share (EPS) = (Net income after taxes - preferred dividends) / Weighted average of outstanding common stocks

EPS rank (earnings per share rank) is a measurement of a company's EPS growth (and stability of that growth) over the last five years.

To calculate the EPS rank of a company, take the percent change in the last two quarters earnings, versus the same quarters of the previous year, combine and average with the 5 year data.

The corresponding calculation should generate a number between 1 and 99. The higher the number the more desirable the stock. For example, a rating of 95 would mean the company's earnings are in the top 5%.

The PEG ratio is a comparison between the price of a stock, a stock's P/E and the expected EPS yearly growth.

To calculate PEG:

PEG = (price / annual earnings) / (% annual growth)

Generally, values of greater than 1 show that the company is possibly overvalued or expects that the companies future earnings per share growth will be higher than the market estimates (growth stock). With PEG values of less than 1 means that the company may be undervalued or that the companies future earnings per share growth will be lower than the market estimates.

Problems with PEG:

1. PEG ratios work best with growth companies. Income stocks/companies are generally well established and offer less growth opportunities
2. The growth estimate is exactly that, an estimate. It could change.
3. PEG values (ie greater than or less than 1) are rules of thumb not absolutes.
4. PEG does not account for inflation. IE with PEG if a company grows at the same speed as inflation the PEG may have a number but it's rather meaningless since in reality there is no growth.
5. PEG should be used as a description of the growth to price trade/off, not as an absolute.

6. PEG ratios should not be used as the only valuation method since ratios are only as reliable as the data on which they are based. PEG ratio's should therefore be supplemented with other complementary methods to achieve a reasonable opinion.
7. PEG ratios with low growth companies generate rather nonsensical values.
8. Companies with zero growth cannot be calculated with PEG (divide by zero).
9. PEG gives a relative value for a companies stock price based on future growth. Tends to work well with companies that are in the growth stage of their life cycle.

Ratios should not be used as the only valuation method since ratios are only as reliable as the data on which they are based. Ratio's should therefore be supplemented with other complementary methods to achieve a reasonable opinion.

One of the most commonly used profitability ratios is profit margin on sales. This is a representation of the percentage of net sales after all expenses are recognized. This ratio is best used when comparing to like type companies since company assets are not taken into consideration.

To calculate profit margin on sales:

Profit margin on sales = Income / Net sales

If there has been a shift in corporate finance and valuation in recent years, it has been towards giving "excess returns" a more central role in determining the value of a business. While early valuation models emphasized the relationship between growth and value - higher growth firms were assigned higher values - more recent iterations of these models have noted that growth unaccompanied by excess returns creates no value. With this shift towards excess returns has come an increased focus on measuring and forecasting returns earned by businesses on both investments made in the past and expected future investments. In this paper, we examine accounting and cash flow measures of these returns and how best to forecast these numbers for any given business for the future.

The notion that the value of a business is a function of its expected cash flows is deeply engrained in finance. To generate these cash flows, though, firms have to raise and invest capital in assets and this capital is not costless. In fact, it is only to the extent that the cash flows exceed the costs of raising capital from both debt and equity that they create value for a business. In effect, the value of a business can be simply stated as a function of the "excess returns" that it generates from both existing and new investments.

While this principle is intuitive and easily proved, measuring excess returns has proved to be difficult to do. On one side of the equation are the costs of debt, equity and capital. While there are clearly significant questions that remain to be addressed, a significant portion of the research in finance has been directed towards estimating these numbers more precisely. On the other side of the equation are the returns themselves and surprisingly little has been done in coming up with a cohesive and consistent measure of returns generated on investments and how these returns can be expected to evolve over time.

6. Measuring Investment Returns

Now that we have established how critical it is that we get a reasonable estimate of the return earned on existing investments, we need to consider the alternatives. In this section, we will first explore the two measures of return based on accounting earnings - return on capital and return on equity - that are widely used in practice and then turn our attention to cash based returns and why they have not attracted as wide a following in practice.

Accounting Returns - Given that much of the information that we work with in valuation and corporate finance comes from accounting statements, it should come as no surprise that the most widely used measures of return are based upon accounting earnings. In keeping with our earlier differentiation between returns to all capital and just to equity investors, accounting returns can be categorized accordingly.

Return on Invested Capital - The return on capital or invested capital in a business attempts to measure the return earned on capital invested in an investment. In practice, it is usually defined as follows:

$$\text{Return on Capital (ROIC)} = \frac{\text{Operating Income}_t\ (1\ -\ \text{tax rate})}{\text{Book Value of Invested Capital}_{t-1}}$$

There are four key components to this definition. The first is the use of operating income rather than net income in the numerator. The second is the tax adjustment to this operating income, computed as a hypothetical tax based on an effective or marginal tax rate. The third is the use of book values for invested capital, rather than market values. The final is the timing difference; the capital invested is from the end of the prior year whereas the operating income is the current year's number. There are good reasons for each of these practices and we will examine the details in the sub-sections that follow.

The return on investment, whether measured to just equity investors or to all capital is a key input in both corporate finance and valuation. Consequently, there is a payoff to measuring it correctly in the first

place. We began this paper by looking at why we attach so much weight to the returns and capital and equity, and how the excess returns we compute underlie the values we attach to companies. While the accounting measures of these returns relate accounting earnings to book value, they can be biased by accounting misclassification of expenses - treating R&D and operating leases as operating expenses skews operating income and capital - and accounting choices - depreciation and restructuring charges can lower book value and increase reported returns. We considered ways in which we can derive more reliable and cleaner measures of these returns.

Having measured returns on investments from the past, we faced the tougher task of forecasting these returns for future periods. We considered how best to weight the past return history of a firm, sector averages and the costs of equity and capital to make this judgment. Ultimately, positive excess returns - return in excess of costs - have to come from competitive advantages or barriers to entry into sectors. Stronger and more sustainable competitive advantages should lead to larger excess returns over longer period. Thus, firms that have generated high returns in the past may continue to make these returns for the next few years, but the excess returns will start decreasing as firms become larger and competition increases.

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Georgeta Vintilă
Academy of Economic Studies of Bucharest, Romania
Lecturer Mihai Nedelescu
Lecturer Iuliana Predescu
Lecturer Cristina Stănescu
Romanian-American University of Bucharest, Romania

LEASING INDUSTRY IN THE ISLAMIC WORLD - OPPORTUNITY'S IN THE DIVERSITY OF LONG TERM FINANCING SOURCES FOR THE COMPANIES LEVEL

Abstract: The leasing it's a form of financing through rent by the specialized financial companies in this operations, of some machines, equipments and some companies goods of the motivation to resort at this form of trade it's in the specific of some operations that they achieve or in the fact that they don't have sufficient founds of they own and borrowed to buy them.

Key words: Islamic Leasing, leasing industry, Islamic Finance

JEL Classification: G15

"What is this "Islamic" leasing and how is it any different than what we are doing now?" The fact is that Islamic leasing, and what I will call, for want of better terminology "conventional" leasing, are very nearly the same. In fact, there are many more similarities between the two than differences. From a practical standpoint, there are really only three distinctive differences between the Islamic and the conventional lease:

1. *In the Islamic lease, interest related characteristics are removed. That means things like late fees, interim rents, and interest accumulation on money deposits are eliminated from the contract. It does not mean elimination of "profit". Profit is an integral part of almost all Islamic financial transactions.*
2. *There are some restrictions on the assets and/or on asset use. Islamic principles typically would prohibit involvement in areas involving such things as alcohol, tobacco, conventional finance, or pork products. The lease of assets used in connection with these industries/items would be prohibited.*
3. *The Islamic lease calls for the lessor to take real responsibilities in the ownership of the Asset. This becomes, in fact, the main difference. The conventional lease tries to contractually move the lessor as far away from asset responsibilities as possible. The Islamic lease insists that the lessor assume certain basic responsibilities as the owner of the asset.*

These three differences are minor, but important distinctions in the contractual arrangement between lessor and lessee. However, the ultimate documentation package leaves the Islamic lessor and the conventional lessor on relatively equal footing from a practical and economic standpoint.

An example of this is an Islamically designed leasing Fund that ILIC is involved in. This Fund is one of a series, and the other Funds in the series are all conventional. Because of exposure limits, these funds often join together in the financing of a single transaction. However, rather than confuse the lessee with different documentation, the Islamic documents are routinely used for ALL the funds. This is a practical and economic recognition of the equality between the conventional and the Islamic lease.

The International Leasing & Investment Co (ILIC) was organized in mid 1999 as the first large ticket, general asset Islamic leasing company in the world. While its business focus is in the Islamic countries, specifically the member countries of the Islamic Development Bank, its range of business activity is worldwide, stretching from Indonesia in the East to the United States in the West. Originally capitalized with US $50 million, ILIC effectively controls assets of nearly half a billion dollars.

One of the mandates of ILIC as a company, is to develop the practice and use of Islamic leasing worldwide. This mandate is manifested in the Company's aggressive development of new leasing companies throughout the world. Because of this activity, ILIC is in a unique position to see and assess the potential for Islamic leasing.

So now you may ask yourself another question: "If the Islamic and conventional lease are so similar, why can't I just go ahead and used my conventional leases—what difference does it make?" The answer to that questions lies within the fundamentals of Islam. Simply stated, a contractual arrangement that does not include these differences is not acceptable under Islamic principles, and is therefore "haram", or prohibited to the Muslim practitioner. Small as they may seem, they are critical differences.

To the practicing Muslim, the principles of Islam are more than just a guide, but are rather a divine dictate that must be followed. To the Muslim, these principles outline a course of living that lead to happiness, a harmonious community, and a thriving economy. The principles must be followed with exactness, however, and thus the practicing Muslim will preferentially use Islamic finance whenever it is available.

Islamic Lease Versatility

The Islamic lease is the most versatile of the Islamic financial products, and this makes the Islamic lease the instrument of choice for many financial transactions. This versatility within the realm of Islamic finance finds the lease used in many instances that would commonly find a different type of instrument were the same transaction done conventionally. This means that within Islamic finance, the lease will be used for a higher percentage of the overall transactions, than would be found in the conventional world.

The source of this versatility is found in two areas:

- *the rules that govern Islamic financial transactions, and;*
- *in the basic nature of the lease.*

One of the basic principles of Islamic finance is that money is not to be treated as an "asset" or "commodity". Money is looked at simply as a medium of exchange, and not as object in and of itself. Thus, In Islamic financial, an asset, other than money, must be at the base of the transaction. This asset may be bought and sold and debt generated as a result of such activity. But the money itself may not. Since it is NOT viewed as a commodity, money, including money (debt) obligations, is not able to be sold once they are originated. This means that in most Islamic financial transactions, once the underlying asset is sold, the seller and holder of any debt generated by the sale may not re-sell the obligation. It must be held through maturity by the original holder of the debt.

In conventional finance, re-sale of debt is a common practice, and constitutes the basis for conventional secondary market activity. Such activity is not allowed under Islamic financial rules.

The Islamic lease, however, provides a different opportunity. In the lease transaction, the money obligation is tied to the asset and to its use. The financier, as Lessor, retains ownership of the asset during the term of the lease, and this ownership interest, together with the obligation to pay lease payments on the use of the asset, MAY be transferred, in whole or in part at any time during the lease. This effectively provides the only viable secondary market vehicle available to Islamic finance. This also provides a huge incentive for Islamic financial institutions to use the lease as the structure of choice in Islamic financial transactions.

A second incentive for use of the lease over other Islamic financial instruments rests with the nature of the lease transactions itself. In most Islamic transactions, an asset is sold and ownership is transferred. When this transfer takes place, the money obligation becomes set (remember, there is no interest in an Islamic transactions, so interest characteristics are not present in the structure of the transaction). The conventional characteristics associated with interest, such as the potential for a variable rate and late payment interest, are not allowed. Once again, we see the versatility of the Islamic lease come to the front. Since the lease effectively runs from period to period, allowance may be made to adjust the lease payment prior to the beginning of each such period. This adjustment may be legitimately formulated to work very similar to the conventional adjustable rate.

To these special issues of versatility is added the natural flexibility of the lease transaction, and when taken as a whole, provide the practitioners of Islamic finance strong incentive to use the lease as the instrument of choice whenever possible.

Islamic Demographics

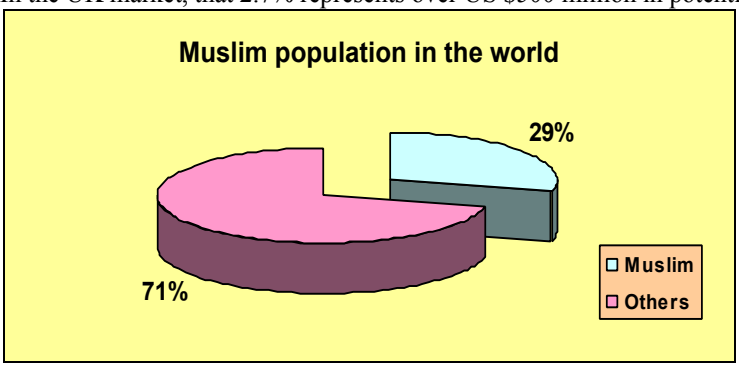
From a real world situation, the practices of Islamic finance are in a resurgence. Much of the Muslim world is currently served through conventional financial institutions. However, the growth and development of Islamic financial institutions and products has led to a quickly increasing Islamic financial marketplace, and those who hope to compete in this marketplace in the future will have to provide products and services that are compatible with Islamic principles.

"Well," you may ask, "Why do I need to worry about this at all?" The answer to this question lays in the demographics of the world population figures. Let's take a look at those numbers, first from an overview standpoint.

There are approximately 6.5 billion people in the world. Depending on whose estimate you use, up to 29% of those people are Muslim. That means that over 1.6 billion people one quarter of the world's population adhere to the principles of Islam. As a general rule, if these people are given a choice, they would have the preference to use Islamic financial products, including Islamic leasing, over conventional methods of finance. Thus, with an offering of Islamic leasing, one-quarter of the world becomes a market with preferential inclinations towards the way you are doing business.

Regionally, these numbers obviously change, with certain parts of the world having much heavier concentrations than others. However, even in markets like the United Kingdom (2.7% Muslim) and the United States (3.75% Muslim), the total Muslim population still provides a tidy market share potential to draw from.

For example in the US marketplace, 3.75% of the leasing market represents over US $7.5 billion in potential business. In the UK market, that 2.7% represents over US $500 million in potential market share.



* UN statistic's 2007

Using the statistical information from the Euromoney World Leasing Yearbook 2004, and combining this with the demographic estimates of Muslim population, a sampling of market potential looks something like this:

Market Potential of Islamic Finance			
Country	**Lease Volume (US $ Bln)**	**Muslims as a Percentage of Total Population**	**Representative Lease Volume (US $ Bln)**
US	204.00	3.75%	7.65
France	22.23	10.00%	2.22
Germany	39.77	3.70%	1.47
Morocco	0.54	99.00%	0.53
Turkey	1.32	99.80%	1.31
Italy	22.35	2.40%	0.53
United Kingdom	19.07	2.70%	0.51
Russia	2.00	19.00%	0.38
Pakistan	0.37	97.00%	0.35
Nigeria	0.37	70.00%	0.25
Netherlands	4.66	5.40%	0.25
Saudi Arabia	0.22	100.00%	0.22
Canada	10.44	2.00%	0.20
Switzerland	6.11	3.10%	0.18
Sweden	5.88	3.10%	0.18
Malaysia	0.28	59.00%	0.16
India	1.00	14.00%	0.14
Bangladesh	0.14	88.30%	0.12
Spain	9.30	1.20%	0.11
Belgium	2.89	3.60%	0.10

* Euromoney World Leasing Yearbook 2004

Certainly, this is an acknowledged simplification of the marketplace. It is, however, also a limited view of the real marketplace and opportunity that exists. Because many of the countries that have heavy Muslim populations are also developing countries, with uncertain reporting methods available for the various economic activities that occur, much of the leasing activity that happens in these countries goes unreported.

For example, ILIC's leasing volume alone would easily put it in the "top 50" of leasing volume for the Euromoney World Leasing Yearbook 2004 report—and ILIC is just one of a dozen or so Islamic financial institutions doing leasing business in Kuwait. A sampling of the lease volume from just a few of the Islamic institutions in Kuwait puts the leasing total for Kuwait a nearly US $2 billion, solidly in the "top 25". This under-reported volume of leasing activity masks the real opportunity that exists in the field of Islamic leasing.

It is important to note, however, that the market potential exists not only in the countries with predominately Muslim populations, but also in those areas where the Muslim population represents a relatively small portion of the total population. Revisiting the United States market gives a prime example of this, where, as pointed out, the representative lease volume for a relatively small percentage of the population still equals over $7.5 billion in potential business! And remember, this is the "extra" edge that would be available to an Islamic leasing company.

Such a company does not do business just with Muslims, but is able to compete against other leasing companies in the general leasing market, whether Islamic or conventional, for all leasing business that is available.

Business Expansion

Islamic leasing also offers an opportunity for a leasing company to dynamically expand their business opportunities. In most of the developed countries, the market share of leasing versus other modes of financing is relatively stable. For example, in the United States market, approximately 1/3 of all capital equipment acquisitions have been made through the use of leasing. This statistic has remained relatively constant for the 25 years that I have been involved in the leasing industry.

So what happens if you want to expand your business? To have dynamic growth? You have, in fact, only a limited number of options:

- *You can increase the share that leasing commands in the over-all capital asset markets.* This, obviously, is very difficult to do in a mature market—as shown by the fact that no one in the US seems to have been able to accomplish it—at least over the last 25 years. This may be a very realistic approach in a developing economy. Remember, though, that many of these developing markets have heavy Muslim populations that will demand the use of Islamic financial products.
- *You can take market share away from someone else.* This is the more typical way that growth occurs for an individual company. It is also the most "dangerous" for a leasing company. Typically, this approach requires tactics designed to lure existing customers away from whomever they are currently doing business. These tactics often incorporate things like easier credit standards, lower rates, etc., each of which may potentially have negative effect on the leasing company's portfolio and business viability. Targeting a "preferential" group of the economy, such as the Muslim population, may allow a company to dynamically gain additional market share simply by offering a compatible product, and not by resorting to portfolio threatening tactics.
- *You can wait for the economy to grow.* A growing economy offers limited growth potential for the leasing industry. Assuming that market penetrations remains somewhat constant, the total volume of leasing business should expand with the general growth of the economy. However, this phenomena rarely, if ever, produces the opportunity for dynamic growth, and the leasing company that looks to expand its share of business through only this means will have a long and frustrating wait.
- *You can expand into new and/or less developed markets.* For the leasing company that is not afraid of the international environment, this may be the most attractive alternative to dynamic company expansion. Developing markets offer huge opportunity, and growth potentially can be quickly realized. Once again, however, many of the most attractive opportunities for such expansion occur in countries dominated by Muslim populations.

Islamic Capital

Companies operating in the realm of Islamic leasing also have an additional advantage, and that is the ability to tap into the Islamic capital markets. An estimated US $380 billion in underutilized capital exists

in this marketplace, and this capital is looking for a worthy "home" in Islamically compatible investments. And, since many of the oil producing countries of the world are Islamic, this capital base, fuelled by the booming oil economy, continues to grow.

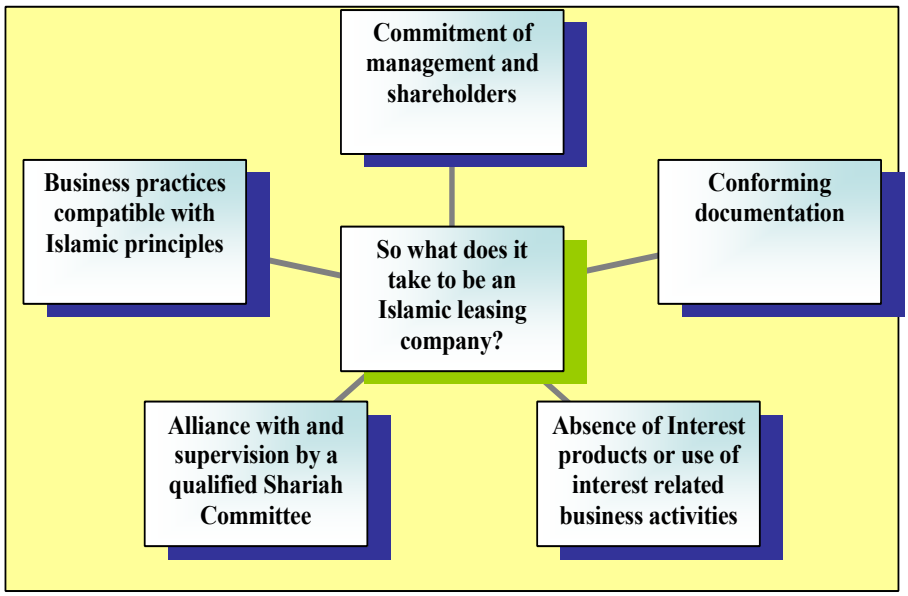
Islamic Finance

Entering into the arena of Islamic leasing should be approached like any other new venture or modification of business focus. Such changes, to be successful, typically require a firm management commitment and a dedicated effort of company resources.

To make such a transition, you must have a thorough understand of exactly what you are trying to accomplish, and how Islamic leasing can help you accomplish it. You must also be willing to make the commitments required for such a change, and then be willing to take the necessary steps to qualify as an Islamic lessor. The changes required demand a clear understanding of Islamic finance and the underlying governing principles. These changes involve, among other things, changes in documentation, staff training, and a modification to business practices.

Getting expert advice early in such a transition is essential. In entering new markets, it may be prudent to partner with an existing Islamic financial institution or leasing company and/or to obtain expert consulting advice.

In this regard, Islamic financial institutions, including Islamic leasing companies, typically work with a "Shariah Committee". The Shariah Committee is a group of Islamic scholars who provide guidance to the company's business activities and practices. The Shariah Committee will review and give input into standard documentation, products, and, as necessary, individual transaction structure and other business activity, to ensure compliance with Islamic principles. Affiliating with a Shariah Committee will be a necessary step in a transition or expansion to Islamic leasing.



Conclusion

For those companies who are not willing and/or able to make the commitments necessary to present Islamic leasing on their own, another avenue may also be available. Coordination with an existing Islamic lessor, through a brokerage arrangement or some other relationship, may allow the company to reap fee income from Islamic transactions.

It is important, in these relationships, to bringing the Islamic lessor into a transaction early.

This will ensure that the deal is properly structured to meet Islamic rules, and will preserve the needs and desires of the client for an Islamic transaction.

There are compelling reasons for a financial services company to become involved in Islamic leasing. As the most versatile of the Islamic financial products, the Islamic lease is assuming an ever-increasing role in the arena of Islamic and world finance. The world demographics add to this compulsion by demonstrating that one-quarter of the world's population can be assumed to have a preference towards the use of Islamic financial products. Companies that wish to enhance and dynamically expand their business scope, would do well to consider the vast potential of the Islamic leasing marketplace.

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PhD Student: Ec Dan Mihai Voicu
D.G.F.P. Arges, Pitesti, Romania

FISCAL REGISTRATION AND FISCAL OBLIGATIONS OF THE TAX PAYERS - CONCEPTS AND APROACHES IN PRESENT CCONTEXT -

Abstract: Lately, there has been much talking about the fact that Romania is among the first countries in the world when taking into account the big number of taxes and fees which the tax payers – physical persons and legal persons – have to pay to the state budget or the social state insurances budget, as well as to the local budgets.

Besides the number of taxes and fees, one the one hand, an important role should have the efficient participation of the tax payers' contribution to the public expenses, this one being materialized through the reduction of their remaining obligations to the consolidated general budget, and, one the other hand, the efficiency of the public expenses, preformed by the state institutions, materilized through the capital investment and the infrastructure of a national importance.

The adhesion of Romania to the family of the European countries was a sign that the country economy is on the good way, as far as its growth and development is concerned, but there are a few more steps to take in order to reach at a certain level of efficiency and profitableness, a level specific to those countries with a tradition in the market economy.

The present work deals not only with the basic notions as far as the fiscal registration is concerned, a very important aspect for each tax payer, but also with financial liabilities which belong to the tax payers – legal persons and physical persons who has to know the importance of the contribution brought to the formation of the funds.

Key words: taxes and fees; fiscal registration; reinforced general budget; public expenses; tax system; budget funds.

JEL Classification: H21.

Our state permanently needs financial resources to forma the public financial funds, a fact which leads to an adequate taxation of all the profits achieved by physical persons and legal persons, being aware of the fact that the financial budgetary resources consist mainly in fiscal incomes, respectively taxes, fees and other shares in accordance with present legislation.[1]

Each person who takes part in the money circulation - physical persons and legal persons – becomes a tax payer in a state as long as he/she gets profit on its territory.[2]

The public expenses are made in order to answer all the social groups needs, which couldn't be made through shares limited in number or in territory. In these conditions, the state takes the responsability, on the one hand, for collecting all the shares owed by the tax payers and on the other hand, for dividing these funds, materialized in public expenses (investments).

In order to succeed, in good conditions, in playing the role of the collector, the state adopts a series of regulations and measures, which have to be accepted and well-known by all the tax payers. This thing can be done on the basis of the principle of the absolute financial power, which the state imposes on the national territory, in accordance with the state supreme law, the Constitution. These rules and measures are expressed through the term of tax system, which is generally defined as representing all the taxes, fees and shares, with whom the biggest part of the public profits can be achieved and which is a constituent part of the financial mecanism of the state.

All the tax payers are obliged to take part in the supporting of the public expenses, through taxes and fees/charges, which are generically called, and the fiscal mecanism should ensure real and precise fiscal tasks.

1. Financial liability. Tax claims.

For the obtained profits, the tax payers - physical persons and legal persons – are obliged to pay taxes, fees, shares and other sums of money owed to the reinforced general budget of our state, taking into

[1] Law No. 571/2003 concerning the Fiscal Code, republished, with modifications and later completions.
[2] Elena Iordache – Fiscality Specialist's Manual, Irecson Publishing House, Bucharest, 2005.

account the term of payment and their methods of calculation. Romanian financial legislation specifies the tax payers' obligations relating to taxes and fees.

Financial liability payment consists in the obligation of physical persons and legal persons, who benefit from the profits achieved in Romania, to pay, according to the term of payment stipulated in the law, his/her taxes, fees/charges, shares and other sums of money owed to the reinforced general budget or to the local budgets.[1]

The Romanian fiscal code establishes the legal environment for the established taxes and fees, which represent public revenues or of the local budgets, states precisely the tax payers who have to pay these taxes and fees, as well as the method of their payment.

The Fiscal Code[2] of Romania is completed with the provisions of the fiscal procedure Code, as well as with other related to the connected normatives.

Through financial liability, one can understand:

- the obligation of entering goods and the taxable or, as the case might be, taxes, fees, shares and other sums of money owed to the reinforced general budget;
- the obligation of calculating and registering taxes, fees, shares and other sums of money owed to the reinforced general budget.
- the obligation of paying taxes, fees, shares and other sums of money owed to the reinforced general budget according to the legal terms of payment;
- the obligation of paying afferent taxes, fees, shares and other sums of money owed to the reinforced general budget, named obligations for paying the accessories.
- the obligation of calculating, retaining and registering in the accounting and payment book keeping to the legal terms of payment, the taxes and shares which are obtained through stopping at the source.
- any other obligations that belong to the tax payers, physical persons and legal persons, in order to bring the financial law into operation.

The payment financial obligation is the responsability of all the tax payers who get profits in Romania, but this obligation is tightly connected to the imperative and absolute right of our state of collecting taxes and fees. In a book keeping sense of the word, taxes and fees represent for the tax payers "passive elements", that means obligations, and for the state "active elements", that means patrimonial right.

The state patrimonial right of collecting taxes and fees is expressed through the notion of fiscal debt.

The Romanian financial procedure code[3] defines the notion of fiscal debt as representing the state patrimonial right which, according to law, derives from the rights of fiscal matter and which consists of:

- the right of collect taxes, fees and other sums of money which represent incomes of the reinforced general budget, the right of the repayment foe the value added tax, the right of returning the taxes, fees, shares and other sums of money which represent incomes of the reinforced general budget, named main fiscal debts.
- the right of collecting interest of late payment penalties in accordance with the law, named fiscal debt accessories.

In order to have a better understanding of the notion of fiscal obligation, respectively fiscal debt, I will begin with the idea that these notions of fiscal obligation is characteristic to the private finances, associated with the tax payers who are legal persons and physical persons, while the notion of fiscal debt is characteristic to the public finances, associated with the state taxes, fees and expenses, loans and debts of the state territorial-administrative institutions and other public institutions.[4]

2. Fiscal book entry, establishing and declaring financial liability

Each person or entity that is subject in a legal financial statement is fiscally registered, receiving a financial identification codes which can be assigned to the tax payers, as follows:

- for legal persons, except for traders, as well as for societies and other entities without legal personality, the book of entry code assigned to the qualified financial body subordinated to the National Agency of Fiscal Administration;
- for physical persons, personal identification number, assigned according to the specific law;

[1] Georgeta Vintila – Fiscality. Methods and fiscal techniques, the 2nd Edition, Economical Publishing House, Bucharest, 2006.
[2] Law No. 571/2003 concerning the Fiscal Code, republished with modifications and later completions.
[3] Government Order No. 92/2003, republished with modifications and later completions.
[4] Marcel Drăcea, Daniel Tobă – Public Finances (University manual), Sitech Publishing House, Craiova, 2005

- for physical persons who do not have their own personal identification number, the financial identification number assigned to the qualified financial body subordinated to the National Agency of Fiscal Administration;
- for traders, including the traders' branches who have the head office of their trade abroad, the registration code assigned according to the specific law;
- for physical persons who develop economical activities independently or exert liberal professions, the fiscal registration code designated by the judicious fiscal institution from the National Agency of Fiscal Administration;

The respective persons have the obligation of providing the registered fiscal declaration in order to receive the fiscal identification code by the judicious fiscal institution, within 30 days from starting date, according to the law, in case of juridical persons, associations and other entities without juridical personality, including, in case of creating secondary headquarters, branches, etc., respectively from the issuing date of the legal functioning document, starting activity date, the date of obtaining the first income or getting the employer status, as it is the case, concerning the physical persons.

On the base of the fiscal registration declaration, the competent fiscal organism within the National Agency of Fiscal Administration, within 30 days from the date of taking place, by completing the declaration of mentions and at the ceasing conditions which generated the fiscal registration, the tax payers have the obligation to offer the fiscal authorities, in order to cancel, the fiscal registration certificate, in the same time with the declaration of mentions.

A special character is represented by fiscal registration in case of tax payers who perform taxable operations and/or excepted from the value added tax with deduction rights, which have the obligation to register as a value added tax payer to the judicious fiscal organism from National Agency of Fiscal Administration, in the following cases:[1]

- at the start up moment, obligatorily, if it declares that there is going to be a turnover above the exemption from taxation level mentioned by the Romanian Fiscal Code. The registration date as a value added tax payer is the communication date of the registration certificate;
- at the start up moment, if it declares that it is going achieve a turnover under the exemption from taxation level, but makes an option for applying the normal value added taxation. The registration date as a value added tax payer is the date of communicating the registration certification;
- after foundation, necessarily, if it overruns the exemption ceiling, within 10 days from the end of the month in which it overran this ceiling. The registration date as payer of VAT is the date of first of the month next to the one in which the taxable person requires the taking into evidence as payer of VAT.
- after foundation, if the turnovers achieved under the exemption ceiling, but it wants to choose the application of the ordinary schedule of VAT.

For establishing the fiscal fact state and the fiscal payment obligations owed, the contributors are obliged to run fiscal books, according to the normative document in force, with the conformation to the rules regarding the operating of the fiscal and financial books, these being kept, according to the case, at the fiscal residence of the contributor, at his/her secondary residences, inclusively on electronic frame, or they can be given for being kept to a authorized society, according to the law, to provide recording services.

3. Fiscal obligations of the legal people

As I have shown above, the contributors-legal people- have the obligation to pay customs, taxes, contributions and other sums owed to the consolidated general budget, for the developed activities. The first step regarding the payment of the customs and taxes was analyzed at the section regarding the contributors fiscal registration. The next step is represented by the determination of the fiscal obligation that these have to pay. From the point of view of the pronouncement and payment expiration, the fiscal obligation can be annual, semester, quarterly, monthly and occasional.

The Romanian Fiscal Code clearly states the types of customs, taxes, contributions and other sums owed to the consolidated general budget by the contributors-legal people- as well as the terms regarding the obligation of their declaration and payment, as it arises from the ones presented further on.

<u>Legal people annual fiscal obligations:</u>

[1] Law No. 571-2003, Concerning the Fiscal Code, republished with modifications and later completions.

- until the date of 31st of January, the contributors offer the declaration regarding the communication of the payment option of the tax on the incomes of the micro-enterprises or of the profit tax, having as a calculation basis the turnover achieved in the previous finished year.
- until the date of 15th of February, the declarations are offered regarding the profit tax for the previous year by the legal people without a lucrative purpose. Together with the declaration of profit tax is also offered the declaration regarding the taxes and the payment engagements to the people non-resident for the previous year. The same term date has to be respected by the contributors who obtain the most of the incomes from the cereals and technical plants growing, trees and grapes cultivating and viticulture, for the declaration and profit tax payment for the previous year. Together with the profit tax declaration, is also left the declaration regarding the payments and the payment engagements to the people non-resident for the previous year. Also, the legal people who have finalized the previous financial exercise and the annual declarations regarding the profit tax. Together with the profit tax declaration is also left the declaration regarding the payment engagements to the non-resident people for the previous year.

It has to be mentioned that the financial annual situations are left to the Trade Register Office, with the observance of the 15 days term from their acceptance by the shareholders/associated people general assembly, according to the stipulations of the Commercial Institutions Law.[1]

The contributors-legal people-have the additional obligation, in addition to the form "Account of profit and loss", of leaving, until the date of 25 February a declaration regarding the turnover achieved within the previous year, in the situation in which its level is under 100.000 euros. Also, until the date of 25 February, the contributors have the obligation to leave the declarations regarding the VAT, namely:

- the informative declaration 392 regarding the delivery of goods and service providing, by the taxable people registered for purposes of VAT who have achieved a turnover under 10.000 euros, and also, by the taxable non-registered people for purposes of VAT, who have achieved a turnover between 10.000 and 35.000 euros;
- the informative declaration 393 regarding the incomes obtained from the tickets sale for the people international road transport, having the leaving place in Romania, by the taxable people registered for VAT purpose, who provide international transport services.

The last day of February is the deadline term for all the contributors who have used during the previous year salary personnel and that have the obligation of leaving the fiscal forms regarding the incomes form salaries, achieved by these, at the Territorial fiscal office, and also for the leaving the notification regarding the lack of activity for the finished year, and also for leaving the form 205-"Declaration regarding the income retained on the incomes having regime of pay-as-you-earn, on income beneficiaries".

Until the date of 31 March, the legal people without lucrative purpose and the legal people who don't apply the Financial Rapport International Standards, balanced with the European Directions, are leaving to the Territorial Fiscal Office the financial annual situations simplified for the previous year. Also, the bank societies have the obligation to leave at the Territorial Fiscal Office the annual declaration regarding the profit tax and the regularization of the profit tax. Together with the declaration of the profit tax is also left the declaration regarding the payments and the payment engagements to the non-resident people for the next year.

The contributors who have not finalized the previous financial exercise until the date of 15 February have the obligation to leave at the Territorial Office the annual declaration regarding the profit tax until the date of 15 April. Together with the profit tax declaration is also leaving the declaration regarding the payments and the payment engagements to the non-resident people for the next year.

The legal people, who apply The Financial Rapport International Standards balanced with the European Directions, have the obligation that, until 30 April to leave at the Territorial Fiscal Office the simplified annual financial situations (book balance).

Until the date of 31 December, the contributors have the obligation of calculate, retain and pay the tax on the dividends due to the previous year and that have not been paid in the current year.

Semester fiscal obligations of the legal people:

The contributors registered for VAT purposes, who within the previous semester have obtained incomes from goods sales or from providing services for which they have drawn invoices, have the obligation that until the date of 25 January to leave at the Territorial Fiscal Office, in electronic shape, the list of the invoices issued in the finished semester. This thing is available also for the next semester, until the date of 25 July.

[1] Law No.31-1990, concerning commercial institutions, republished with modifications and later completions.

The legal people who have got in their patrimony capital goods (fixed means) as buildings, lands or means of transport, are obliged to the tax payment for such goods twice a year, this is until the date of 31 March, for the first semester, respectively, until the date of 30 September for the second semester.

Trimester fiscal obligations of the legal people:

According to the stipulations of the Romanian Fiscal Code, the legal people have the obligation to calculate, declare and pay each trimester profit tax, respectively tax for the micro-enterprises incomes, according to the case. For this, until the date of 25 inclusively of the month next to the finished trimester, these have the obligation to fill in and to leave at the Territorial Fiscal Office the declaration regarding the profit tax, respectively the tax on micro-enterprises incomes. This term has to be observed also in the case of the declaring an paying of the social contributions for the contributors that meet the criteria necessary to be micro-enterprises, as in the case of the semester VAT payers.

The economic agents who accomplish intra-community acquisitions and deliveries have the same obligation of leaving a revising declaration regarding such operations, from the point of view of the leaving term.

Until the date of 15 of the last month of the trimester, the contributors have the obligation of paying the tax for displaying in advertising purpose and publicity.

Monthly fiscal obligation of the legal people:

The contributors that develop hotel-type housing activities have the obligation to pay an additional tax (the hotel tax) until the date of 10, inclusively, of the next month, for the previous month.

The economic agents who develop activities such as shows, have the obligation that monthly, until the date of 15 inclusively of the next month, to leave at the Local public administration authority the declaration regarding the shows that will be organized, and also the declaration regarding the tax payment on shows.

In the most of the cases, the contributors have the obligation to leave at the Territorial Fiscal Offices, until the date of 25 inclusively of the next month, the declarations regarding the social contributions, for the contributors that do not meet the conditions for being micro-enterprises[1] (Declaration 100), as well as the break-up of VAT (Declaration 300), for the payers of monthly VAT.

The contributors that use salary personnel have the obligation of a monthly submission, until the date of 15 inclusively of the next month, the declarations regarding the social insurances, health social insurances, unemployment insurances, respectively of the funds for guaranteeing the salary debts, etc., to the institutions authorized with the administrations of these funds (Pension House, Health Insurance House, The County agencies regarding the employment capacity or the Work territorial inspector's office).

Occasional fiscal obligation of legal people: are connected to the payment of the tax on dividends, of the imported subjected to excise goods' excises, to the tax payment for writing a notice, certificates, licenses, etc. Also, the non-registered people in Vat purposes, but who are obliged to the tax payment for certain operations (intra-community acquisitions), have the obligation to leave a special break-up VAT at the Territorial Fiscal Office, until the date of the 25 of the month following to the one in which the tax that has exactly occurred.

4. The fiscal obligations of the private people

In the contributors' category that has the obligation to declare and to pay customs, taxes, contributions and other sums owed to the consolidated general budget are also those private people who obtain incomes from the provided activities and who are not obliged to the association under a legal way established by the Commercial Society Law.[2]Although they are not organized, from legal point of view, as the commercial societies are, the private people who develop activities in their own name, acquire, after the fiscal registration, the quality of subject in the frame of the commercial legal rapports, so, the quality of payer of customs and taxes. In both the Romanian Fiscal Code and the Fiscal Code of Procedure, are established the categories of customs, taxes and contributions of the private people that accomplish incomes, but also the terms until which the contributors have to pay the fiscal tasks.

As in the case of the legal people, the fiscal obligations of the private people can be annual, semester, trimester, monthly and occasional.

Annual fiscal obligations of the private people:

[1] Micro-enterprises are considere those enterprises that have less than 9 employees and a turnover or total operations of maximum 2 million Euros (Law No. 346-2004)

[2] Law No. 31-1990 concerning commercial institutions, republished with modifications and later completions.

The contributors that obtain incomes from the independent activities, imposed by income norms, as well as the contributors that obtain incomes from transferring the goods use of from intellectual property rights have the obligation of leaving until the date of 31 January an application for the option of determining the net income in real system, in the current year, together with the 'Declaration regarding the income appreciated from independent activities, in the current year". The same obligation have also, the contributors hat obtain incomes from growing and capitalization of flowers, vegetables and green stuffs, in greenhouses, solaria, and also of bushes , ornamental plants and mushrooms, from the exploitation of the grape fields and fruit-growing nursery gardens and other the same. Until the date of 31 January, the private people mentioned have the possibility to choose for the renouncing, in the fiscal current year, to the option of determining the net income in real system; if in the previous year have been imposed in this way, by leaving of a application to the competent fiscal organ.

For the contributors that accomplish incomes from salaries, the last day of February is the term until which these will undertake from the employer the form for the employee of the fiscal documents.

The private people that accomplish incomes from independent activities, from transferring the goods' use, incomes from agricultural activities imposed in real system, earnings resulted from the papers transfer, as the contributors that obtain incomes from abroad, have the obligation to leave until 15 May a special declaration on each income source, regarding the incomes accomplished from the above sources. Also, until the date of 15 May, the private people will leave the income declaration for the previous year and they will can choose for the destination of the sum of 2 % from the income tax, by leaving a special application (form 230) regarding the destination of the sum representing to 2 % from the annual tax.

The contributors that obtain net income from agricultural activities and make anticipated payments in the account of the income tax, in two equal entrancements, until the date of 1 September, respectively 15 November.

Semester fiscal obligations of private people:

For the patrimony goods owned, the private people have the obligation to pay taxes to the local administrations' budgets. The Romanian TIN states that until the date of 31 March, respectively 30 September, the private people who have got in their patrimony buildings, lands, means of transport will pay the additional taxes for each semester in the current fiscal year.

Trimester fiscal obligations of the private people:

The contributors that accomplish in the current fiscal year incomes from transferring the goods and from independent activities have the possibility to make anticipative payments for the income tax thus accomplished no later than the date of 15 of the trimester month, as well as for the tax payment for display with advert and publicity purpose. But, in this case, the additional tax payment of the last trimester will be made until the date of 15 November, inclusively. In the case in which the contributors use employed personnel and they meet the conditions necessary to be considered micro-enterprises, they will declare and pay the social contributions for the personnel employed no later than the date of 25 of the month following the finished semester.

Monthly fiscal obligations of the private people:

In the case that the contributors use employed personnel, but they don't achieve the conditions for being considered micro-enterprises, have the obligation that until the date of 25 of the next month, inclusively, to calculate, declare and pay the social contributions for the employed personnel, as for the salary tax and assimilated to the salaries by retaining from the source, to the Territorial Fiscal Organ. Each social contribution will be declared to the other institutions specially receiving the task of their administrating, respectively The Pensions House, The Count Agencies for employment capacity, The Health Insurance House, Work territorial inspector's office, regarding to the social contributions which they have to administrate: payment obligations to the state social insurance budget, payment obligations to the unemployment insurances budget, the contributions to the Health Social Insurances Fund and the contribution regarding the dismissals and the health social insurance expenses, respectively the commission for the Work Chamber.

In **conclusion**, the private and legal people have the obligation to register themselves legally and to declare, permanently, the customs, taxes, the contributions and other sums owed to the general consolidated budget. But this thing supposes a big work volume, so, personnel immobilization for solving a small number of problems, which generates high costs, and, not the less important, bureaucracy, being the fact that a large

number of taxes and contributions supposes also a sophisticated, rigid handling of the forms. We consider as necessary the simplification of the periodical forms and declarations transmitted by the contributors to the entitled institutions, and, on the other hand, the implementation, as fast as possible of an unitary national informatics' system, in order to transmit electronically (on-line) these declarations which can be accessed by each person or institution interested in the information and the dates declared by the contributors. Introducing a filter of picking up and transmitting data could solve, even from the beginning, the errors problem linked to these declarations. I also consider as necessary, useful and operative the declaring "on-line" of the data and of information referring to these customs, taxes, contributions and other sums owed to the general consolidated budget, as well to the ones referring to the contributor's identification data.

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Conf. univ. dr. Vasilica Voicu
Conf. univ. dr. Daniela Zirra
Asis. univ. drd. Andreea Raluca Voicu
Romanian-American University of Bucharest, Romania

EXPORT-LOANS INSURANCE MARKET - THE CASE OF ROMANIA

Abstract: *Romanian insurance market came up as the banking industry did. The sector of export loans has been facing with new financing needs and commercial or banking products. Till now, the export loans has won the battle for a dominant position, but can they remain a main financing resources? Thus, insurances products related to them will come on the same path. Due to last boom period, the increasing liquidity needs for cross-border transactions was an opportunity for Romanian insurance market. But there are also several week points: an undeveloped stock market leading to low capacity of risk management for insurance industry. What proves the previous affirmation? It is the high degree of correlation among the conditional banking term deposits both in foreign and domestic currency, and export loans as substitute for insurance premium trend*

Key words: *export loans, premium, alternative risk-transfer products, export risk insurance.*

Known especially for its young democracy, Romania economy presents an economic recovery. That can be seen both in the GDP increase and also in the dynamics of its domestic financial markets and activity.

Due to the lack of statistic information about the overall domestic insurance premium on the export activities' insurance market, our article's analysis has used an approximation being direct correlated to the outstanding export loans. It was considered that the insurance premium's total amount would follow the evolution of export loans (base assets) both for the past years and the future.

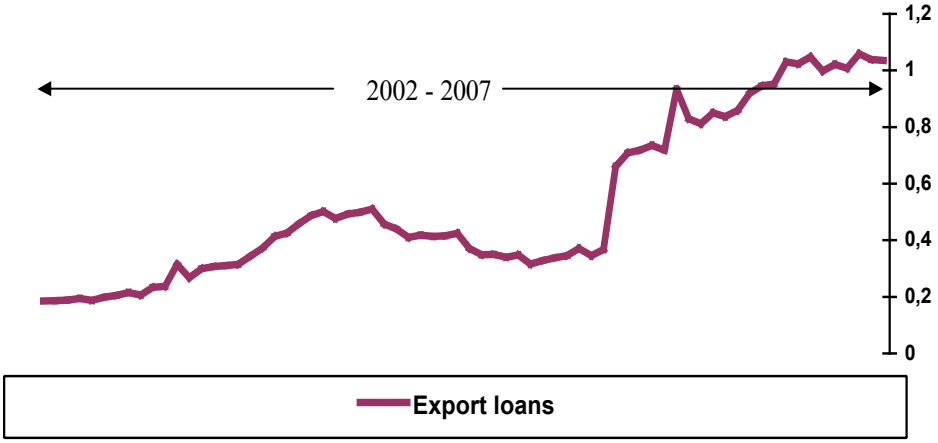

Fig.nr 1. The evolution of export loans

Additionally, the domestic analysis noticed the truth related to the low development of Romanian stock exchange market being unable to compete against the banking products. The achievement of a high degree of dependence or correlation between the conditional national-currency term deposits, respectively foreign-currency term deposits, on one side, and the export loans, on the other side, supported the working hypothesis according to which an important proportion of export-loans' insurance premium was drawn inside the banking system in conditional deposits. Thus, there was identified an insufficient-developed domestic strategy of risk management at macroeconomic levels.

Other observations on export-loans insurance activities can be summarized as following:

► Export loans

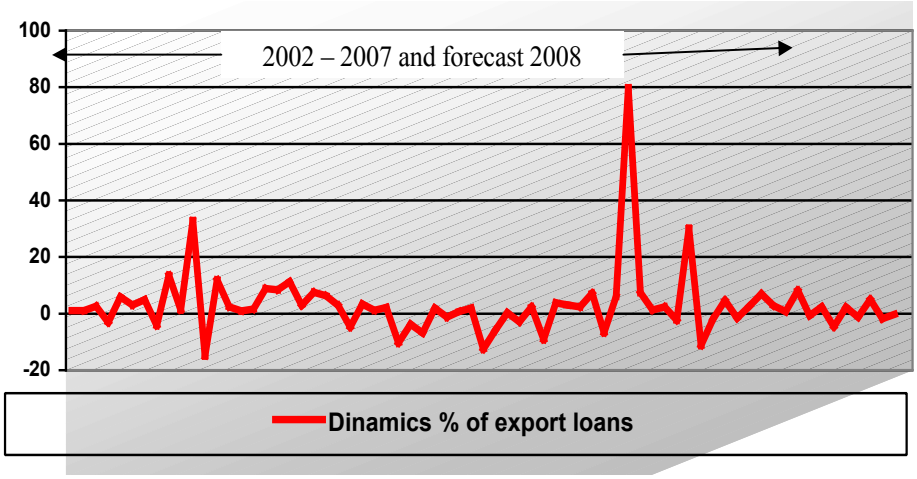

Fig..nr. 2. Export-loans insurance activities

- The computed values for the forecasted time intervals have a high degree of relevance due to the fact that there were very small differences among the results computes by different statistics methods (ARIMA and Smooth Functions).
- Visual analysis showed that the main import amplitude of export credit was recorded in 2007, before and after that year there were/are not expected higher surprises or value dispersions (the amplitude is going to stay below 6 procentual points).

► Conditional national currency banking term deposits

- As historically, for Romania, such deposits were found in direct relationship to the outstanding export loans, their trend is upward, but having an yearly amplitude around 4 procentual points.
- The peak of synergy increase is consider to happen in 2007.

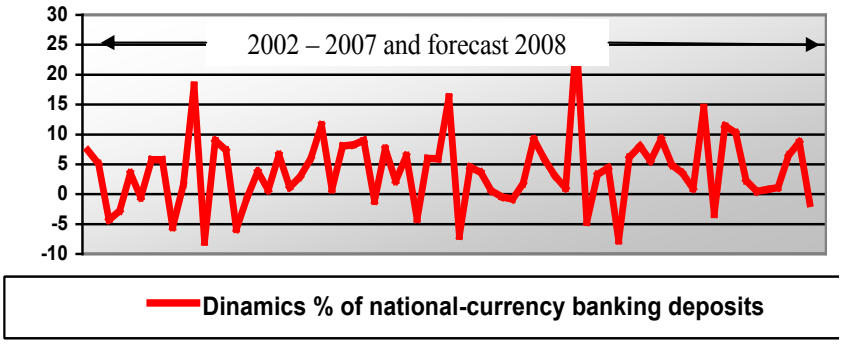

Fig. Nr. 3. The dinamics of national currency

► ***Conditional foreign currency banking term deposits***

- The variable also knows the same growing tendency of export loans.
- The main fluctuation was also recorded in 2007, proving a seasonality for the forth quarter of 2008.
- The amplitude for the following years is expected to be higher than one percent point.

► The export-loans' risks have two characteristics that make the difference compared to the rest of them: the risks are correlated, and the risk exposure is timely varying. So, the insurer usually has a higher risk aversion for that export loans.

► For Romania, during 2002-2007 the evolution of export loans was under direct influence of monetary politics' decisions that were looking for controlling the monetary aggregates as intermediate targets in the process of price stability.

► The low development of capital markets is/will be a worry reason for the risk management. There is an interesting situation in which the private insurer compete against the state insurer having subsidies in their activity. Thus, the competition is disturbed. The present years are known as a period of defense of

state main insurer (Eximbank) that is retreating out of banking operation and is rethinking its insurance services.

- For business activity inside the OECD area, the Romanian companies did not use export risk insurance. The justification consisted in the fact that OECD countries had known a political stability and the partners had long term and stable business relations.
    - For the rest of the countries outside of OECD area, there were recognized not only commercial risks, but also a political one being in fact the main concern.
- Romania has an insurance market of export loans that was accessible especially for medium and big companies, while the small ones were forced to apply services from the state insurers.
- From a different point of view, a credit insurance could be considered more than a hedging instrument, being in fact an information-collecting instrument regarding the creditworth of debtors. So, many exporters used the experience of insurer in the business relation with foreign countries.
- It was a common behavior of insurance companies to support better short term contracts up to 180 days, than those on longer term due mainly to reinsurers' pressure.
- Once the Romanian economy will join European Union, there are expected a higher influences coming from:
    - New entries on the insurance market especially international companies.
    - Cost reduction by e-commerce innovation.
    - An increase number of brokerage firms.
    - Better quality services and adequate products.
    - Lowering reinsurance premium amounts.
- For Romania the proportion of overall financing by export loans is considered to remain constant in total commercial credit, Thus, the alternative risk-transfer financial products did not and will not know the boom for becoming a viable alternative against traditional insurance products, so the export loan insurance will keep its position of key element of export success.
- The existence of state insurer for export loans market was justified by the following arguments:
    a. highly unpredictable environment and risks
    b. risk used to materialize especially in case of big contracts.
    c. there were a lost of transaction with less developed countries having high incertitude.
    d. there existed risks being not secured by private insurers due to an overexposure in relation with certain countries.
    e. it was the perception according to which the government had a better interventional power for recovering the receivables and preventing loses.
    f. many of the necessary information for country's risk assessment used to be available only to the government or state institutions.

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THE "LUCIAN BLAGA" UNIVERSITY OF SIBIU
THE FACULTY OF ECONOMIC SCIENCES

Str. Calea Dumbrăvii No. 17, Sibiu, Romania
Tel: +40-(269) 21.52.43
Fax: +40-(269) 21.03.75
E-mail: economice@ulbsibiu.ro
Web: http://economice.ulbsibiu.ro